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ORDER NO. 1541

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners: Ruth Y. Goldway, Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton;
Tony Hammond; and
Robert G. Taub

Notice of Market-Dominant Price Adjustment | Docket No. R2013-1

ORDER ON PRICE ADJUSTMENTS FOR MARKET DOMINANT PRODUCTS AND RELATED MAIL CLASSIFICATION CHANGES

Washington, DC 20268-0001

November 16, 2012

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(Issued November 16, 2012)

I. INTRODUCTION AND OVERVIEW

On October 11, 2012, the Postal Service filed notice of its planned price adjustments for most market dominant products.[1] The Postal Service also proposes to implement numerous mail classification changes in conjunction with the price adjustments. Most of the classification changes affect Special Services.

The Commission has reviewed the pricing proposals for consistency with the requirements of title 39. Pursuant to 39 CFR 3010.13(j), the Commission finds provisionally that the planned price adjustments do not violate the price cap in 39 U.S.C.

[1] The citation to the Postal Service's notice appears in section II. Procedural History.

3622(d); are consistent with, or justified by an exception to, the workshare discount limitations in 39 U.S.C. 3622(e); and establish prices that satisfy 39 U.S.C. 3626.

The Commission also has reviewed the pricing proposals for compliance with applicable Commission directives and orders. The Commission finds that the Postal Service proposed Standard Mail Flats rates fail to satisfy the applicable directives set forth in the FY 2010 Annual Compliance Determination (ACD), and further clarified and reaffirmed in Order No. 1427, and Order No. 1472.[2]

In recognition of the Postal Service's authority to develop rates to meet applicable legal requirements, the Commission remands all Standard Mail rates to allow the Postal Service to modify its planned rates to comply with the FY 2010 ACD and applicable statutory standards. The Postal Service could comply with these directives by adjusting a limited number of Standard Mail Flats prices.

Pursuant to 39 CFR 3010.13(e), the Postal Service shall file its amended notice of rate adjustment and describe how the modifications to the planned Standard Mail Flats rate adjustments comply with applicable legal requirements. An opportunity for comments from interested parties will be provided. *See* 39 CFR 3010.13(f). The amended notice is due within 10 days of this Order so that new rates that comply with applicable legal requirements can be reviewed and implemented, as planned, on January 27, 2013.

[2] Docket No. ACR2010, Order No. 1427, Order on Remand, August 9, 2012; Docket No. ACR2010-R, Order No. 1472, Notice and Order Confirming Termination of Stay, September 21, 2012.

II. PROCEDURAL HISTORY

Background. On October 11, 2012, the Postal Service filed a Notice of Market-Dominant Price Adjustment with the Commission in conformance with 39 U.S.C. 3622(d)(1)(C) and Commission rules in 39 CFR Part 3010.[3] The Notice announces the Postal Service's intention to change most domestic and international market dominant prices on January 27, 2013 at 12:01 a.m. by amounts which are, on average, within a 2.570 percent statutory price cap for all classes of mail.

The Notice includes three attachments presenting detailed price and mail classification changes; worksharing discount calculations; and price index change calculations. Supporting workpapers address, for each class, how the planned prices comply with the price cap. First-Class Mail International data and information appear in both public and non-public workpapers, pursuant to the Postal Service's interest in non-public treatment for certain material.[4] The Postal Service Application was not opposed.

Commission Order No. 1501, issued October 15, 2012, provided public notice of the Postal Service's filing; established Docket No. R2013-1 to consider the planned price adjustments; and appointed a Public Representative.[5] Pursuant to rule 3010.13(a)(5), the Commission allowed 20 days for public comment. By Order No. 1522, the Commission granted a 1-day extension (from October 31, 2012 to

[3] United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012 (Notice). *See* Appendix A for citations to subsequent errata notices. In companion Docket No. CP2013-3, the Postal Service proposed price adjustments for competitive products to take effect January 27, 2013, in conjunction with planned market dominant price adjustments. The Commission addressed the competitive price adjustments in Order No. 1526, issued November 8, 2012.

[4] Notice of the United States Postal Service of Filing of USPS-LR-R2013-1/NP1, October 11, 2012, including Attachment 1, Application of the United States Postal Service for Non-public Treatment of Materials (Postal Service Application).

[5] *See* Notice and Order on Planned Rate Adjustments and Classification Changes for Market Dominant Postal Products, October 15, 2012 (Order No. 1501), appearing at 77 FR 64362 (October 19, 2012).

November 1, 2012) due to storm-related power outages and the closing of federal agencies, including the Commission, pursuant to a United States Office of Personnel Management directive.

Supplemental data and information. The Commission issued, and the Postal Service responded to, one multi-part information request seeking clarification of the Postal Service's planned price adjustments for Standard Mail Flats and Standard Mail Letters.[6] Seven Chairman Information Requests were issued seeking clarification or further explanation of additional Standard Mail pricing matters and other aspects of the Postal Service's filing. Appendix B provides citations to these information requests, to Postal Service's responses, and to related filings.

Commenters. The Commission received 12 sets of formal comments in response to Order No. 1501, including two sets filed on behalf of multiple commenters and two sets filed by one commenter. Appendix C provides a list of commenters and citations to their filings. The Postal Service filed Reply Comments.[7] Valpak filed an objection to acceptance of the Postal Service Reply Comments.[8]

Motion practice. On October 22, 2012, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. filed a motion to strike the portion of the Notice addressing planned price increases for Standard Mail.[9] On October 31, 2012, the

[6] *See* Commission Information Request No. 1, October 18, 2012 (CIR No. 1) and Responses of the United States Postal Service to Questions 1-6 of Commission Information Request No. 1, October 23, 2012.

[7] *See* Reply Comments of the United States Postal Service, November 9, 2012 (Postal Service Reply Comments) and Motion of the United States Postal Service for Leave to File Reply Comments, November 13, 2012 (Postal Service Motion for Leave to File Reply Comments). Reply Comments were not specifically authorized in this case. The Commission grants the Postal Service Motion for Leave to File Reply Comments.

[8] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Objection to United States Postal Service Reply Comments, November 13, 2012.

[9] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion to Strike Standard Mail Price Adjustment from United States Postal Service Notice of Market-Dominant Price Adjustment, October 22, 2012 (Valpak Motion to Strike).

Postal Service and L.L. Bean, Inc. filed responses opposing the Valpak Motion to Strike.[10] The issues raised in the Valpak Motion to Strike were also addressed in several of the participant comments provided in response to Order No. 1501. These issues are fully addressed in section IV. B. of this Order.

[10] Response of the United States Postal Service in Opposition to Valpak's Motion to Strike Standard Mail Price Adjustment from Notice of Market-Dominant Price Adjustment; Response of L.L. Bean, Inc. to Valpak Motion to Strike Standard Mail Price Adjustment, both dated October 31, 2012.

III. FIRST-CLASS MAIL

A. Introduction

There are six products assigned to First-Class Mail: Single-Piece Letters/Postcards, Presorted Letters/Postcards, Flats, Parcels, Outbound Single-Piece First-Class Mail International, and Inbound Single-Piece First-Class Mail International. The Postal Service proposes to increase the price for First-Class Mail, on average, by 2.570 percent. Notice at 6. The Postal Service does not use any of its -0.530 percent banked pricing authority. *Id.* After applying the 39 CFR 3010.26(c) adjustment, the Postal Service calculates a new unused pricing authority of -0.530 percent. *Id.*

The Postal Service reports the percentage price changes for individual products within First-Class Mail as follows:

Table III-1

First-Class Mail Product Price Changes

First-Class Mail Product	Price Changes (%)
Single-Piece Letters/Postcards	2.283
Presorted Letters/Postcards	2.555
Flats	2.675
Parcels	4.971
Outbound Single-Piece First-Class Mail International and Inbound Single-Piece First-Class Mail International (combined)	7.923
Source: United States Postal Service Notice of Errata to USPS-LR-R2013-1/1, CAPCALC-FCM-R2013.xls, worksheet “Percent Change Summary”.	

In this price adjustment, the Postal Service increases the price of the first ounce, single-piece First-Class Mail letter by one cent to 46 cents. *Id.* at 19. The Postal Service retains the single-piece additional ounce price of 20 cents. The price of a single-piece postcard is increased from 32 cents to 33 cents. *Id.* at 15. The price of the first ounce for a single-piece flat is increased from 90 cents to 92 cents. *Id.*

The Postal Service introduces a new classification for single-piece residual letters weighing up to 2 ounces.[11] The Postal Service proposes a 48 cent price applicable to all residual pieces. Residual letters weighing more than 2 ounces will pay the single-piece First-Class Mail letter price of 46 cents plus the additional ounce price of 20 cents for each additional ounce.

First-Class Mail Parcels receives a 4.971 percent increase. *Id.* at 17. Only Retail Parcels and Keys and Identification Device price categories remain within the Parcels product as market dominant.

Most other First-Class Mail prices are adjusted accordingly to achieve the average 2.570 percent price change.

The commenters addressing First-Class Mail compliance with the price cap, Greeting Card Association (GCA), Pitney Bowes, and the Public Representative, state that the Postal Service has complied with the First-Class Mail price cap requirements of 39 U.S.C. 3622(d)(1).[12] The other commenters addressing First-Class Mail, National Association of Presort Mailers (NAPM), National Postal Policy Council (NPPC), Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak), and the joint comments of Direct Marketing Association, Inc. (DMA), the Mailing and Fulfillment Service Association (MFSA), NPPC, and the Parcel Shippers Association (PSA), offer

[11] *Id.* at 15-16. Residual letters are mailpieces prepared as part of a First-Class Mail Presorted Letters/Postcards mailing that remain after completion of a presort sequence and do not qualify for First-Class Presorted Letter/Postcards prices.

[12] Comments of the Greeting Card Association, October 31, 2012, at 1 (GCA Comments); Comment of Pitney Bowes Inc., November 1, 2012 (Pitney Bowes Comments); Public Representative Comments in Response to United States Postal Service Notice of Market Dominant Price Adjustments, November 1, 2012, at 8 (PR Comments).

no opinion on the Postal Service's compliance with the price cap.[13]

Commission analysis. The percentage price changes developed by the Commission are slightly different than those developed by the Postal Service. The Postal Service's price changes by product did not incorporate the effect of the proposed First-Class Mail promotions in the calculation of the price change for the class. When calculating the price change for the class, the Postal Service accounted for the promotions by applying a separate adjustment. The Commission also uses accepted methodologies when developing percentage price changes for International First-Class Mail.

The Commission includes the forgone revenue from promotions in the calculation of price changes by product. The Commission allocates forgone revenue from the Mail to Mobile Promotions to Presorted Letters/Postcards and Flats. The revenue forgone from the Earned Value Reply Mail Promotion is allocated to Presorted Letters/Postcards.[14] The resulting price changes for Presorted Letters/Postcards and Flats are 2.467 percent, and 2.674 percent, respectively. *See* PRC-LR-R2013-1/2.

The Commission finds the Postal Service's planned price adjustments for First-Class Mail comply with the price cap limitations specified by 39 U.S.C. 3622(d). The Commission finds that the planned prices for individual components of First-Class Mail result in an increase in the price for First-Class Mail, as a class, of 2.568 percent.

[13] Comments of the National Association of Presort Mailers, November 2, 2012 (NAPM Comments); Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price Adjustment, November 1, 2012 (Valpak Comments); Joint Comments of the Direct Marketing Association, Inc., the Mailing and Fulfillment Service Association, the National Postal Policy Council, and the Parcel Shippers Association, November 2, 2012 (Joint Comments).

[14] In response to CHIR No. 4, question 6, the Postal Service allocates revenue foregone from the Earned Value Reply Mail Promotion to Presort Letters and Cards. Because the rebate results from the sending of Business Reply Mail and Courtesy Reply Mail, an argument can be made that allocating the revenue forgone to Single-Piece Letters/Postcards is more accurate. The proper allocation of revenue forgone from promotions that involve more than one product may be explored further and refined in a separate docket.

This creates 0.002 percent new unused rate authority. The sum of all unused rate adjustment authority for First-Class Mail, from the instant price adjustment and previous price adjustments, is -0.528 percent.[15]

B. First-Class Mail Worksharing

The First-Class Mail worksharing discussion is separated into three areas: Qualified Business Reply Mail (QBRM) discounts, automation letters and cards worksharing, and automation flats worksharing. Comments on appropriate price signals are also discussed. The Commission has reviewed the workshare discounts submitted by the Postal Service and concludes that the proposed price adjustments are consistent with the worksharing requirements of title 39.

Qualified Business Reply Mail (QBRM) Discounts. The Postal Service reduces the QBRM discounts for letters and cards from 2.2 cents to 1.7 cents. Given the Postal Service's estimates of avoided costs of 0.9 cents per piece for letters and cards, the passthrough of avoided costs is 212.5 percent. Notice at 37. The Postal Service contends that reducing the QBRM discounts further (raising the QBRM prices) is not desirable from a business perspective. Referencing the exceptions for discounts exceeding 100 percent in 39 U.S.C. 3622(e)(2)(A), the Postal Service argues that reducing the discounts may undercut the objective of the Earned Value Reply Mail Promotion for returned Business Reply Mail (BRM) and Courtesy Reply Mail (CRM) pieces. *Id*. at 38.

In Docket No. R2012-3, the Commission noted that the models used by the Postal Service may not accurately determine QBRM cost avoidances. It urged the Postal Service to develop a proposal to improve the methodology for determining QBRM cost avoidances.[16] In Docket No. RM2012-2, the Postal Service proposed, and

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[15] *See* PRC-LR-R2013-1/2, Compliance Calculations for First-Class Mail.

[16] Docket No. R2012-3, Order No. 987, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011, at 14.

the Commission approved with some modifications, a new methodology for calculating the QBRM cost avoidance estimates.[17] Based on the cost avoidance estimates resulting from the application of the new methodology, the discounts for QBRM letters and cards pass through 100 percent of the costs avoided.

Automation letters and cards worksharing. The Postal Service calculates the following passthroughs of avoided costs for automation letters: Mixed automated area distribution center (AADC), 93.2 percent; AADC, 100.0 percent; 3-Digit, 0.0 percent; and 5-Digit, 96.0 percent. The Postal Service calculates the following passthroughs of avoided costs for Automation Cards: Mixed AADC, 121.1 percent; AADC, 109.1 percent; 3-Digit, 0.0 percent; and 5-Digit, 100.0 percent.[18]

The Postal Service cites the large decrease in the avoided cost between FY 2010 and FY 2011 as the reason for the excessive passthrough for Mixed AADC cards. Notice at 39. The Postal Service's proposal reduces the discount from 2.5 cents to 2.3 cents to bring the passthrough closer to 100 percent. The Postal Service argues that setting the Mixed AADC cards passthrough at 100 percent would not only increase the price of Mixed AADC automation cards higher than what is proposed, but would lead to higher increases for all the other presort levels. *Id.* It contends that this should be mitigated to avoid rate shock (39 U.S.C. 3622(e)(2)(B)). *Id*.

The Postal Service asserts that for AADC cards, the passthrough exceeds 100 percent, pursuant to section 3622(e)(2)(D). *Id.* at 40. In Docket No. R2012-3, the Postal Service set the prices for AADC and 3-Digit automation letters equal as a way to manage operational and network realignment issues. In the instant docket, the Postal Service proposes to make the same change to AADC and 3-Digit automation cards so

[17] Docket No. RM2012-2, Order No. 1383, Order Concerning Analytical Principles for Periodic Reporting (Proposals Sixteen through Twenty), June 26, 2012.

[18] *See* PRC-LR-R2013-1/1, Compliance Calculations for First-Class Mail.

mailers can more easily combine 3-Digit and AADC cards and letters and calculate the postage accurately.[19]

Automation flats worksharing. The Postal Service calculates the following passthroughs of avoided costs for automation flats: ADC, 178.6 percent; 3-Digit, 100.0 percent; and 5-Digit, 100.0 percent. The Postal Service cites FY 2008 methodology changes, as explained in Docket No. RM2008-2, Proposal Eight, as the major reason the ADC flats passthrough exceeds 100 percent. The Postal Service argues that setting all flats worksharing passthroughs at 100 percent would lead to significantly higher prices. It contends that this should be mitigated to avoid rate shock (39 U.S.C. 3622(e)(2)(B)). Notice at 41.

Pitney Bowes observes that the Postal Service has overstated the First-Class Mail ADC automation flats passthrough as 178.6 percent by using out-of-date cost avoidance figures. Pitney Bowes Comments at 6. It notes that a subsequently revised cost model approved by the Commission (Docket No. RM2012-2), and further additional changes proposed by the Postal Service (Docket No. RM2012-8) result in a passthrough of 92.6 percent. Pitney Bowes suggests revisions to the Commission's rules to require that cost avoidance estimates be derived using the most recent Commission approved methodology. *Id.* at 7.

The Commission concurs with Pitney Bowes that the Commission's rules may need to be revised to ensure that the most up to date methodologies are incorporated in price adjustment filings, and the Commission intends to explore this matter.

Pricing Signal comments. Several commenters express concern that the Postal Service is pricing in a way that encourages less finely sorted mail in order to use excess capacity. NAPM, NPPC, and Pitney Bowes note that presort First-Class Mail letters are more profitable to the Postal Service than single-piece First-Class Mail letters. NAPM

[19] NPPC contends that the price difference between AADC and 3-Digit for First-Class Mail postcards should not be eliminated. NPPC Comments at 11.

Comments at 2; NPPC Comments at 1, 3; Pitney Bowes Comments at 2. NAPM also observes that the volume of presorted mail is declining at a slower pace than single-piece mail. Given the value of presorted mail, NAPM, NPPC, and Pitney Bowes contend that the Postal Service is sending the wrong pricing signals by giving a greater percentage increase to presort First-Class Mail than to single-piece First-Class Mail, and by not passing through 100 percent of avoided costs for several worksharing discounts. NAPM Comments at 4; NPPC Comments at 5-6; Pitney Bowes Comments at 3. They argue that this is indicative of a disturbing trend in pricing strategy to drive mail volumes towards operations with excess capacity. NAPM Comments at 5; NPPC Comments at 6-7; Pitney Bowes Comments at 4-5. The joint comments of DMA, MFSA, NPPC, and PSA express agreement with the views presented above. *See* Joint Comments.

NPPC also comments that adoption of a single-piece metered mail worksharing benchmark would be more reasonable in setting presort discounts. NPPC Comments at 10.

Persuasive evidence has not been presented on the record to determine if the Postal Service’s pricing strategy for First-Class Mail is focused on utilizing excess capacity. The Commission concludes that the proposed price adjustments are consistent with the worksharing requirements of title 39.

C. Classification Changes

The Postal Service proposes three notable classification changes for First-Class Mail products. It introduces a new price for single-piece residual letters, an International Forever Stamp, and a handling surcharge applied to foreign-origin, inbound direct entry mail tendered by foreign postal operators.

Single-piece residual letters. The Postal Service introduces a new classification for single-piece residual letters weighing up to 2 ounces. Notice at 15-16. The price is

48 cents. Currently, presort letters (non-automation and automation) pay the same price up to 2 ounces. Letters that do not meet presort requirements require mailers to separate their residual letters into groups of 1 and 2 ounces in order to accurately calculate postage at the single-piece First-Class Mail price for each ounce. By establishing a single price for residual letters up to 2 ounces, mail preparation requirements are simplified. Mailers will be able to prepare and present their residual letter mailings to the Postal Service with 1 and 2 ounce letters combined.

Pitney Bowes supports the new price and classification for single-piece residual letters. Pitney Bowes Comments at 6. However, Pitney Bowes contends that further refinements are necessary for residual pieces weighing more than 2 ounces. It urges the Postal Service to work with the mailing community to develop a solution applicable to all mail weighing more than 1 ounce. *Id.* NPPC notes that the new classification is well intended, but that a rate design resulting in a price of 46 cents would have been more appropriate. NPPC Comments at 17.

International Forever Stamp. The Postal Service introduces an International Forever Stamp for outbound single-piece First-Class Mail International letters. The proposed International Forever stamp "will be sold at the price of a single-piece First-Class Mail International first ounce machinable letter, and have a postage value equivalent to the price of a single-piece First-Class Mail International first ounce machinable letter in effect at the time of use." Notice at 19. As the international counterpart to the domestic Forever stamp introduced in 2007, the proposed International Forever stamp will remain valid for postage regardless of future rate increases.

Handling charge for Inbound Direct Entry of Foreign Origin First-Class Mail. The Postal Service proposes a 0.1 cent handling surcharge applicable to foreign-origin, inbound direct entry of single-piece First-Class Mail. Inbound First-Class Mail subject to the handling charge consists of inbound letterpost items that are tendered by foreign postal operators for direct entry into the Postal Service's domestic First-Class Mail mailstream, provided each item upon entry bears postage paid indicia for single-piece First-Class Mail letters, cards, flats or parcels, and pays the 0.1 cent handling charge. The Commission finds the classification changes reasonable and shall incorporate the substance of these changes into the draft Mail Classification Schedule.

D. Promotional Pricing

The Postal Service proposes to offer five seasonal promotional pricing incentives within First-Class Mail: Mobile-Coupon/Click-to-Call Promotion (March 1, 2013 to April 30, 2013); BRM/CRM Promotion (April 1, 2013 to June 30, 2013); Emerging Technology Promotion (August 1, 2013 to September 30, 2013); Picture Permit Promotion (August 1, 2013 to September 30, 2013); and Mobile Buy-It-Now Promotion (November 1, 2013 to December 31, 2013).

Mail to Mobile category. The Mobile-Coupon/Click-to-Call Promotion, Emerging Technology Promotion, and the Mobile Buy-It-Now Promotion are included in the Mail to Mobile category. The Mobile Coupon/Click-to-Call Promotion seeks to increase the value of direct mail by further highlighting the integration of mail with mobile technology. Participants receive a two percent discount on the qualifying postage for First-Class Mail and Standard Mail presort or automation letters, postcards, and flats which include a two-dimensional mobile barcode inside or on the mailpiece. The barcode must either lead the recipient to a coupon that can be stored on a mobile device, or enable the recipient to connect by telephone to another person or call center via a mobile device.

The Emerging Technology Promotion intends to promote awareness of how innovative technology, such as Near Field Communication, Augmented Reality, and Authentication, can be integrated with a direct mail strategy to enhance the value of direct mail. Participants receive a 2 percent discount on the qualifying postage for First-Class Mail and Standard Mail presort or automation letters, postcards, and flats that include print that allows the recipient to engage in one of the following: an augmented reality experience facilitated by a smartphone or computer, authentication of the recipient's identity, or an experience facilitated via Near Field Communication.

The Mobile Buy-it-Now Promotion is designed to encourage mailers to adopt and invest in technologies that enhance how consumers interact and engage with mail, and demonstrate how direct mail can be a convenient method for consumers to do their holiday shopping. The promotion provides a 2 percent discount on the qualifying postage for First-Class Mail and Standard Mail presort or automation letters, postcards, and flats which include a mobile barcode inside or on the mailpiece. This barcode must facilitate a mobile optimized shopping experience.

The Postal Service seeks to recover some of the revenue forgone from these promotions by factoring the lost revenue into the price cap calculation. The volumes from the 2011 Mobile Barcode Promotion serve as the basis for this calculation.

Picture Permit category. The Picture Permit category consists of the Picture Permit Promotion. During the promotion period, the Postal Service will eliminate the Picture Permit charge for First-Class Mail and Standard Mail presort or automation letters and postcards that are sent during the established program period, and that include approved Picture Permit Imprint Indicia. The Postal Service does not seek to recover the revenue forgone from this promotion.

Earned Value Reply Mail category. The Earned Value Reply Mail category consists of the BRM/CRM Promotion. Participants receive a rebate of 2 cents per piece on all BRM and CRM pieces that meet program requirements and are returned to the registered customer during the program period. The Postal Service uses estimates of BRM and CRM volumes that qualify for this promotion to calculate the revenue forgone from this promotion.

Comments on promotional pricing. The Public Representative and Valpak note that the Postal Service has never before included revenues foregone due to promotional pricing in its price cap calculations. PR Comments at 5; Valpak Comments at 42. The

Public Representative, Valpak, and Pitney Bowes suggest that the policy and technical issues raised by promotional pricing be thoroughly evaluated in a separate docket. Pitney Bowes Comments at 8; PR Comments at 6; Valpak Comments at 8.

The Public Representative does not object to the Postal Service's approach to accounting for promotional pricing in this docket because of the procedural difficulties that would be created by instructing the Postal Service to remove the revenue forgone from its price cap calculations. PR Comments at 5.

Pitney Bowes further highlights policy and technical (price cap) issues raised by the Postal Service's current approach to accounting for promotional pricing, but similarly argues that the promotions should be approved at this time. Pitney Bowes Comments at 7-8.

Valpak notes the Postal Service's inconsistent treatment of revenue forgone by including revenue forgone in the calculation of average price increases for some promotions at the class level, but not at the product level. Valpak Comments at 45. Valpak urges the Commission to keep with the established practice of not allowing inclusion of revenue forgone in the price cap calculation at this time. *Id.* at 47.

While generally supporting promotions as an important pricing tool, NAPM argues that the Postal Service should not be permitted to recover revenue in excess of the price cap in the event revenue forgone projections overstate the revenue "leakage" associated with the promotions. NAPM Comments at 6.

NPPC contends that more advance notice of promotional pricing is necessary because NPPC has been advised by many of its members that postal budgets have already been set for 2013. NPPC Comments at 18. NPPC also expresses concern of shifting the risk of failed discounts from the Postal Service to mailers because of the accounting methodology of promotions within the price cap. *Id.* at 19-20.

Commission analysis. Although this is the first time that the Postal Service is including revenues foregone due to promotional pricing in its price cap calculations, the Postal Service demonstrates compliance with rules 3010.14(b)(1) through (4).

Generally, the concern with including promotions in the cap calculation is that if the volume weights used in the cap calculation are overstated, the price authority created would be overstated as well. In Docket No. R2011-1, classification and price adjustments for First-Class and Standard Mail Initiatives, the Commission concluded that expected new volume should not be considered in the price cap calculation. Specifically, the Commission stated: "[a]djustments to the volume weights [used to measure the percentage change in rates]…should not attempt to anticipate changes in mailers' behavior in response to changes in prices or classifications."[20]

In the instant docket, the Postal Service seeks to recover the forgone revenue resulting from the promotions being offered in calendar year 2013 where historical volumes are available for the calculation of the effect of the price change resulting from the promotions on the price cap. Thus, the Postal Service does not rely on forecasts of expected volume to establish the volume weights in the cap calculation.

For the Mail to Mobile category, the Postal Service uses actual volumes from the 2011 Mobile Barcode Promotion (July and August, 2011), which took place during the hybrid year period used in this filing. Since the volume the Postal Service uses in the cap calculation only includes one Mail to Mobile Promotion, it is likely to understate, not overstate the volume from the three promotions proposed in the Mail to Mobile category. For the Earned Value Reply Mail Promotion, the Postal Service uses historical data to identify BRM and CRM volumes that would qualify for the promotion.

The Postal Service presents its price changes by product for First-Class Mail. These price changes by product do not include the effect of the promotions included in

[20] Docket No. R2011-1, Order No. 606, Order Approving Market Dominant Classification and Price Changes, and Applying Price Cap Rules, December 10, 2010, at 19.

the calculation of the price change for the class. When calculating the price change for the class, the Postal Service accounts for the promotions by applying a separate adjustment. In response to CHIR No. 4, question 6, the Postal Service provides price changes by product that incorporate the revenue forgone from the discounts offered in the promotions.

For the reasons discussed above, the Commission finds that the Postal Service's price cap treatment of promotions is permissible so long as volumes are properly ascribed to the appropriate products.

E. International First-Class Mail

First-Class Mail International (FCMI) consists of two products: Outbound Single-Piece First-Class Mail International and Inbound Single-Piece First-Class Mail International. The Postal Service calculates a combined price increase for First-Class Mail International of 7.923 percent.[21] The calculated price increase for Outbound Single-Piece First-Class Mail International letters and flats is 14.338 percent.[22] The percentage change in price for outbound single-piece international cards is positive. *Id.* For Inbound Single-Piece First-Class Mail International, the percentage change in price is negative. *Id.* The non-machinable surcharge of 20 cents for Outbound Single-Piece First-Class Mail International letters is unchanged.

The Postal Service also introduces a handling surcharge of $0.001 for foreign-origin, inbound direct entry of single-piece First-Class Mail tendered by foreign postal

[21] USPS-LR-R2013-1/1, First-Class Mail Cap Compliance, Excel File CAPCALC-FCM-R2013.xls.

[22] Notice at 19; *see also* Library Reference USPS-LR-R2013-3/NP1 (non-public), First-Class Mail International Cap Compliance, Excel file CAPCALC-FCMI-R2013.xls, worksheet tab FCMI TOTAL PRICE INCREASE.

operators, subject to the terms of an authorization arrangement.[23]

The Postal Service maintains that increasing the price of outbound single-piece letters “significantly above” the First-Class Mail average of 2.570 percent is necessary “to increase contribution and improve cost coverage for FCMI Letters at the one-ounce weight step.” Notice at 19. The above-average price increase is also intended “to accommodate the introduction of the International Forever stamp.” *Id.*

The price cap calculation for Outbound Single-Piece First-Class Mail International letters, cards, and flats is based upon the hybrid fiscal year developed from quarterly outbound volumes reported in the International Market Dominant Products Billing Determinants.[24] Because quarterly inbound data are not available, the price cap calculation for Inbound single-piece First-Class Mail International is based upon FY 2011 inbound volume and weight totals presented in the International Cost and Revenue Analysis (ICRA) report.[25]

The Postal Service’s price cap calculation for Outbound Single-Piece First-Class Mail International conforms to the Commission’s accepted methodology. By contrast, its price cap calculation for Inbound Single-Piece First-Class Mail International includes two new changes to the price cap calculation methodology established in last year’s price adjustment proceeding. First, the Postal Service relies on a different data source for inbound volume and weight totals. The use of these inbound volume and weight totals results in a slightly smaller decease in price than if the Postal Service had used

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[23] *Id.* at 54. The Postal Service inadvertently omitted the $0.001 handling charge from its price cap calculation for First-Class Mail. Response to CHIR No. 1, question 17. The Postal Service subsequently filed errata to Library Reference USPS-LR-R2013-1/1, First-Class Mail Cap Compliance. United States Postal Service Notice of Errata to USPS-LR-R2013-1/1, November 8, 2012, Excel file CAPCALC-FCM-R2013_Errata.xls

[24] International Market Dominant Products Billing Determinants are one of several Postal Service periodic reports generally filed with the Commission on a quarterly or monthly basis that provide information on the financial or operational status of the Postal Service. *See* http://www.prc.gov/prc-pages/library/usps-periodic-reports/default.aspx?gridpart=periodic.

[25] *See* Docket No. ACR2011, Library Reference USPS-LR-FY11-NP2.

the same data source for inbound volume and weight totals used in the last proceeding. The Postal Service also includes some negotiated terminal dues rates from bilateral agreements with certain foreign postal operators rather than the UPU terminal dues rates.[26]

Commission analysis. The Commission accepts the Postal Service's explanation for above-average increases for the Outbound Single-Piece First-Class Mail International product and approves the price changes proposed by the Postal Service for First-Class Mail International. However, with respect to the price cap calculation for Inbound Single-Piece First-Class Mail International, the Commission finds that the Postal Service's departures from the accepted methodology are not explained on this record. In the absence of an adequate explanation for these changes, the Commission continues to rely on the accepted methodology underlying last year's adjustment in Docket No. R2012-3 when calculating the price cap for Inbound Single-Piece First-Class Mail International.

Applying the accepted methodology results in a revised price increase for First-Class Mail International of 7.627 percent compared to the 7.923 percent calculated by the Postal Service. This small percentage decrease has little impact on the overall percentage change in price for First-Class Mail as a whole, although it generates a small increase of 0.002 percent in unused new pricing authority for the class.[27]

F. Additional Comments

Consideration of classification changes within price adjustment dockets. The Public Representative expresses concern that presenting promotional pricing proposals in the context of an expedited price filing does not provide sufficient time for interested

[26] Terminal due rates are paid by foreign postal operators to the Postal Service for delivery of Inbound First-Class Mail International (letterpost) in the United States.

[27] Additional explanation and supporting calculations appear in Library Reference PRC-LR-R2013-1/NP1.

parties to review the proposals. PR Comments at 4. He suggests that decisions on these proposals be deferred subject to the provision of additional information in conformance with 39 CFR 3010.14(b). *Id.* at 5.

The Commission encourages the Postal Service to file classification changes that may be complex or potentially controversial separately from annual price adjustments. In recent years, the Postal Service has filed proposals to shift products from market dominant to competitive separate from rate filings and then provided new rates after the change was previously approved. Relatively minor classification changes may be accommodated within the context of annual price adjustments. However, if questions concerning supporting data or policy issues arise, the expedited schedule of annual rate adjustments may not allow sufficient time to review certain classification proposals. This may result in deferral of the proposals, and ultimately delay implementation.

Timing of price adjustment filings. The Public Representative notes that in previous years the Postal Service initiated price adjustments after an Annual Compliance Report (ACR) was issued. PR Comments at 8. He argues that this allowed closer alignment of discounts with avoided costs. He contends that with this year's price adjustment preceding the ACR, the Commission will not know whether the discounts will be better aligned, or whether there will be substantial departures from the principles of efficient component pricing. *Id.* at 9.

Pitney Bowes commends the Postal Service for simultaneous filing of the market dominant and competitive price adjustments and for providing substantial advance notice (108 days) to enable the mailing community to prepare for the price changes. Pitney Bowes Comments at 1.

The Commission recognizes that the timing of ACRs in relation to annual price adjustments influence the alignment of discounts with avoided costs. The Commission further recognizes that the Postal Service has pricing flexibility that allows it to determine the timing of its price adjustments.

Passthroughs exceeding 100 percent. The Public Representative states that the large number of passthroughs exceeding 100 percent appearing every year are problematic and should be addressed by the Commission. PR Comments at 10. He argues for the rejection of passthroughs that substantially disadvantage one group of mailers relative to others, or which create substantial entry barriers to worksharing competition. *Id.* The Commission finds within First-Class Mail, the Postal Service has provided adequate justification for each passthrough exceeding 100 percent.

Pricing incentives. NAPM encourages the Postal Service to create pricing incentives to help drive adoption of Full-Service Intelligent Mail barcodes (IMb). NAPM Comments at 6-7. It notes the 2014 mandate requiring the application of IMb in order to receive all automation discounts, and the mailer's costs of implementing and maintaining the information technology infrastructure necessary to support IMb. *Id.*

The Commission encourages mailers to work with the Postal Service to create price incentives that benefit both the mailers and the Postal Service.

Service Standards. NPPC notes the Postal Service's recent proposals for reductions in service standards.[28] It suggests a separate proceeding to consider the effects of change in service in regard to the price cap. NPPC Comments at 22.

[28] *See* Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012.

IV. STANDARD MAIL

A. Introduction

This section discusses the proposed initial price adjustments for each product within Standard Mail, worksharing relationships, and mail classification changes. The Commission is remanding all Standard Mail prices to the Postal Service so that it may revise Standard Mail prices consistent with the FY 2010 ACD directives. The Commission approves all proposed worksharing relationships and classification changes. However, the Postal Service may use its pricing flexibility to modify the workshare discounts and classification changes when setting prices consistent with the FY 2010 ACD's directives, statute, and applicable regulations.

There are six products in the Standard Mail class: Letters; Flats; Parcels; High Density and Saturation Letters; High Density and Saturation Flats and Parcels; and Carrier Route. The Postal Service calculates a price adjustment authority for the Standard Mail class of 2.570 percent, and proposes to increase rates for Standard Mail, on average, by 2.541 percent. Errata to Notice at 1. The Postal Service does not use any of the -0.380 percent banked pricing authority. Notice at 6. The Postal Service reports the distribution of percentage price changes for products within Standard Mail as follows:

Table IV-1

Standard Mail Product Price Changes[29]

Product	Price Changes %
Letters	2.610
Flats	2.416
Parcels	3.081
High Density/Saturation Letters	2.059
High Density/Saturation Flats and Parcels	2.092
Carrier Route Letters, Flats and Parcels	2.907
Overall	2.541
Source: PRC-LR-R2013-1/6.	

The Commission finds the Postal Service's planned price adjustments for Standard Mail comply with the price cap limitations specified in 39 U.S.C. 3622(d). New unused authority created in this proceeding equals the unused portion of the annual limitation of 0.029 percent. The sum of all unused rate adjustment authority for Standard Mail, from the instant price adjustment and previous price adjustments, now equals -0.351 percent.

[29] Response to CHIR No. 5, question 5. To ensure consistency and transparency, the price adjustments reflect the adjusted percentage increase for each product and the class.

B. Standard Mail Flats Rates

The Postal Service proposes below-average rate increases for Standard Mail Flats. For the reasons stated below, the Commission finds that the Postal Service has failed to take the remedial steps identified by the Commission in its FY 2010 ACD[30] to remedy non-compliance with 39 U.S.C. 101(d).

The Commission finds the proposed rates for Standard Mail Flats are in conflict with the directives of the FY 2010 ACD. In recognition that the Postal Service has the authority and flexibility to adjust any Standard Mail rates in order to comply with the price cap, the Commission therefore remands Standard Mail rates to the Postal Service for revision consistent with the FY 2010 ACD directives.

1. Background

The Postal Service filed its Annual Compliance Report (ACR) for FY 2010 on December 29, 2010.[31] Upon receipt of the report, the Commission was required to perform a written ACD within 90 days "as to—(1) whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with the applicable provisions of this chapter…; or (2) whether any service standards in effect during such year were not met." 39 U.S.C. 3653(b)(1) and (b)(2).

In the FY 2010 ACD, the Commission found that the rates for Standard Mail Flats did not comply with section 101(d)'s mandate that "[p]ostal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." 39 U.S.C. 101(d). It directed the Postal Service to "increase the cost coverage of the Standard Mail Flats product through a combination of above-average price

[30] Docket No. ACR2010, Annual Compliance Determination, March 29, 2011 (FY 2010 ACD).

[31] United States Postal Service 2010 Annual Compliance Report, December 29, 2010 (FY 2010 ACR).

adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs." FY 2010 ACD at 106.

The Postal Service appealed this directive in *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105 (D.C. Cir. 2012). In the appeal, the Postal Service argued that the Commission's reliance upon the mandate in section 101(d) was outside the scope of its authority. *Id.* at 1107. It also argued that the Commission's determination was arbitrary and capricious. *Id.*

Subsequently, the court found that the Commission acted within its statutory authority by considering the general standards of section 101(d) in an annual compliance determination, "at least in extreme circumstances." *Id.* at 1108. However, the court also questioned whether the remedy imposed by the Commission on Standard Mail Flats would continue to be appropriate if cost coverage were to improve. *Id.* at 1106-07. On April 17, 2012, the court remanded the case to the Commission "for a definition of the circumstances that trigger section 101(d)'s failsafe protection, and for an explanation of why the particular remedy imposed here is appropriate to ameliorate that extremity…." *Id*. at 1110.

On August 9, 2012, the Commission issued Order No. 1427 in response to the court's mandate.[32] The Commission clarified that its analysis of the circumstances that would trigger section 101(d) depended on the totality of the circumstances presented. The Commission explained that it would not automatically find the Postal Service out of compliance anytime rates for a product fail to cover attributable costs. *Id.* at 4. It explained that its finding in the FY 2010 ACD was based on several factors, including:

> a significant and growing cost coverage shortfall; duration of the shortfall over a significant period; evidence that the cost coverage shortfall was likely to increase further; a significant adverse impact on users of other mail products (some of whom could be competitors of mailers of the subsidized mail product) requiring

[32] Docket No. ACR2010-R, Order on Remand, August 9, 2012 (Order No. 1427).

> subsidization of the non-complying product; failure of the Postal Service to address the shortfall by rate increases, cost decreases, or a combination thereof, despite the capability to do so; and failure of the Postal Service to provide an adequate explanation for not taking necessary remedial steps designed to ameliorate the cost coverage shortfall.

Id. at 9; 676 F.3d at 1107 (citing Respondent's Brief at 29).

The Commission provided counter-examples where an extreme case may not be found, including situations where "the Postal Service had not yet had a reasonable opportunity to remedy the shortfall" or "if the Postal Service were to demonstrate that price increases would be counterproductive under the statutory price cap or that cost reductions were not feasible." *Id.* at 10. Finally, it provided further explanation to justify the remedy imposed in the FY 2010 ACD and explained that in the future, Standard Mail Flats may cease to be an extreme case despite less than 100 percent cost coverage "provided the Postal Service has either taken adequate steps toward the elimination of the shortfall or presented adequate reasons to explain the shortfall." *Id.* at 13.

Proposed Standard Mail Flats Rates for FY 2013. In the Notice, the Postal Service states that "[l]etters receive an above-average increase, while Flats receive an average (at cap) increase." Notice at 20. It asserts that these pricing decisions reflect a balance among: (a) the Commission's findings in its FY 2010 ACD, (b) the Postal Service's concern over the health of the catalog industry, and (c) "the Postal Service's belief that above-average price increases for Flats (at the expense of letters) will impair its ability to enhance revenue and contribution under the statutory price cap (Objective 5)." *Id*.

To support its claims that its Standard Mail pricing decisions will improve net contribution, it presents a Standard Mail Contribution Model (Contribution Model) that purports to show that an above-average increase for Standard Mail Letters and an average increase for Standard Mail Flats increase total contribution by $5 million. *Id.* at 22-23. It contends that this pricing approach moves Flats toward 100 percent cost coverage and captures the revenue available under the price cap. *Id.* at 23. Further, it states that following the remedy ordered by the Commission, *i.e.*, that Standard Flats cost coverage be increased through a combination of above-average price adjustments and cost reductions, "would force [it] to use precious cap space in an attempt to boost Flats cost coverage." It contends "such efforts" could have "negative long-term effects on the ability of Standard Mail to contribute to covering network costs." *Id.* at 23-24.

The Postal Service also asserts that its pricing decision for Flats was influenced by the need to manage the price differential between Standard 5-Digit automation Flats and Carrier Route Flats. It states that had it given a larger price increase to Flats, "it would be forced to increase Carrier Route prices...even further." *Id.* at 24. It claims that it has allowed the price differential between the two products to grow from 8.2 to 8.3 cents, but it does not intend to create a wider gap in the future. *Id*.

Finally, the Postal Service states that when taking into account additional costs savings realized from the realignment of its mail processing network (Network Rationalization), the proposed price changes will set Flats on a sustainable path toward 100 percent cost coverage. *Id*. It estimates that cost coverage will modestly increase in FY 2012 and continue increasing in FY 2013. *Id.* at 24-25.

Valpak's Motion to Strike. On October 22, 2012, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak) filed a Motion to Strike the Standard Mail price adjustments in the Notice. Valpak alleges that the Standard Mail price adjustments proposed in the Notice are *prima facie* unlawful and violate prior Commission orders, the Postal Accountability and Enhancement Act (PAEA), and 39 U.S.C. 101(d). Valpak Motion to Strike at 1.

According to Valpak, the Postal Service was required to comply with the Commission's directive to file an above-average price increase in the subsequent rate adjustment. Instead of doing so, the Postal Service proposed a "balanced pricing approach", setting forth prices for Standard Flats that were less than above-average.

Id. at 7. Valpak contends that it is immaterial whether the Postal Service can demonstrate that price increases would be counterproductive, because two findings of non-compliance have already been made—in the FY 2010 ACD and the FY 2011 ACD. *Id.* at 8.

Additionally, Valpak argues that the Postal Service's proposed price adjustments are deficient in that they ignore products' elasticities as well as the effect on Standard Mail products other than Standard Mail Letters. *Id.* It claims that in addition to being *per se* illegal, the proposed adjustments do not reduce the cross-subsidy from other Standard Mail products to Standard Mail Flats. *Id.* at 9.

Valpak requests the Commission strike the Standard Mail price adjustments as *per se* unlawful, in violation of its order in the FY 2010 ACD and illegal under the PAEA, with leave for the Postal Service to notice and file new Standard Mail price adjustments based around a meaningfully above-average price increase for Standard Mail Flats along with corresponding reductions in other Standard Mail prices. *Id.* at 11.

Postal Service reply. The Postal Service filed its response to the Valpak Motion to Strike on October 31, 2012.[33] It raises both procedural and substantive objections to the motion.

Procedurally, it claims that the Valpak Motion to Strike inappropriately attempts to circumvent the public comment period by demanding that the Commission act on the Postal Service's proposal prematurely. Postal Service Response at 3. This approach alleges the Postal Service would deprive the public of the opportunity to comment on the proposed rates. *Id.*

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[33] Response of the United States Postal Service in Opposition to Valpak's Motion to Strike Standard Mail Price Adjustment from Notice of Market-Dominant Price Adjustment, October 31, 2012 (Postal Service Response). The Postal Service Response to Motion to Strike was originally due on October 29, 2012, but due to weather related closures on October 29 and 30, the Postal Service filing is considered timely.

The Postal Service also claims that its proposal for Flats rates do comply with the Commission's remedial pricing orders. *Id.* at 4. It reiterates its interpretation of the language of Order No. 1427 providing an exception to a finding of an extreme case if the Postal Service could demonstrate that price increases would be counterproductive under the statutory price cap. It argues that the Notice explains why significant price increases to Standard Mail Flats would be counterproductive under the price cap. *Id.* at 5. It explains its belief that any price adjustment that moves the Flats product toward 100 percent cost coverage simultaneously reduces the intra-class subsidy. *Id.*

Participant comments. The Commission received seven comments related to the proposed pricing of Standard Flats.[34] L.L. Bean, Inc.,[35] the Association for Postal Commerce,[36] the National Postal Policy Council,[37] Pitney Bowes,[38] the American Catalog Mailers Association,[39] the Public Representative,[40] and Valpak[41] all commented on this issue.

L.L. Bean expresses concern about the fixed pricing differential that the Postal Service wants to maintain between Carrier Route and Flats. It states that because the Postal Service claims it would be "forced" to increase Carrier Route prices if it increased Flats prices, "this pricing approach holds Carrier Route hostage to any further increases

[34] Comments were originally due on October 31, 2012, but due to weather related closures on October 29th and 30th, the deadline was extended to November 1, 2012 by Order No. 1522.

[35] Response of L.L. Bean, Inc., Valpak Motion to Strike Standard Mail Price Adjustment, October 31, 2012 (L.L. Bean Response to Motion to Strike).

[36] Comments of the Association for Postal Commerce, October 31, 2012 (PostCom Comments).

[37] Comments of the National Postal Policy Council, November 1, 2012 (NPPC Comments).

[38] Comments of Pitney Bowes Inc., November 1, 2012 (Pitney Bowes Comments).

[39] Comments of the American Catalog Mailers Association, November 1, 2012 (ACMA Comments).

[40] Public Representative Comments in Response to United States Postal Service Notice of Market Dominant Price Adjustments, November 1, 2012 (PR Comments).

[41] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price Adjustment, November 1, 2012 (Valpak Comments).

in Flats prices." L.L. Bean Response at 2. It disagrees with the contention that this pricing differential is forced upon the Postal Service, and believes that the approach contravenes the interest of not only catalog mailers, but also the Postal Service itself. *Id.* It urges the Postal Service to focus on ways to make Carrier Route a more viable product for the catalog industry and plans to pursue reformulations to allow more flexible pricing of this product. *Id.* at 3. In the meantime, however, L.L. Bean opposes the Valpak Motion to Strike because it believes that it would likely lead to higher price increases for Carrier Route Flats. *Id.*

PostCom suggests that organic changes within the industry favor taking a wait-and-see approach to Flats prices. PostCom Comments at 2. It states that due to improvements in price, co-mailing, and co-palletization, a substantial portion of Flats volume (including catalogs), has migrated to Carrier Route. *Id*. The current proposed prices are expected to continue that shift. *Id.* at 1-3. It states that regardless of whether a worksharing relationship between Flats and Carrier Route exists, the three factors enumerated above will drive migration away from Flats and to Carrier Route pieces. *Id.* at 4. It recommends that the Commission direct the Postal Service to track this migration, study its causes and effects, and only take action once a clearer picture of mailing patterns emerges. *Id.* at 4-5.

PostCom also questions the extent of the Commission's authority to alter prices that comply with the price cap in a rate adjustment proceeding, suggesting that the Commission may only direct the Postal Service to modify its prices for other reasons by instituting a complaint proceeding on its own motion. *Id.* at 3.

NPPC identifies the disproportionate price increases on Standard Letters relative to Standard Flats as a recurring problem. NPPC Comments at 14. It asserts that the noticed Flats prices fail to comply with the Commission's remedial orders and will continue the intra-class cross-subsidy. *Id.* It expresses concern about the Postal Service's reliance upon unproven future cost savings from network rationalization as justification for below-cost rates for Flats. It contends that prices should be set on the basis of known, current costs, and that prices should be adjusted in the future if anticipated cost savings are realized. *Id.* at 15.

Pitney Bowes argues that the assumptions underlying the Postal Service's Contribution Model are theoretically unsound, noting that the impact of alternative pricing proposals on profitability depends not only on volume trends, but also on the relative profitability and price sensitivity of individual products. Pitney Bowes Comments at 4.

ACMA opines that the substantial increases in Standard Mail Flats costs should be explored and until this step is taken, a conservative approach to increasing Standard Flats prices is prudent. ACMA Comments at 7, 15. Additionally, ACMA's comments included a survey reflecting consumer attitudes and opinions on catalogs and predictive modeling on consumer behavior.[42]

The Public Representative supports Valpak's Motion to Strike, claiming that the losses from the shortfall in institutional cost coverage will continue to mount if the proposed prices are accepted. PR Comments at 13. However, the Public Representative suggests that the Commission order a specific remedy and direct the Postal Service to reach 100 percent compliance by setting reasonable price increases for Standard Mail Flats over a measurable time frame. *Id.* at 15-17.

Valpak provides comments that elaborate on the assertions in its motion to strike and presents an extensive critique of the Postal Service's Contribution Model. According to Valpak, the Postal Service's model is flawed in the following ways: (a) it assumes that neither Flats nor Letters exhibits any elasticity of demand with respect to price (Valpak Comments at 19-22); (b) the assumptions underlying the Postal Service's

[42] These topics are not directly relevant to the limited issues before the Commission in a 39 CFR 3010 rate change proceeding. However, by filing at this time, ACMA has provided the Commission and the community with information which maybe germane to future Commission reports and cases.

model were designed to support its conclusion instead of reflecting sound economic principles (*id.* at 22-24); (c) if elasticity is incorporated into the model, it becomes clear that a higher increase for Flats leads to increased contribution (*id.* at 24-28); (d) pricing of Standard Mail does not maximize contribution and is arbitrary and capricious because it gives up potential additional contribution from increasing Flats prices for a smaller contribution from Letters (*id.* at 28-36); (e) a less than average price increase for Flats is unlikely to improve cost coverage (*id.* at 36-38); and (f) attributable costs vary with volume and, therefore, prices should be set to cover costs before Network Rationalization is complete, not afterward (*id.* at 38-41).

On November 9, 2012, the Postal Service submitted a pleading in response to the comments filed by Valpak and the Public Representative.[43] The Postal Service Reply Comments are intended to address Valpak's criticisms of the Postal Service's Contribution Model and include three alternative Contribution Models. The merits of this pleading and its timing are addressed in section VI., *infra.*

On November 13, 2012, Valpak filed an objection to the Postal Service Reply Comments, noting, among other things, that the Commission's rules do not permit the filing of reply comments in price adjustment dockets.[44]

2. Commission Analysis

In its FY 2010 ACD, the Commission found that Standard Mail Flats prices violated 39 U.S.C. 101(d) and directed the Postal Service to take specific remedial actions to address the persistent and worsening intra-class cross-subsidy. On review, the Commission's decision was left undisturbed. *United States Postal Service v. Postal*

[43] Reply Comments of the United States Postal Service, November 9, 2012 (Postal Service Reply Comments). The Postal Service submitted a Motion of the United States Postal Service for Leave to File Reply Comments, November 13, 2012. The motion is granted.

[44] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Objection to United States Postal Service Reply Comments, November 13, 2012.

Regulatory Commission, 676 F.3d 1105 (D.C. Cir. 2012). In lieu of proposing Standard Mail Flats prices that satisfy those remedial directives, the Postal Service contends that doing so "would impair its ability to enhance its revenue/contribution under the price cap." Notice at 21. The Commission is not persuaded that the rationale offered by the Postal Service justifies a waiver of the directive that cost coverage for Standard Mail Flats be increased through a combination of above-average price increases and cost reductions. The Commission finds that the planned Standard Mail Flats price increases are below the class average, and directs the Postal Service to file revised prices that comport with the remedial directives set forth in the FY 2010 ACD.

Valpak contends that the planned Standard Mail Flats prices are *per se* unlawful and urges the Commission to strike the Postal Service's Standard Mail Flats prices. Valpak Motion to Strike at 11. The Commission rejects the view that the prices are *per se* unlawful.

The Postal Service offers an explanation of why it should not comply with the Commission's directive in the FY 2010 ACD. Valpak correctly points out that the Postal Service's reliance on Order No. 1427's explanation of when an extreme case would not be justified, *i.e.,* further price increases would be counterproductive, is misplaced. Valpak Motion to Strike at 8. The Commission is not engaged in a de novo compliance determination. Rather, it is reviewing proposed rates for consistency with the statute and applicable Commission orders. Neither the ACD nor Order No. 1427 precludes the Postal Service from suggesting reasons supporting its pricing decisions. Changed circumstances may have a bearing on whether applicable remedial directives warrant a waiver. In this instance, the Commission finds the Postal Service's explanation unpersuasive. As discussed below, the new Postal Service Contribution Model is predicated on unsound assumptions which undermine the purported results.

ACMA contends that the Commission should not take action to enforce its 2010 ACD mandate because the costs reported for Flats are not accurate. ACMA

Comments at 15. ACMA advocates a “conservative approach” concerning increases for Standard Flats. *Id.* ACMA made similar arguments, and the Commission analyzed those arguments, in the FY 2011 ACD and the last general market dominant price adjustment in Docket No. R2012-3.[45] In this case the Postal Service does not propose, and the Commission does not require by this order, action that is inconsistent with the “conservative approach” ACMA advocates.

PostCom contends that, ‘[a]rguably, the Commission’s sole review role in this docket is to ensure that the proposed prices comply with the cap at the class level, and the Commission may only direct the Postal Service to modify its prices for other reasons by instituting a complaint proceeding on the Commission’s own motion.” PostCom Comments at 3 (citation omitted).

There is no merit to this contention. The Commission’s FY 2010 ACD findings, including its remedial directives, have been affirmed on appeal. It represents a lawful order which is binding on the Postal Service. Based on the record before it, the Commission finds the Postal Service’s planned Standard Mail Flats prices inconsistent with the FY 2010 ACD and Order No. 1427.

a. Postal Service Compliance with FY 2010 ACD Directive

In the FY 2010 ACD, the Commission directed the Postal Service: to increase cost coverage for the Standard Mail Flats product through a combination of above-average price adjustments and cost reductions; to provide the Commission with an explanation of how the proposed prices would move Standard Mail Flats cost coverage toward 100 percent; and to provide a statement estimating the effect that the proposed

[45] *See* FY 2011 ACD at 115-19 (“The Commission encourages interested parties to continue to attempt to identify specific anomalies in conjunction with proposed solutions to correct methodologies that produce anomalous costs.”); *see also* Order No. 987 at 27-28, 31-32, (“On the whole, the costing systems employed by the Postal Service and approved by the Commission produce reasonably reliable product costs for ratemaking purposes.”)

prices would have in reducing the subsidy of the Standard Mail Flats product. FY 2010 ACD at 106-07. In this proceeding, the Postal Service neither proposes an above-average rate adjustment nor convincingly demonstrates that cost reductions will result in an increase in the cost coverage of the Standard Mail Flats product. It also fails to establish that the proposed prices would reduce the intra-class cross-subsidy.

The Postal Service's Standard Mail workpapers (USPS-LR-R2013-1/2) demonstrate that its proposed prices include a below-average price increase for Standard Mail Flats. The Postal Service's original workpapers did not distribute the revenue forgone from certain pricing promotions to calculate percentage increases by product. The Postal Service's assertion that it followed its prior practice is addressed below. *See* section IV., 2e. The failure to do so overstates the percentage increase by product. As a consequence, in its Notice, the Postal Service mistakenly represents that Standard Mail Flats price increases equal the class (cap) average. Notice at 20. When the effects of the promotional discounts are taken into account, Standard Mail Flats planned prices increase by 2.416 percent, and remain below the revised class average, 2.541 percent.[46]

In response to Commission Information Request No. 1, October 18, 2012 (CIR No. 1), the Postal Service states that it anticipates the cost coverage for Standard Mail Flats to increase to 83 percent in FY 2012 and 86 percent in FY 2013 due, in part, to estimated decreases in the average unit cost for Standard Mail Flats.[47] It asserts that "Network Rationalization will result in significant cost reductions for the Postal Service.... A significant share of these anticipated savings…will come from flats products." *Id.* at 4.

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[46] *See* Response of the United States Postal Service to Questions 1-5 and 7 of Chairman's Information Request No. 5, question 5, November 6, 2012 (Response to CHIR No. 5). The increases properly reflect the distribution of all of the revenue forgone from promotions to each Standard Mail product; *see also* United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment, November 8, 2012.

[47] *See* Response of the United States Postal Service to Questions 1-6 of Commission Information Request No. 1, question 2, File: StandardFlats.xls., October 23, 2012, (Response to CIR No. 1).

The Postal Service estimates the FY 2013 unit cost savings from Network Rationalization for Standard Mail Flats to be 0.56 cents. The response includes a worksheet, sourced to cost forecasts filed in Docket No. CP2013-3, showing the estimated savings.

These model outputs do not contain sufficient data for the Commission to substantiate the expected cost savings. The Postal Service did not provide supporting supplemental input files which contain all of the cost effect input factors and distribution key information used for each year of the cost forecast.[48] In short, the Postal Service fails to demonstrate that Standard Mail Flats average unit costs are likely to decrease.

In its comments, NPPC raised concerns about the Postal Service's "unproven future cost savings" as follows:

> NPPC members are among the many Standard Letter mailers that are disadvantaged by the current and proposed Standard Letter prices. And NPPC is rather concerned that the Postal Service is relying upon unproven future cost savings from network rationalization as a justification for below-cost rates for Standard Flats. It would be preferable to set prices on the basis of known, current costs, and moderate future prices in the future should anticipated cost savings, in fact, be realized.

NPPC Comments at 15.

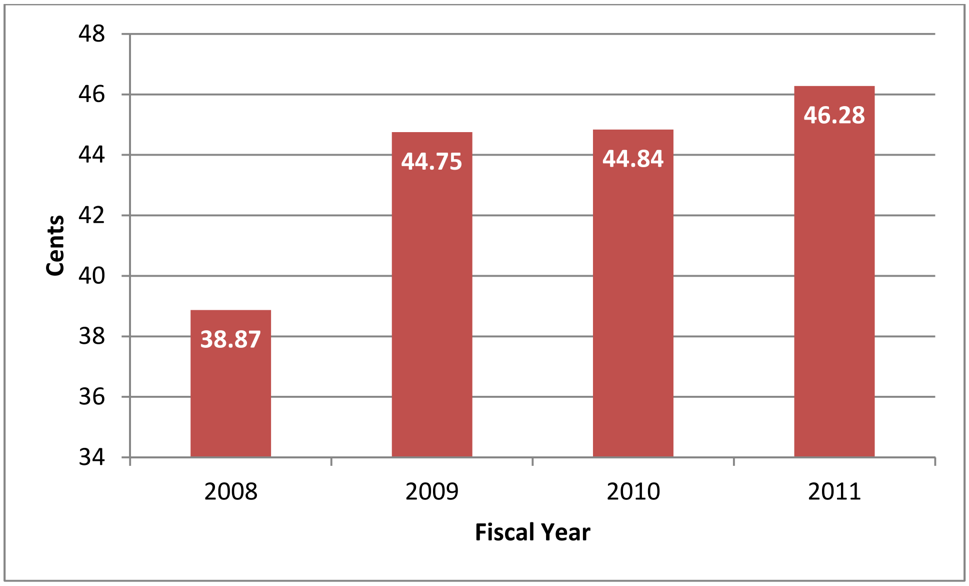
In addition, in its Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012 (Advisory Opinion), the Commission found that the Postal Service's mail processing cost savings estimates were optimistic and that the actual savings could be much lower. Advisory Opinion at 90-91. The Postal Service does not address this issue in its response.

The Commission shares NPPC's concern about the Postal Service's reliance on unproven future cost savings as justification for below-cost rates for Standard Mail Flats.

[48] The "cost effect input factors" refers to all of the different factors involved within the 10 cost roll forward effects (*i.e.*, cost level, non-volume workload, cost reductions, etc.).

NPPC Comments at 15. Figure 1 shows that since FY 2008, the unit cost of Standard Mail Flats has increased every year.

Figure 1: Standard Mail Flats Unit Cost



Below-cost pricing of Standard Mail Flats and the resulting negative contribution have been a persistent and growing problem since the passage of the PAEA. Since FY 2008, Standard Mail Flats have generated cumulative losses totaling $2.1 billion. On a unit cost basis, the loss per piece has grown from -2.2 cents to -9.5 cents. The Postal Service's planned below-average price increase for Standard Mail Flats does not appear to begin to ameliorate the problems which gave rise to the Commission's ACD finding of non-compliance. On remand, the Postal Service must comply with the directives of the FY 2010 ACD.

Market dominant price adjustment proceedings are, by statute and regulation, conducted under an accelerated timetable. *See* 39 U.S.C. 3622(d)(1)C); 39 CFR 3010.13(b). The Postal Service is aware of the FY 2010 ACD's remedial directives. It acknowledges that it understand that its planned price increases for Standard Mail Flats do not comply with those directives. Instead, the Postal Service offers an explanation for its pricing decisions which, as noted, the Commission finds unpersuasive.

In offering an explanation for its pricing decisions, the Postal Service is, in effect, seeking a waiver of the FY 2010 ACD directives. Under the circumstances, it was incumbent on the Postal Service to provide full documentation to substantiate its claims at the outset of the proceeding. It failed to do so. The Postal Service's filing of reply comments, which are not permitted by rule under the expedited proceeding of a price adjustment, compromises both interested persons' ability to comment and the Commission's time for review. The Postal Service should have avoided the prejudice to parties and the Commission by petitioning for relief a reasonable period in advance of its price adjustment filing. Nevertheless, the Commission has made every effort to ensure a complete record and meaningful opportunity for all parties, including the Postal Service, to comment on this pivotal issue.

b. Postal Service Standard Mail Contribution Model

The Postal Service argues that giving Standard Mail Flats an above-average increase would reduce the overall contribution for Standard Mail. The Postal Service contends that as a result, it should not be required to comply with the Commission's FY 2010 ACD directive that it improve Standard Mail Flats cost coverage through a combination of above-average price increases and cost reductions. It projects that its Standard Mail Flats pricing (as contrasted with the remedial directive of an above-average increase) will generate approximately $4.9 million in additional contribution. The Contribution Model on which this projection is based is flawed as described below, producing results that are contrary to universally accepted economic principles.

The Postal Service's Contribution Model assumes that Standard Mail Letters volume will increase 4 percent annually while Standard Mail Flats volume will decrease 7 percent annually. The Contribution Model assumes that regardless of price changes, future annual volume changes will be exactly the same as the Postal Service experienced during the last 2 years.[49] This assumption is unfounded and unsupported. Recent data indicate these assumptions are erroneous.

The Postal Service's latest FY 2012 quarterly volume data (through June 2012) show that Standard Mail Letters declined 7.8 percent over the same period last year (SPLY) and Standard Mail Flats declined 12.7 percent over SPLY.[50] These FY 2012 results contradict the assumptions used in the Postal Service's Contribution Model and highlight the flaw in using a volume trend with only two data points to predict future volume growth.

The Postal Service's Contribution Model does not take into account current economic trends which are known to impact volume.[51] In contrast, the Postal Service's traditional Demand Analyses incorporate myriad factors, such as Gross Domestic Product, employment, Consumer Price Index (CPI), retail sales, broadband subscriptions, and population, known to affect demand for postal products.[52]

As Valpak and Pitney Bowes correctly note, the Postal Service's failure to use price elasticities leads to erroneous conclusions because it ignores the effect of price changes on volume. Valpak Comments at 19-28. Assuming price changes have no impact on volume could lead to the unrealistic conclusion that prices could increase exponentially without fear of losing a single mailpiece. Valpak Comments at 21; Pitney Bowes Comments at 4. This conclusion does not correspond with basic economic

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[49] The Postal Service's volume trend is based on 3 years of data, or two data points, *i.e.,* the volume change from 2009 to 2010, and from 2010 to 2011.

[50] *See* Quarterly Statistic Report filed September 12, 2012 (Quarterly Statistic Report).

[51] The Postal Service asserts that failure to use its own-price elasticities does not sacrifice accuracy in its Standard Mail Contribution Model because it does not have different elasticities by shape. Response to CIR No. 1, question 3b. This assertion does not justify its omission of price elasticities from its Standard Mail Contribution Model.

[52] *See* 2012 Demand Analyses and Volume Forecast Materials for Market Dominant Products, January 20, 2012 (Postal Service Demand Analyses).

theory or proven postal demand scenarios. It is a well-established economic principle that price increases have a demonstrable impact on volume. This fundamental tenet is widely acknowledged and, indeed, has been used by the Postal Service for decades.

The Commission estimates the impacts of the scenarios presented in the Postal Service's Contribution Model using the established Postal Service Demand Analyses.[53] The Postal Service Demand Analyses estimate four different Standard Mail price elasticities: Regular, Nonprofit Regular, Enhanced Carrier Route, and Nonprofit Enhanced Carrier Route. These price elasticities reflect the effect of price changes on volume. Importantly, the Postal Service Demand Analyses also incorporate long-term volume trends and economic factors that impact volume changes. The Postal Service's Demand Analyses provide more robust results than its simplistic Contribution Model. Using these proven techniques, the Commission demonstrates that the Postal Service's contention—that an above-average increase for Standard Mail Letters and an average increase for Standard Mail Flats produce $4.9 million more in contribution than an alternative that complies with the 2010 ACD directives—is incorrect. In fact, an above-average price increase for Letters and an average price increase for Flats would result in $5.8 million **less** contribution than complying with the 2010 ACD directives. *See* PRC-LR-R2013-1/1 and CIR No. 1, question 4.

Standard Mail consists of six products, but the Contribution Model considers pricing options for only two of those products. The Postal Service offers the Contribution Model to demonstrate how its pricing decisions (affecting two products) maximize contribution. Notwithstanding the models other flaws, due to the model's focus on only two products within the class, the results are inconclusive. If the Postal Service was truly attempting to maximize contribution from the Standard Mail class, it would need to take into account all Standard Mail products.

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[53] *See* CIR No. 1, question 4; *see also* PRC-LR-R2013-1/1.

c. Postal Service Reply Comments

As noted above, on November 9, 2012, the Postal Service filed reply comments responding to criticisms of its Contribution Model by Valpak and the Public Representative. The Postal Service presents three “Alternative Contribution Models,” which, unlike its original Contribution Model, include various assumptions about the price elasticities of the Standard Mail Letters and Flats products. The Postal Service asserts that, under each scenario, there is a “tipping point” between 3 and 7 years in the future, where the Postal Service would generate less cumulative contribution by raising Flats prices by a greater percentage than Letters. Postal Service Reply Comments at 3-4.

The Postal Service’s analysis was presented at the conclusion of the case, after the comment period had closed, and past the point where parties or the Commission could thoroughly examine it. Upon initial examination it appears the analysis suffers from several significant flaws. First, each of the Alternative Contribution Models utilizes the same short-term volume trends used in the original Contribution Model. These trends are assumed to persist for every future year in each scenario. This assumption, which underlies the Postal Service’s conclusion that, given a long enough time horizon, concentrating price increases on Letters would generate greater contribution, is contrary to historical volume trends, and the most recent data.

The Postal Service’s analysis is a simple demonstration of a known characteristic of backward-weighted indices. If the volume of a product in the index increases from one year to the next, the use of an historical volume will tend to understate the revenue generated by a price increase on that product. This conclusion follows because the new, higher price will actually apply to more pieces than the index assumes. Conversely, if the volume of a product in the index decreases, the use of a historical volume will overstate the revenue generated by a price increase, because the new price will apply to fewer pieces than the index assumes. Given this characteristic of backward-weighted indices, the Postal Service's assertions could be read as suggesting that it would be counterproductive for it to do anything other than concentrate all of its available pricing authority on maximizing price increases for the fastest growing products in each class.

The most recent data available indicate that volume trends for Letters and Flats have already changed from those used in the Postal Service's Contribution Models.[54] The Alternative Contribution Models' assumption that a recent volume trend will continue 8 years into the future is overly simplistic and belied by a review of the prior 8-year period, which reveals the effect of then-existing economic and related factors on postal volumes.[55]

As with the original Contribution Model, the Alternative Contribution Models analyze only the Letter and Flat products, ignoring the four other products in Standard Mail. This construct, which vastly simplifies the number of possible combinations of price increases, forecloses the possibility that the Postal Service could implement its preferred price increases for Letters and, where necessary, implement slightly lower price increases for other (more price elastic)[56] products to keep Standard Mail below the price cap. The Postal Service's Contribution Model provides no insight as to whether such alternatives might generate even greater contribution.

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[54] The year-to-date 2012 Quarterly Statistic Report shows that Letters volumes have decreased 7.8 percent over SPLY and Flats volumes have decreased 12.7 percent over SPLY. *See* United States Postal Service Quarterly Statistic Report, September 12, 2012.

[55] The Alternative Contribution Models assume that unit costs will remain constant for 8 years. While the original Contribution Model employs a similar assumption, the problem is exacerbated in the former by the extended time period being considered.

[56] The own-price elasticity of Standard Regular (which includes commercial Letters and Flats) is -0.335, whereas the own-price elasticity of Standard ECR (which includes commercial Carrier Route and High Density/Saturation Letters and Flats) is -0.782. *See* Postal Service Demand Analyses.

d. Price Differential between Standard Mail Flats and Standard Mail Carrier Route

PostCom suggests that the Commission need not address Standard Mail Flats pricing issues in this proceeding. It contends that due to existing price incentives and improved mail preparation techniques "a substantial portion of flats volume—including catalogs—has migrated from Standard Mail Flats to Carrier Route." PostCom Comments at 2; *see also id.* at 3. Comparison of volume trends for the Standard Flats and Carrier Route products over the last three years does not conclusively demonstrate that this migration is occurring. The Postal Service, in signaling its intent to maintain the price differential between Standard Mail Flats and Carrier Route, disclaims use of its pricing authority to encourage further migration. Furthermore, migration from one product to another does not necessarily mitigate the fundamental problem of cross-subsidization.[57] In fact, in some circumstances, it could exacerbate the problem.[58]

PostCom suggests that the Postal Service be directed to monitor the impact of migration of Standard Mail Flats to Carrier Route. The Postal Service may wish to consider that suggestion. However, until it can be demonstrated that the migration from Standard Mail Flats to Carrier Route is, in itself, reducing the intra-class cross-subsidy, this consideration does not obviate the need to adjust prices.

L.L. Bean expresses concern regarding the fixed price differential between Carrier Route and Standard Mail Flats imposed by the Postal Service. L.L. Bean Response at 2. The Commission notes, and the Postal Service confirms, that there is no legal requirement to maintain a fixed differential. The Postal Service also acknowledges that no worksharing relationship, which might dictate a narrow price

[57] The actual effect of an inter-product migration on the cost coverage of each product would depend on the specific revenue and cost characteristics of the mail that migrates.

[58] For example, lower cost pieces could migrate leaving higher cost pieces in the original product.

differential, exists between the two products.[59] The Postal Service has the pricing flexibility to set price differentials outside of worksharing relationships. However, the Postal Service's desire to maintain fixed price differentials between Carrier Route and Flats does not override the need to reduce the intra-class cross-subsidy. This Order should not be read as encouraging the Postal Service to increase or maintain the fixed pricing differential.

e. Errors and Discrepancies and Standard Mail Workpapers

Five Chairman's Information Requests were issued regarding: the exclusion of promotional discounts from product percentage change and nonprofit ratio calculations, the inclusion of pounds in ratios used to distribute pieces, the exclusion of pound revenue from calculations, the exclusion of a portion of Simple Sample revenue, inconsistent Mail Classification Schedule (MCS) language, and non-uniform discounts between commercial Standard Mail Flats and Nonprofit Flats.[60]

Each of these issues is discussed below. In most instances, errata were submitted to make corrections where necessary. Additional workpapers needed to support revised Standard Mail prices should incorporate these errata.

The Postal Service did not distribute the revenue forgone from promotions to each product as part of its Standard Mail price cap workpapers. *See* USPS-LR-R2013-1/2. In Response to CHIR No. 5, the Postal Service filed updated workpapers that

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[59] Response of the United States Postal Service to Commission Information Request No. 1, October 23, 2012, at 12.

[60] The Postal Service responded to Chairman's Information Request No. 1 on October 26, 2012. Chairman's Information Request No. 2 was filed on October 24, 2012 (CHIR No. 2). The Postal Service responded to Chairman's Information Request No. 2 on October 26, 2012. The Postal Service responded to Chairman's Information Request No. 3 on November 1, 2012 (Response to CHIR No. 3). Chairman's Information Request No. 4 was filed on October 25, 2012 (CHIR No. 4). The Postal Service responded to CHIR No. 4 on November 1, 2012. Chairman's Information Request No. 5 was filed on October 31, 2012 (CHIR No. 5). The Postal Service responded to CHIR No. 5 on November 5, 2012 (Response to CHIR No. 5).

distribute the revenue forgone from promotions to individual Standard Mail products. The Postal Service states that its original filing presented “unadjusted” percentage increases for products, while it presented an “adjusted” percentage increase for the Standard Mail class. The “unadjusted” percentage increases by product do not account for all of the proposed prices offered for each product within the class.

In Response to CHIR No. 5, question 5, the Postal Service argues that it reported unadjusted percent changes of certain products in the past. The only two instances were in Docket Nos. R2011-2 and R2012-3, where the Postal Service was unable to disaggregate adjustments for the Intelligent Mail Barcode incentive and the Move Update Penalty among three products: High Density and Saturation Letters, High Density and Saturation Flats, and Parcels and Carrier Route. The Postal Service did not disclose that it was reporting unadjusted figures, and the Commission did not remark on the Postal Service’s use of unadjusted figures. The Commission’s rules provide a method for calculating the percentage change in rates for a class. *See* 39 CFR 3010.23. While the Commission rules do not specifically address the method to calculate a percentage change in rates by product, the Postal Service should use the same methodology as prescribed for a market dominant class of mail when calculating a percentage change for a market dominant product.

The Commission finds that use of “adjusted” percentage increases for each product is the most transparent method because it reflects all of the prices and discounts present for each product within the class.[61]

The Commission’s FY 2010 ACD directive requires above-average increases for the Standard Mail Flats product. The percentage change in rates for each Standard

[61] It is worth noting that the weighted average of the “unadjusted” price increases for all Standard Mail products exceeds the price cap. In contrast, the weighted average of the “adjusted” price increases for all Standard Mail products equals the planned increase of Standard Mail. The Commission provisionally finds that the price increases proposed for the Standard Mail class satisfy the requirements of 39 U.S.C. 3622(d)(2)(A).

Mail product must include all price categories within that product, including promotions, for the Commission to evaluate accurately the percentage increase by product.[62]

The Postal Service's Standard Mail promotion workpapers include two flaws. First, when distributing promotion pieces to price cells, the Postal Service mistakenly includes pounds in its piece ratio. Second, the Postal Service does not include the revenue forgone from pounds in its price cap calculations. It acknowledges both of these errors and provides corrected workpapers in response to CHIR No. 5. *See* Response to CHIR No. 5, questions 1, 5, 7, at 7-12.

Additionally, in CHIR No. 5, question 7, the Commission notes that Carrier Route Simple Sample revenues were excluded from the Postal Service's price cap calculations. *See* CHIR No. 5, question 7. The Postal Service corrects this error in Response to CHIR No. 5.

The Postal Service's presentation of workshare discounts for commercial and nonprofit is not transparent. Attachment B to the Postal Service's Notice implies that all Letter and Flat commercial and nonprofit workshare discounts are the same.[63] However, the rate calculation worksheets apply workshare discounts to some rate categories that differ between commercial and nonprofit. In Response to CHIR No. 5, questions 8 through 13, the Postal Service explains that:

> The discounts in USPS-LR-R2013-1/2 show the Nonprofit discount, while Attachment B shows the Commercial discount. In both ACR and price adjustment filings, neither the Postal Service nor the Commission has compared Nonprofit discounts to avoided

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[62] *See* Reply of Alliance of Nonprofit Mailers to USPS Response to Chairman's Information Request No. 5, Question 2, November 8, 2012. For some previous promotional discounts, the Postal Service proposed, and the Commission approved, that the effects of the discounts be excluded from consideration of any impact on the price cap. The instruction in this Order to distribute promotional discounts to products applies where the discounts are included in determining compliance of the class with the price cap.

[63] *See, e.g.*, Attachment B Workshare_Final.xls, tab: Standard Mail Flats, titled: Workshare Discounts and Benchmarks-—Standard Mail Flats (Commercial and Nonprofit).

> costs, so long as there is both a Commercial and Nonprofit category for that particular price category. Instead, just the Commercial discount is used to calculate the passthrough. Since the Nonprofit discounts are generally lower than the Commercial discounts, showing just the Commercial passthrough protects against over 100 percent passthroughs for both Commercial and Nonprofit.

This explanation is insufficient. All workshare discounts must be evaluated by the Commission for compliance with 39 U.S.C. 3622(e).[64] Merely setting nonprofit discounts lower than commercial discounts does not allow for transparent evaluation supporting a conclusion that the requirements of 39 U.S.C. 3622(e) are being met. When nonprofit and commercial discounts differ, the Postal Service must calculate separate passthroughs for those discounts. The Postal Service Attachment B workpapers must calculate passthroughs for each discount it offers.[65]

Finally, in Response to CHIR No. 3, questions 2 and 3, the Postal Service acknowledges inconsistencies in its MCS language. The Postal Service must resolve these inconsistencies in its response to this Order.

3. Conclusion

Based on this analysis, the Commission finds the proposed rates for Standard Mail Flats are in conflict with the directives of the FY 2010 ACD. In recognition that the Postal Service has the authority and flexibility to adjust any Standard Mail rates in order to comply with the price cap, the Commission therefore remands Standard Mail rates to the Postal Service for revision consistent with the FY 2010 ACD directives. There are

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[64] *See* 39 CFR 3010.14(5). Pursuant to this rule, the Postal Service must also identify workshare discounts that are set substantially below their avoided costs.

[65] Notwithstanding its assertion that it no longer believes that the proposed High-Density Plus price tier should be added as a workshare discount, the Postal Service must provide the information requested in CHIR No. 1, question 5 in response to this Order. *See* Response to CHIR No. 1, question 5.

differing approaches available to the Postal Service when satisfying the remedial directives of the FY 2010 ACD.[66]

The Commission maintains a narrow scope of review in the accelerated proceedings reviewing market dominant price adjustments. The Commission's primary review concerns compliance with the market dominant price cap described in 39 U.S.C. 3622(d). The Commission is averse to inserting itself into the policy considerations of rate setting. However, it is incumbent on the Postal Service to follow lawful Commission directives. The Commission previously found a violation of the applicable statute and prescribed a remedy in its FY 2010 ACD, that remedy was affirmed on appeal, and the Postal Service has failed to follow or adequately justify its deviation.

C. Statutory Preferential Rates

39 U.S.C. 3626(a)(6) requires nonprofit rates to be set in relation to their commercial counterparts regardless of the nonprofits' independent costs. Nonprofit rates are set to yield per-piece revenues that equal, as nearly as practicable, 60 percent of commercial revenues. No commenter challenges the Postal Service's compliance with this requirement. The Commission finds that the Postal Service's planned nonprofit rates conform with this statutory preference.

[66] The Commission sets forth two examples, both of which would permit the Postal Service to comply with the FY 2010 ACD directive and the applicable price cap by making changes to only Standard Mail Flats prices and no other Standard Mail prices. For instance, the prebarcoding discount between automation and non-automation Flats could be reduced. The increase in this discount was "not a strategic move from the Postal Service, but instead an inadvertent increase" and the Postal Service notes it plans to "gradually eliminate the excess incentive." Notice at 44. Reducing it now would result in prices that comply with the directive. If the Postal Service's proposed price adjustments for the Standard Mail class minimally exceed the price cap (2.570 percent), unused rate adjustment authority from Docket No. R2008-1 (0.062 percentage points) and Docket No. R2009-2 (0.041 percentage points) could be used pursuant to 39 U.S.C. 3622(d)(2)(C)(iii). Alternatively, the Flats origin pound-rate price could be increased. Currently, the passthrough between origin and DNDC Flats is 70.6 percent and the passthrough between origin and DSCF Flats is 79.2 percent. Increasing the Flats origin pound-rate would move both passthroughs toward 100 percent and result in prices that comply with the directive. These examples are illustrative only.

The Alliance of Nonprofit Mailers (ANM) filed two replies to the Postal Service's response to CHIR No. 5. ANM's comments concern the calculation of the nonprofit commercial ratio and the differential discounts between certain commercial and nonprofit price categories.

Calculation of nonprofit commercial ratio. ANM questions the Postal Service's original calculation of the nonprofit commercial ratio.[67] The Postal Service's initial calculation did not include revenue forgone from certain promotions. *See* Response to CHIR No. 5, question 2. As ANM acknowledges, the inclusion of promotions in the nonprofit commercial ratio only changes the calculation by 0.01. However, ANM is concerned that if the Postal Service continues the practice of not including all revenue in the nonprofit commercial ratio, the difference could grow to be substantial.

Commission analysis. The Commission shares ANM's concerns and the Postal Service should file workpapers in future rate adjustments that include all revenues in its nonprofit commercial ratio calculations to better promote transparency in nonprofit rates.

Nonprofit discounts. ANM also submits comments on the subject of worksharing discounts for nonprofit Standard Mail.[68] ANM takes issue with several proposed discounts that are smaller for nonprofit than its commercial counterparts. ANM CHIR No. 5 Reply Comments at 1. It states that disparities of this kind, unless supported by a rational justification, violate 39 U.S.C. 403(c) and contravene the holding in *National Easter Seal Society v. USPS*, 656 F.2d 754 (D.C. Cir. 1981). It maintains that the Postal Service has not offered any rational justification for the disparity in discounts between commercial and nonprofit mail in the current rate proceeding other than the explanation that the disparity "protects against over 100 percent passthroughs for

[67] Reply of Alliance of Nonprofit Mailers to USPS Response to Chairman's Information Request No. 5, question 2, November 8, 2012.

[68] Reply of Alliance of Nonprofit Mailers to USPS Responses to Chairman's Information Request No. 5, questions 8-13, November 13, 2012.

Commercial and Nonprofit." *Id.* at 3. ANM asserts that this rationale is unconvincing because the Postal Service uses the same cost avoidance data as benchmarks for both commercial and nonprofit worksharing discounts, and therefore provides no basis for having different nonprofit and commercial discounts. *Id.*

Commission analysis. ANM's arguments were not provided during the initial comment period. It contends that the Postal Service failed to justify disparities between discounts offered to commercial and nonprofit users of Standard Mail and that the disparities violate section 403(c).

Upon re-filing of its Standard Mail rates, the Postal Service is requested to provide a justification as to why it views the different levels of discounts to Standard Mail consistent with the PAEA and not contrary to *National Easter Seal Society*. Alternatively, the Postal Service may also revise these discounts.

D. Worksharing Issues

The Commission is required to ensure that workshare "discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" unless the discount falls within a specified exception. 39 U.S.C. 3622(e).

Commission rules require the Postal Service to justify any proposed workshare discount that exceeds 100 percent of the avoidable costs by explaining how it meets one or more exceptions under the PAEA. The Postal Service shall also 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. 39 CFR 3010.14(b)(6).

In its filing, the Postal Service identifies eleven[69] planned rate discounts within the Standard Mail class that have passthroughs exceeding 100 percent. The following passthroughs exceed 100 percent of avoidable costs:

- Mixed Network Distribution Center (NDC) Irregular Nonbarcoded Parcels to Mixed NDC Irregular Barcoded Parcels discounts 156.1 percent of the avoidable cost;
- Mixed NDC Machinable Nonbarcoded Parcels to Mixed NDC Machinable Barcoded Parcels discounts 156.1 percent of the avoidable cost;
- Mixed NDC Nonbarcoded Marketing Parcels to Mixed NDC Barcoded Marketing Parcels discounts 156.1 percent of the avoidable cost;
- Mixed NDC Irregular Parcels to NDC Irregular Parcels discounts 280.8 percent of the avoidable cost;
- NDC Irregular Parcels to Sectional Center Facility (SCF) Irregular Parcels discounts 119.1 percent of the avoidable cost;
- Mixed NDC Marketing Parcels to NDC Marketing Parcels discounts 180.0 percent of the avoidable cost;
- NDC Marketing Parcels to SCF Marketing Parcels discounts 116.9 percent of the avoidable cost;
- Non-automation Mixed ADC Flats to Automation Mixed ADC Flats discounts 326.1 percent of the avoidable cost;
- Non-automation Mixed ADC Non-machinable Letters to Non-automation ADC Non-machinable Letters discounts 120.3 percent of the avoidable cost;
- Non-automation ADC Non-machinable Letters to Non-automation 3-Digit Non-machinable Letters discounts 136.0 percent of the avoidable cost; and
- Non-automation 3-Digit Non-machinable Letters to Non-automation 5-Digit Non-machinable Letters discounts 125.0 percent of the avoidable cost.

[69] Initially, the Postal Service reported that the passthrough for Automation 3-Digit Flats was over 100 percent. In Response to CHIR No. 3, question 1 the Postal Service explained that the discount for Automation 3-Digit Flats to Automation ADC Flats is set at 100 percent, and the error was a result of the Postal Service relying on an incorrect avoided cost.

The Postal Service's stated statutory justifications for these proposed passthroughs are discussed below.

Mixed NDC irregular nonbarcoded parcels to Mixed NDC irregular barcoded parcels; Mixed NDC machinable nonbarcoded parcels to Mixed NDC machinable barcoded parcels; and Mixed NDC nonbarcoded Marketing Parcels to Mixed NDC barcoded Marketing Parcels. These passthroughs support discounts for having the mailer affix a barcode to mailpieces, eliminating the need for the Postal Service to barcode the pieces.

The Postal Service justifies these three excessive passthroughs under section 3622(e)(2)(D), as necessary to encourage mailers to develop a fully barcoded parcels mailstream. *Id*. at 48. The Postal Service states that a fully barcoded mailstream would allow the elimination of keying stations on parcel sorters and increase efficiency overall. *Id*. The Postal Service also anticipates implementing a requirement for all ground parcels to have a barcode, and states that it is inappropriate to reduce the incentive to voluntarily barcode parcel-shaped pieces. *Id*.

Mixed NDC irregular parcels to NDC irregular parcels and NDC irregular parcels to SCF irregular parcels. These passthroughs support discounts for a greater level of presort for mailpieces.

The Postal Service justifies these excess passthroughs under section 3622(e)(2)(D), as needed to ensure long-run operational efficiency in its parcel mail processing system. *Id*. at 45.

The Postal Service notes that the Commission accepted, in Docket No. R2011-2 and in the FY 2010 ACD, the Postal Service's rationale for greater than 100 percent passthroughs in these areas. *Id*. The Postal Service's rationale was that a new and improved costing model for parcel-shaped pieces "produced avoided costs that were significantly different from those estimated using the former cost model." *Id*. The Postal

Service stated that adjusting the discounts to match the new costs would be needlessly disruptive to parcel mailers, and sudden shifts in mailing patterns may cause disruption to postal operations. *Id*. at 45-46.

In this case, the Postal Service continues the trend of reducing the passthrough to better align with avoidable costs. *Id*. at 46.

Mixed NDC marketing parcels to NDC marketing parcels; and NDC marketing parcels to SCF marketing parcels. These passthroughs support discounts for greater level of presorting for mailpieces.

The Postal Service justifies the excess passthrough under section 3622(e)(2)(D) as necessary to ensure operational efficiency due to recent mail classification schedule changes. *Id*.

The Postal Service has reduced the passthroughs of both of these pairs from the last rate adjustment in Docket No. R2012-3, but urges caution in implementing more drastic changes at this time because it states that it is not clear what the final effects of the changes are on avoided costs estimates. *Id*. The avoided costs for both pairs have decreased. *Id.* While the Parcels category remains in transition, stable avoided costs estimates are not available. *Id.* at 47.

The Postal Service contends that experience with Marketing Parcels will allow it to ensure the worksharing discounts for the category ensure efficient operations. *Id*. at 43.

Non-automation Mixed ADC Non-machinable Letters to Non-automation ADC Non-machinable Letters; Non-automation ADC Non-machinable Letters to Non-automation 3-Digit Non-machinable Letters; and Non-automation 3-Digit Non-machinable Letters to Non-automation 5-Digit Non-machinable Letters. The Postal Service justifies the passthroughs for each of these discounts pursuant to 3622(e)(2)(B).

The Postal Service explains that to align each of these discounts with avoided costs would result in rate increases of 9.2 percent, 11.7 percent, and 18.1 percent, respectively. Response to CHIR No. 3, question 1. The Postal Service indicates that it will work towards aligning the discounts with avoided costs in the future. *Id.*

Non-automation Mixed ADC Flats to Automation Mixed ADC Flats. This passthrough supports a discount for having the mailer affix a barcode to mailpieces, eliminating the need for the Postal Service to barcode the pieces.

The Postal Service justifies the excess passthrough under section 3622(e)(2)(D), as aiding in the implementation of the Flats Sequencing System (FSS) program by encouraging barcoding to the maximum extent possible. Notice at 43. The Postal Service anticipates gradually phasing out the excess discount. *Id.* at 44. The Postal Service "inadvertently increased" the discount, and explains that the increase was not a strategic move. *Id*. at 44.

Commission analysis. The Commission approves all of the proposed workshare discounts in Standard Mail. The Postal Service explanations adequately describe how each of these discounts is consistent with or is justified by an exception under 39 U.S.C. 3622. *See* 39 CFR 3010.13(j).

E. Mail Classification Changes

In conjunction with its proposed price adjustment for Standard Mail, the Postal Service requests the approval of several mail classification changes.

First, the Postal Service requests the addition of six promotions that will occur at various times during calendar year (CY) 2013: (1) Mobile Coupon/Click-to-Call; (2) Earned Value Reply Mail Promotion; (3) Emerging Technologies; (4) Picture Permit Promotion; (5) Mobile Buy-It-Now Promotion; and (6) Product Samples Promotion. The first five of these promotions have been discussed in detail in section III. First-Class Mail of this Order.

The Product Samples Promotion, scheduled to be in effect from August 1, 2013 through September 30, 2013, encourages mailers to send samples via the mail by offering a 5 percent discount for Standard Mail Regular and Nonprofit Marketing Parcels. No comments were received regarding the Product Samples Promotion. The Commission approves the addition of the Product Samples Promotion. However, the Commission is concerned that the Promotion is being offered for a product that had a 79.5 percent cost coverage in FY 2011. The Postal Service has provided no discussion of whether and how the Promotion may aid Standard Mail in producing sufficient revenues to cover its attributable costs. The Commission encourages the Postal Service to monitor the impact of the Promotion on the Standard Mail Parcel cost coverage.

Second, the Postal Service proposes the addition of High Density Plus Letters and High Density Plus Flats price categories. The Postal Service originally characterized these price categories as worksharing discounts, with Carrier Route Letters and Carrier Route Flats serving as the respective benchmarks. Subsequently, in a late Response to CHIR No. 1, question 3, the Postal Service states it no longer believes these new price categories qualify as worksharing. CHIR No. 1, question 3 requested information required by the Commission when a new workshare discount is established. Based on its belief that a workshare relationship does not exist, the Postal Service did not provide the requested information.

The Commission authorizes the addition of these new price categories. Whether the new rates constitute workshare discounts under section 3622(d) is a question that must be more fully addressed and considered. The Commission will establish a separate docket to provide for public comment on and Commission consideration of whether or not these rates constitute workshare discounts.

Third, the Postal Service proposes a restructuring of the parcel rates for Carrier Route Parcels, High Density Parcels and Saturation Parcels. These changes are referred to as “Simple Samples.” Notice at 25. The Postal Service proposes to eliminate all worksharing relationships and replace the previous rate structure with volume discounts and pallet and container charges. The Postal Service explains that the new discounts will benefit Consumer Packaged Goods companies and Mail Service Providers who send samples through the mail. Response to CHIR No. 4, question 2. The Postal Service proposes the new pricing structure as a way to help the product samples industry and states that it should not have a negative impact on small businesses. The Postal Service maintains that while the handling fees could be considered reverse discounts, that was not the Postal Service’s intent. *Id.* question 3. The Postal Service also explains that the handling fees were developed from the transportation costs and mail processing costs associated with cross docking pallets and sorting cartons. *Id*.

The classification and rate changes proposed by the Postal Service are approved. As with High Density Plus rates, there is concern over whether the workshare discount limitations of section 3622(d) should be applied. Here too, the issue should properly be addressed and resolved in a public proceeding not subject to the time limitations of a rate request.

F. Commenter Issues

Mail Classification changes. The comments regarding promotions that were filed by the Public Representative, NPPC, Valpak, Pitney Bowes, and NAPM are discussed and addressed in the First-Class Mail section of this Order.

Standard Mail Flats. Seven parties commented on the proposed price adjustment for Standard Mail Flats and the Postal Service filed Reply Comments. This section provides a detailed discussion of these comments and the Commission's Analysis.

Worksharing. The Public Representative expresses concern that passthroughs significantly above or below 100 percent may disadvantage some groups of mailers or create substantial entry barriers to worksharing competition. PR Comments at 10. He recommends that the Commission reject discounts that disadvantage one mailer over another. *Id.*

The Public Representative enumerates several potential issues with the new High Density Plus and Simple Samples rate structures. First, he notes that the Postal Service has severed the worksharing relationship between Carrier Route Letters and High Density Saturation Letters as part of its introduction of High Density Plus Saturation Letters. *Id.* at 11.

Second, he states that the elimination of High Density Parcels with no justification enables the Postal Service to eliminate the worksharing discounts between High Density and Carrier Route Parcels. *Id.* at 12. He takes issue with elimination of pricing structures in favor of prices that are not based on Efficient Component Pricing (ECP). He requests the Commission to protect worksharing relationships based on ECP as the best method of maintaining efficient preparation practices by the mailing community. *Id.*

Finally, the Public Representative states that the pricing structure of Carrier Route Parcels is "unjustified and irrational" because its pallet handling fees do not follow worksharing relationships. *Id.* He contends that this pricing structure signals a pattern which may signal dismantling of ECP, and urges the Commission to seriously inquire into this matter and consider the issue. *Id.*

The Newspaper Association of America comments in support of the new High Density Plus pricing tiers. It is pleased that the Postal Service has incorporated this pricing tier, establishing a more user-friendly rate design. NAA Comments at 2. However, it views the level of discount as problematic, stating that the Postal Service has not priced the new tier at a discount sufficient to retain or attract volume that has moved out of the system. NAA asserts that for the new High Density Plus tier to attract significant volume, this rate will need to be substantially closer to the midpoint between High Density and Saturation rates. *Id.* at 2. It also maintains that the High Density Plus tier does not aid NAA members that may not have sufficient density in their mailings to qualify for the new tier, and urges the Postal Service to work actively to reduce the 2.7 cent difference between the High Density and Saturation tiers. *Id.* at 3.

Valpak's comments address two areas related to worksharing. First, it expresses concern that the Postal Service has set passthroughs within the Standard Mail Flats product substantially above 100 percent, while setting passthroughs for highly profitable High Density well below 100 percent. Valpak Comments at 47-48. It claims that the Postal Service "has not adequately explained why it offers discounts above cost avoided for a significantly underwater product like Standard Flats, and discounts well under cost avoided to highly profitable mail like High Density and Saturation Letters." *Id*. at 48 Second, Valpak does not believe the new High Density Plus workshare tier should be considered worksharing because it alleges that density does not meet the definition of workshare in 39 U.S.C. 3622(e). *Id.* at 49.

NAPM raises the issue of excess capacity in the system and petitions the Commission to "instruct the Postal Service to construct price signals that recognize the importance of efficiency by promoting worksharing, as opposed to making use of excess capacity." NAPM Comments at 3.

Commission analysis. As previously stated, the Commission approves all the proposed workshare discounts as consistent with the law or adequately justified. The Commission supports the reduction, over time, of those discounts with excess passthroughs. The Postal Service is also encouraged to adjust discounts with passthroughs well under 100 percent as a way of sending efficient price signals to mailers.

The Public Representative is concerned that the new pricing structure for Simple Samples sends inefficient pricing signals. There the Postal Service explains that a mailer who submits a 3-Digit Pallet must pay a pallet handling fee, as well as a carton/sack fee. A mailer who submits a 5-Digit Pallet is only required to pay a pallet fee. This pricing structure is likely to send logical price signals to mailers *i.e*., a 5-Digit Pallet is cheaper than a 3-Digit Pallet.

Prior to the Postal Service's claim that it does not believe High Density Plus is worksharing, Valpak filed comments that High Density Plus should not be treated as a workshare discount. Valpak contends that density does not meet the definition of worksharing. *See* Valpak Comments at 49.

As discussed earlier, the Commission finds that there may be worksharing relationships present within the new pricing structures for Simple Samples and High Density Plus. The Commission has the authority to define workshare discounts pursuant to 39 U.S.C. 3622(a).[70] To further examine these new pricing structures, the Commission will establish a separate docket to provide for public comment on and Commission consideration of whether or not these rates constitute workshare discounts.

[70] That provision defines worksharing as the "presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a). The reference is to subsection 3622(a), the Commission's general authority to promulgate regulations necessary to establish a modern system of rate regulation.

V. PERIODICALS

A. Introduction

Products. The Periodicals class, which includes publications such as magazines and newspapers, consists of two products: Within County and Outside County. Notice at 27.

B. Price Adjustments

Postal Service's planned adjustments. The Postal Service plans to increase Within County Periodicals prices by an average 2.903 percent and Outside County Periodicals prices by an average 2.535 percent. The proposed overall average increase for the Periodicals class is 2.549 percent. Response to CHIR No. 7 at 2. This percentage increase is 0.021 percentage points less than the Postal Service's current annual limitation authority of 2.570 percent. The Postal Service does not apply any unused rate authority to the pricing of Periodicals. *Id*. Cumulative unused pricing authority for the Periodicals class following this change is -0.541 percent.

The following table summarizes the proposed average percentage price changes for Periodicals.

Table V-1

Summary of Planned Average Percentage Price Increase for Periodicals

Product	Price Changes %
Outside County	2.535
Within County	2.903
Overall	2.549
Source: CHIR No. 7	

Postal Service's position. The Postal Service characterizes the Periodicals class as "challenged in terms of cost coverage," as it did not cover its attributable costs in FY 2011 (Factor 2, Objective 8). Notice at 27. The Postal Service says it is cognizant of the special situation for Periodicals in terms of both its value to the public (Factor 8, Factor 11), and its failure to cover costs. *Id*. at 27-28. It says this price change "simply refines price relationships to encourage efficiency and containerization, while limiting the price increases for individual publications." It notes that the actual price paid by a given publication is the combination of many price elements, so care has been taken to adjust the individual price elements in a manner that limits the resulting postage increases. *Id*.

Commenters' views. Valpak observes that the Periodicals class has a history of losses, including a loss of $2.747 billion from FY 2007 to FY 2011. Valpak Comments at 4. It notes that the Postal Service has used almost all its Periodicals price cap authority, and states that "there will never be a way that PAEA cap-limited price adjustments alone will enable Periodicals to cover [attributable] costs." *Id*. at 4 n.7. No other commenter specifically addresses the planned adjustments for Periodicals.

Commission analysis. The Postal Service's planned price adjustment of 2.549 percent for the Periodicals class is 0.021 percentage points less than the current annual limitation authority; therefore, the Commission finds this adjustment in compliance with the annual price cap limitation.

C. Statutory Preferential Rates

Postal Service's position. The Periodicals class is accorded several statutory pricing preferences. The Postal Service says it implements these preferences in the same manner as in Docket No. R2012-3. Postal Service Comments at 32. It notes that the Commission's conclusion in that case was that the Postal Service's approach reflected an appropriate interpretation of 39 U.S.C. 3626. *Id*.

Within County. Section 3626(a)(3) requires that the prices for Within County Periodicals reflect this product's preferred status relative to the prices for regular rate (Outside County) Periodicals. The Postal Service says the price adjustment in this case "continues to recognize the preferential status of Within County Periodicals by setting prices below those of regular Outside County Periodicals." *Id*.

Outside County—Nonprofit and Classroom. 39 U.S.C. 3626(a)(4)(A) requires that Nonprofit and Classroom Periodicals receive, as nearly as practicable, a 5 percent discount from regular rate postage, except for advertising pounds. Consistent with past practice, the Postal Service maintains this rate preference by giving Nonprofit and Classroom pieces a 5 percent discount on all components of postage except for advertising pounds and ride- along pieces. *Id*. at 33.

Outside County—Science of Agriculture Periodicals. Section 3626(a)(5) requires that Science of Agriculture Periodicals be given preferential treatment for advertising pounds. The Postal Service says it continues to provide these publications with advertising pound rates for destination delivery unit (DDU), destination sectional center facility (DSCF), and destination area distribution center (DADC), and Zones 1 & 2 that are 75 percent of the advertising pound rates applicable to regular Outside County Periodicals. *Id*.

Limited circulation discount. Section 3626(g)(4) provides preferential treatment for the Outside County pieces of a Periodicals publication with fewer than 5,000 Outside County pieces and at least one Within County piece. The Postal Service notes that it implemented a "limited circulation" discount in 2008, which gives these mailers a discount equivalent to the Nonprofit and Classroom discount. It retains that discount in this case. *Id*. at 34.

Commenters' views. No commenter addresses the consistency of the Postal Service's Periodicals pricing plan with statutory preferences.

Commission analysis. Commission review of the Postal Service's filing confirms its consistency with statutory preferences for mail in the Periodicals class. Comparable categories of automation and non-automation Within County Flats have rates that are approximately 65 percent less than comparable Outside County Flats prices. This satisfies section 3626(a)(3). The proposed "limited circulation" discount is approximately 5 percent, in line with section 3626(g)(4). Nonprofit and Classroom publications receive a 5 percent discount from regular, Outside County piece, bundle, sack, and pallet prices, and editorial pounds consistent with 39 U.S.C. 3626(a)(4)(A). Science of Agriculture advertising pound rates are 25 percent less than regular Periodicals, thereby satisfying section 3626(a)(5). Finally, the discount for editorial pounds is between 16 and 72 percent. This exceeds the minimum 5 percent discount required under section 3626(4)(a)).

D. Worksharing

Exception to statutory requirement on avoided costs. 39 U.S.C. 3622(e) generally requires the Commission to ensure that worksharing discounts do not exceed avoided costs with certain exceptions. One exception applies when the discount is provided in connection with subclasses of mail consisting exclusively of educational, cultural, scientific, or informational (ECSI) value. 39 U.S.C. 3622(e)(2)(C). Commission rule (39 CFR 3010.14(b)(6)) requires the Postal Service to explain discounts set substantially below avoided costs.

Postal Service's position. The Postal Service presents worksharing-related data for Periodicals in Attachment B to the Notice.[71] The Outside County table shows discounts or surcharges, cost differentials, and passthroughs for presorting. *Id*. at 52. The Within County table shows the same information for presorting, prebarcoding, and dropshipping. *Id*. Another table shows bundle and container pricing. *Id*.

[71] The Commission notes that the Postal Service's presentation of worksharing-related data for periodicals facilitates the rate review process.

The Postal Service observes that “some” Periodicals passthroughs exceed 100 percent. Many apply to low volume categories, such as automation letters. *Id*. at 51. The Postal Service notes that price swings would occur if these passthroughs were changed. *Id*. at 51-52. The Postal Service states that for this price adjustment, the flexibility of the container-bundle-piece price structure is used to limit the extent to which price increases for individual publications differ from the average.

Within County passthroughs. No Within County passthrough exceeds 100 percent; one equals 100 percent.

Postal Service’s position. The Postal Service does not address Within County worksharing.

Commenters’ views. No commenter addressed Periodicals worksharing.

Commission analysis. The Postal Service’s pricing reflects its interest in keeping price increases for individual publications close to the annual price cap limitation. The Postal Service did not provide information detailing how the planned price adjustments will impact mailers or improve pricing efficiency. Because most prices increase by the annual price cap limitation, the planned prices generally result in similar passthroughs and price/cost ratios for bundles, sacks, and pallets in the Outside County product. The Commission continues to believe that aligning prices more closely with costs would improve the Postal Service’s financial situation; however, because the Periodicals class consists exclusively of mail matter with some ECSI content, the Commission finds that the worksharing discounts proposed by the Postal Service for the Periodicals class comply with statutory requirements. The following table details the distribution of passthroughs.

Table V-2

Docket No. R2013-1 Periodicals Piece Passthrough Distribution

	Number of Passthroughs	Rate Category Volume
Below 80 Percent	5	4,235,084,020
Between 80 and 120 Percent	6	1,587,588,983
Between 120 and 250 Percent	3	219,084,388
Over 250 Percent	6	83,678,627
Total	20	6,125,436,019

Source: PRC-LR-R2013-1/3

The Postal Service continues to focus on minimizing differences in price increases between publications in designing Periodicals prices. As avoided costs have changed, this has led to passthroughs diverging further from 100 percent. This is reflected in the changes to the price/cost ratios for pallets. The following table compares the price/cost ratios resulting from the Docket No. R2012-2 and the Docket No. R2013-1 Price Adjustments.

Table V-3

Periodicals Pallet, Sack, and Bundle Price/Cost Ratios

	R2012 Prices	R2013 Prices
Under 30 Percent	6	9
Between 30 and 50 Percent	34	43
Over 50 Percent	15	6

Source: PRC-LR-R2013-1/3

Since the Docket No. R2012-2 price adjustment, costs for pallets, sack and bundles have increased approximately 10 percent on average. In the planned Docket No. R2013-1 prices, the Postal Service increases prices for these three rate elements by approximately 2.5 percent. Consequently, the average price/cost ratio of these rate elements will be lower in 2013 than it was in 2012.

The proposed rates appear to be consistent with the statutory standards of 39 U.S.C. 3622.

VI. PACKAGE SERVICES

A. Introduction

The Package Services class contains five products: (1) Alaska Bypass Service; (2) Bound Printed Matter Flats (BPM Flats); (3) Bound Printed Matter Parcels (BPM Parcels); (4) Media Mail/Library Mail; and (5) Inbound Surface Parcel Post (at UPU rates).[72]

B. Price Adjustments

For Package Services, the Postal Service proposes an average price increase of 2.567 percent.[73] Based on the available inflation-based price adjustment authority, the instant proceeding creates new unused rate authority of 0.003 percent.[74] Summing the new unused rate adjustment authority with the existing rate adjustment authority produces a total unused rate adjustment authority of -0.530 percent.[75]

Table VI-1 displays the average price increase given to each product, as well as each product's FY 2011 cost coverage. The Postal Service proposes above average price increases for BPM Parcels and Media Mail/Library Mail. For all other products, the Postal Service proposes below class average price increases.

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[72] The prices for Inbound Surface Parcel Post are determined by the Universal Postal Union (UPU), not the Postal Service. Notice at 28 n.21.

[73] United States Postal Service Notice of Errata to USPS-LR-R2013-1/4, [Errata], November 8, 2012, which shows a revised average price increase of 2.567 percent.

[74] The Postal Service chose not to use any unused rate authority in this filing.

[75] The -0.530 percent in total unused rate adjustment authority is calculated by adding the 0.003 percent in new unused authority from the instant docket to the -0.533 percent in existing unused authority.

In Docket No. MC2012-13, the Commission approved the Postal Service's Request to transfer Parcel Post to the competitive product list.[76] The Postal Service proposed to leave Alaska Bypass Service on the market dominant product list as a Package Services product offering.[77] The addition of Parcel Post to the competitive product list and Alaska Bypass Service to the market dominant list will occur concurrently on January 27, 2013. The Postal Service explains that for this price adjustment, Alaska Bypass Service prices will be based on the previous 70-pound Parcel Post prices for Zones 1, 2, and 3. It clarifies that in future price adjustments, Alaska Bypass Service prices will not be based on the competitive Parcel Post product.

Table VI-1

Package Services Price Adjustment

Package Services Product	Price Change %
Alaska Bypass Service	1.890
BPM Flats	0.002
BPM Parcels	3.424
Media Mail/Library Mail	3.469
Inbound Surface Parcel Post (at UPU rates)	1.552
Source: USPS-LR-R2013-2/4, Revised November 8, 2012	

[76] Docket No. MC2012-13, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 19, 2012 (Order No. 1411). In Docket No. CP2013-3, the Commission determined that the Postal Service satisfied the conditions of Order No. 1411. Docket No. CP2013-3, Order No. 1536, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012, at 16.

[77] Alaska Bypass Service allows shippers to send shrink-wrapped pallets of goods within Alaska from designated "hub points" to designated "bush points."

Comments. No commenter opposes the planned price increases for Package Services.

The Commission finds that the price adjustments for Package Services are consistent with 39 U.S.C. 3622(d).

C. Statutory Preferential Rates

39 U.S.C. 3626(a)(7) requires that Library Mail prices be set at 95 percent of Media Mail prices. The Postal Service explains that it satisfies this requirement by setting each Library Mail price element equal to 95 percent of its corresponding Media Mail price element. Notice at 33.

The Commission finds that the prices for Media Mail and Library Mail comply with section 3626(a)(7).

D. Worksharing

39 U.S.C. 3622(e) requires the Commission to ensure workshare discounts do not exceed estimated avoided costs unless an exception applies. To determine if workshare discounts comply with section 3622(e), the Commission analyzes the passthroughs (discounts divided by cost avoidances) for each discount.

Three Package Services products offer workshare discounts: Media Mail/Library Mail, BPM Flats, and BPM Parcels.

Media Mail/Library Mail. There are four discounts offered for Media Mail/Library Mail. All workshare discounts for Media Mail/Library Mail are equal to or less than their avoided costs. *Id*. at 53.

BPM Flats and BPM Parcels. There are 15 discounts offered for BPM Flats and 12 discounts for BPM Parcels. All workshare discounts for both products are equal to or less than their avoided costs. *Id*.

The Commission finds that the workshare discounts for the Package Services class are consistent with 39 U.S.C. 3622(e).

E. Classification Changes

The Postal Service proposes classification changes for one Package Services product. No commenters oppose the classification changes.

As discussed previously, in Docket No. MC2012-13, the Commission approved the Postal Service's Request to leave Alaska Bypass Service, a former subset of Parcel Post, on the market dominant product list. The Postal Service proposes two modifications to the Alaska Bypass Service classification language approved in Docket No. MC2012-13. First, the Postal Service proposes to increase the maximum Alaska Bypass pallet weight from 2,200 lbs to 2,500 lbs. Second, the Postal Service proposes to eliminate Zone 4 through Zone 8 price categories that were available when Alaska Bypass Service was a part of Parcel Post.

The Commission approves both classification changes concerning the Alaska Bypass Service. Bypass customers will benefit from the increased maximum pallet weight. Since Alaska Bypass Service is an intra-Alaska service offering, price categories for Zone 4 through Zone 8 would be superfluous.

VII. SPECIAL SERVICES

A. Introduction

The Special Services class consists of 12 products: (1) Ancillary Services;[78] (2) Address Management Services; (3) Caller Service; (4) Change-of-Address Credit Card Authentication; (5) Confirm Service; (6) Customized Postage; (7) International Ancillary Services;[79] (8) International Business Reply Mail Service; (9) International Reply Coupon Service; (10) Money Orders; (11) Post Office Box Service; and (12) Stamp Fulfillment Services.

B. Price Adjustments

For the Special Services class, the Postal Service proposes an average price increase of 2.850 percent. Notice at 29. This is 0.280 percent over the CPI-U price cap authority. At the time of filing, the Postal Service had 2.570 percent in inflation-based price adjustment authority. The Postal Service also had 2.394 percent in unused price adjustment authority. *See* Order No. 987 at 2. Consequently, after the Postal Service implements the 2.850 percent price increase, the new total unused price authority will be 2.114 percent (0.052 percent from Docket No. R2008-1; 0.085 percent from Docket No. R2009-2; -0.577 percent by application of 39 CFR 3010.26 in Docket No. R2011-2; 0.002 percent from Docket No. R2011-2; 2.832 percent from Docket No. R2012-3; and -0.280 percent from Docket No. R2013-1).

[78] The Domestic Ancillary Services product includes 22 services: (1) Address Correction Service; (2) Applications and Mailing Permits; (3) Business Reply Mail; (4) Bulk Parcel Return Service; (5) Certified Mail; (6) Certificate of Mailing; (7) Collect on Delivery; (8) Delivery Confirmation; (9) Insurance; (10) Merchandise Return Service; (11) Parcel Airlift; (12) Registered Mail; (13) Return Receipt; (14) Return Receipt for Merchandise; (15) Restricted Delivery; (16) Shipper-Paid Forwarding; (17) Signature Confirmation; (18) Special Handling; (19) Stamped Envelopes; (20) Stamped Cards; (21) Premium Stamped Stationery; and (22) Premium Stamped Cards.

[79] The International Ancillary Services product includes 6 services: (1) International Certificate of Mailing; (2) International Registered Mail; (3) International Return Receipt; (4) International Restricted Delivery; (5) International Insurance; and (6) Customs Clearance and Delivery Fee.

The Postal Service indicates that for most Special Services products, it aimed to have fee increases close to 4.5 percent, consistent with historical rounding constraints. Notice at 30. The overall increase fell short of this target because portions of the Delivery Confirmation ancillary service were reduced to zero. *Id.* at 30 n.21.

Table VII-1 displays the average price increase proposed for each product.

Table VII-1

Special Services Price Adjustment

Special Services Product	Price Changes %
Ancillary Services	1.835
Address Management Services	5.948
Caller Service	5.876
Change-of-Address Credit Card Authentication	0.000
Confirm Service	0.000
Customized Postage	5.000
Money Orders	4.214
Other Services*	2.222
Post Office Box Service	6.002
Stamp Fulfillment Services	0.000
International Ancillary Services	11.331
International Business Reply Mail Service	16.707
International Reply Coupon Service	-100.000
*Other Services include Standard Mail Weighted Forwarding and Return. This service is not part of the Special Services MCS language. However, the service is comparable to ancillary services and is included with the Special Services class.	
Source: USPS-LR-R2013-1/5.	

Three Special Services do not receive price increases – Change-of-Address Credit Card Authentication, Confirm Service, and Stamp Fulfillment Services. As discussed below, the Postal Service proposes changing the name of Change-of-Address Credit Card Authentication to just Credit Card Authentication, for which it proposes to continue to impose a flat $1.00 fee. *Id.* Attachment A at 119. Confirm Service is no longer being offered.[80] Prices for Confirm Service will remain at zero as the Postal Service anticipates filing a request to eliminate Confirm Service later this year. Notice at 31. In its Notice, the Postal Service states that Stamp Fulfillment Services will not receive a price increase in recognition of the 25 to 75 percent price increase it received in last year's price adjustment. *Id.* at 30. The Postal Service is concerned that an additional price increase could provide a disincentive for customers to receive stamps by mail. *Id.*

Proposed prices for Post Office Box service increase by 6.0 percent on average. The Postal Service indicates that prices for size 1 boxes will generally not be increased, while prices for larger box sizes, which have not changed since 2009, will be increased. *Id.* at 31. Fees for all box sizes in fee group 4 will be increased. The Postal Service states that the current fees in group 4 are much lower than the fees for the next higher fee group. *Id.*

The Postal Service proposes a number of changes to fees for services that comprise the Ancillary Services product. The Postal Service proposes to increase the prices of Collect on Delivery by 9.2 percent, reflecting the value of the service and the lack of historical stability in the cost data. *Id.* at 30. To reflect the value of the services provided, the Postal Service proposes to increase Express Mail Insurance prices by 7.9 percent, to increase Return Receipt prices by 7.5 percent, and to increase Special Handling prices by 16.8 percent. *Id.* The Postal Service indicates that it is setting the

[80] In Docket No. R2012-3, the Postal Service reported that it intends to discontinue Confirm Service once existing subscriptions expire. Docket No. R2012-3, United States Postal Service Notice of Market-Dominant Price Adjustment, October 18, 2011, at 27.

prices for retail Delivery Confirmation for Package Services and Priority Mail and for electronic Delivery Confirmation for Parcel Post at zero as it continues the transition to an environment where tracking is an integral feature of parcels. *Id.* at 31. For Stamped Envelopes and Stamped Cards, the Postal Service is increasing the price of each product by one cent, resulting in price increases of 6.2 percent and 33.3 percent, respectively. *Id*. at 32. To simplify the pricing structure, the Postal Service proposes to eliminate the Periodicals Additional Entry Application fee, a fee that is part of the Applications and Mailing Permits ancillary service. *Id.* at 31.

International Reply Coupon Service has a 100 percent price decrease because the Postal Service intends to remove Outbound International Reply Coupon Service from that product. *Id.* at 55; Attachment A at 121. International Ancillary Services has an overall price increase of 11.3 percent. Based on weighted volumes, a 10.2 percent price increase in International Registered Mail, a component of this product, is largely responsible for this increase. International Business Reply Mail Services prices increase 16.7 percent. The price of International Business Reply Cards increases from $1.00 to $1.25 and the price of International Business Reply Envelopes increases from $1.50 to $1.75. Proposed prices for International Certificate of Mailing Service, which is part of the International Ancillary Services product, are set equal to the fee for the equivalent domestic service. *Id.* at 32.

Comments. No commenters commented on the proposed price changes to Special Services.

Commission analysis. The Commission finds that the planned rates for Special Services are consistent with 39 U.S.C. 3622(d).

C. Classification Changes

The Postal Service proposes classification changes for five Special Services products: (1) Address Management Services, (2) Ancillary Services, (3) Change-of-

Address Credit Card Authentication, (4) International Ancillary Services, and (5) International Reply Coupon Service. Two commenters—the Public Representative and Popkin—express concerns about some of the proposed classification changes.

Address Management Services. The Postal Service proposes to update the MCS language to add a MASS IMb Quality Testing fee of $300.00 as well as additional MASS IMb footnotes.[81] In addition, the Postal Service proposes adding Postal Explorer (CD-ROM) service to provide customers with select postal documents[82] and Change-of-Address Customer Confirmation Letter Reprint to the MCS.[83] The Postal Service proposes to eliminate the FASTforward MLOCR[84] service from the MCS because the service is no longer available. *Id.* at 55. The Residential Delivery Indicator (RDI) Service is being updated to allow copying as an additional service. *Id.* Attachment A at 111.

Ancillary Services. The Postal Service proposes to add the following ancillary services to Standard Post: Certificate of Mailing, Collect on Delivery (COD), Delivery Confirmation, Insurance, Return Receipt, Return Receipt for Merchandise, Restricted Delivery, Signature Confirmation and Special Handling. *Id.* Attachment A at 85-100. The Postal Service proposes to allow notice of attempted delivery via an electronic notice rather than "just by [a] paper notice left at the address" for Certified Mail, COD, Insurance, and Registered Mail. *Id.* at 55. The Postal Service proposes to remove two

[81] MASS is a mail certification program.

[82] The postal documents available for the Postal Explorer (CD-ROM) include the: Domestic Mail Manual (DMM); International Mail Manual (IMM); Quick Service Guides; Domestic Price Calculator; International Price Calculator; Postal Zone Charts; Notice at 123, Price List; Customer Support Rulings; Postage Statements; Publication 28, Postal Addressing Standards, Publication 417, Nonprofit Standard Mail Eligibility and Customs Forms Indicator *http://pe.usps.com/cd_order.asp.*

[83] Change-of-Address Customer Confirmation Letter Reprint "provides customers with a copy of the letter that is sent to the customer's new address following the filing of a Change-of-Address order with the Postal Service." Notice, Attachment A at 111.

[84] MLOCR is Multi-line Optical Character Reader.

premium options—Color other than white and Monogram—from the Premium Stamped Envelopes ancillary service.

Change-of-Address Credit Card Authentication. The Postal Service proposes to rename the "Change-of-Address Credit Card Authentication" product to "Credit Card Authentication." *Id.* Attachment A at 119. The Postal Service indicates that it proposes to do this "so that it applies to all credit card authentications, rather than just those for filing Change-of-Address requests." *Id.* at 55. The proposed MCS language indicates that Credit Card Authentication will be available to verify the customer's identity and authenticate the credit card. *Id.* Attachment A at 119.

International Ancillary Services. The Postal Service proposes to eliminate Outbound International Restricted Delivery from the description of the International Restricted Delivery ancillary service while retaining Inbound International Restricted Delivery service. *Id.* at 55. It indicates that the reason for doing so is due to a steady decline in volume and revenue.

International Reply Coupon Service. The Postal Service proposes to modify the International Reply Coupon Service product by removing Outbound International Reply Coupon Service while retaining Inbound International Reply Coupon Service. *Id.* at 55. The Postal Service indicates that its reason for doing so is due to a steady decline in volume and revenue. In the FY 2011 ACD, the Commission requested that the Postal Service report on the feasibility of separately reporting costs and volumes for International Reply Coupon Service.[85] That report has not been submitted.

Comments. Two commenters—the Public Representative and Popkin–express concerns with the proposed change to the Change-of-Address Credit Card Authentication product. The current MCS language indicates that the Postal Service charges a $1.00 fee when customers use a credit card to make a change of address

[85] Docket No. ACR2011, Annual Compliance Determination Report, March 28, 2012, at 147 (FY 2011 ACD).

service request over the Internet or telephone. Notice, Attachment A at 119. The credit card information is used to verify the customer's identity to the Postal Service. *Id.* The Public Representative comments that the Postal Service has not explained whether and how often it expects to charge customers the authentication fee. PR Comments at 18. He contends that "frequent application of the fee for credit card use could impact customers' perception about the convenience and value of the Postal Service" and may have a negative impact on retail sales. *Id*. at 18-19. In his comments, Popkin seeks clarification as to whether the Postal Service intends to apply the authentication fee to routine credit card retail transactions. Popkin Comments at 2.

In a CHIR, the Postal Service was requested to identify all products and services to which the credit card authentication fee will apply. CHIR No. 6 at 1. In response, the Postal Service indicates that:

> While the Postal Service does not plan to apply the fee to any products or services in January, 2013 (other than Change-of-Address requests made online or by telephone), the Postal Service is planning later in 2013 to allow frequent customers to provide credit card information in advance for future mailings using a variety of existing products and classes of mail. The authentication fee would apply to those customers when the credit card is authenticated for future use.[86]

Popkin also comments on the proposed elimination of Outbound International Reply Coupon Service. He contends that Outbound International Reply Coupon Service provides the only practical means for amateur radio operators to exchange "QSL" cards when they make contact with other amateur radio operators throughout the world.[87] *Id.* at 1-2. He proposes that the Postal Service continue to offer outbound reply coupon service through Stamp Fulfillment Services in Kansas City. Popkin also seeks confirmation that the Postal Service will continue to redeem inbound reply

[86] Response of United States Postal Service to Chairman's Information Request No. 6, November 6, 2012, at 2 (CHIR No. 6 Response).

[87] A QSL card is a printed or picture post card that provides written confirmation of the radio contact.

coupons. The Postal Service has not proposed to eliminate Inbound International Reply Coupon Service, which will continue to be offered.

In a CHIR, the Postal Service was requested to identify what alternatives to International Outbound Reply Coupon Service, if any, are available in *lieu* of this service. CHIR No. 6 at 1. In response, the Postal Service indicates that in some cases, money orders and online payment services may serve as alternatives to International Outbound Reply Coupons. Response to CHIR No. 6 at 2. Commenting on the Postal Service's response to CHIR No. 6 and returning to his amateur radio example, Popkin claims that payment by money order is an impractical alternative because international money orders may only be sent to 29 countries and because it would require the sender to determine the cost of postage to mail a QSL card from a foreign country to the United States.[88] Even where international money orders are available, Popkin claims that they are substantially more expensive than reply coupons.[89] With respect to online payment options, Popkin asserts that online payment would require that both parties participate in the service. *Id.* at 2.

Commission analysis. The Commission approves the proposed mail classification changes for Special Services. The proposal to remove Outbound International Reply Coupons Service is not inconsistent with the statute. The small number of consumers, such as amateur radio operators, who purchase International Outbound Reply Coupons, will no longer be able to do so. However, they will still have options. For countries to which a Money Order may be sent, once the U.S. sender ascertains (or estimates) the cost of sending the QSL card from the foreign country to the U.S., the U.S. sender can obtain and send a money order in that amount. Senders

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[88] Additional Comments of David B. Popkin, November 7, 2012, at 1 (Popkin Additional Comments).

[89] The specific example that Popkin uses is Finland. In the case of Finland, a reply coupon costs $2.20. To send an International Money Order, a sender would be required to pay $4.45 for the money order, plus the additional cost for mailing a QSL card from the foreign country to the United States.

and recipients may find it more convenient and less costly to use an online payment service to transmit the cost of mailing a QSL card.

With respect to Credit Card Authentication, the Postal Service clarifies that it does not intend to impose this fee on routine retail transactions, but rather will limit it to instances in which it needs to specifically verify customer identity.

VIII. ORDERING PARAGRAPHS

It is ordered:

1. The Commission finds that the Postal Service planned price adjustments for Standard Mail Flats fail to satisfy the applicable directives for moving to remedy unlawful rates as set forth in the FY 2010 Annual Compliance Determination and further clarified and reaffirmed in Order No. 1427 and Order No. 1472.

2. The Commission remands the Standard Mail planned price adjustments identified in the United States Postal Service Notice of Market Dominant Price Adjustment, filed October 11, 2012, to allow the Postal Service to submit amendments that achieve compliance with the FY 2010 Annual Compliance Determination directives, statute, and applicable regulations.

3. In all other respects, the Commission provisionally finds that the Postal Service planned price adjustments identified in the United States Postal Service Notice of Market Dominant Price Adjustment, filed October 11, 2012, are consistent with 39 U.S.C. 3622(d), 3622(e), and 3626, and may be put into effect, as planned.

4. The Commission finds the classification changes described in the United States Postal Service Notice of Market Dominant Price Adjustment, filed October 11, 2012, are consistent with the title 39 United State Code, and may be implemented with the changes to the proposed Mail Classification Schedule language described in the body of this order. The appropriate language will be added to the draft Mail Classification Schedule.

5. Except to the extent granted or otherwise disposed of herein, all outstanding motions in this docket are denied.

By the Commission.

Shoshana M. Grove
Secretary

Commissioner Taub dissenting, in part.

DISSENT IN PART OF COMMISSIONER TAUB

I.

For the pending Docket No. R2013-1 Notice of Market Dominant Price Adjustment (Notice), I concur with the Commission's findings that the Postal Service's pricing proposals are consistent with the requirements of title 39. However, I find that the Postal Service has complied with the Commission's most recent mandates in regard to Standard Mail Flats.

In Order No. 1472, issued September 21, 2012, the Commission required, at page 3, that "the Postal Service **shall provide information** on the general remedial actions as described on pages 106-107 of the 2010 Annual Compliance Determination." (ACD) (Emphasis added). In response, in its Notice, the Postal Service provided information on the general remedial actions by explaining how it believed its proposed prices for Standard Mail Flats would capture additional revenue and contribution and move toward 100 percent cost coverage. Notice at 19-25. The Postal Service responded further in several substantive filings.

On October 18, 2012, the Commission requested from the Postal Service more detailed explanations on specific remedial actions outlined in the Commission's ACD for Fiscal Year 2010. The Postal Service provided its response on October 23, 2012, noting that although it has not given Standard Mail Flats an above-cap price increase, it believes that it will still be able to comply with the intent of the Commission's FY 2010 ACD to move Standard Mail Flats toward 100 percent cost coverage given its proposed price increases and anticipated processing savings. In this regard, the Postal Service explains that the reason it did not give Standard Mail Flats an above-average price cap increase is that it believes such an increase would impair the ability of the Postal Service to enhance its revenue/contribution under the price cap. In the Postal Service's view, this decision reflects an appropriate balance between the need to improve the cost coverage for Standard Mail Flats pursuant to the Commission's order, and the need for the Postal Service to increase contribution in order to remain economically viable.

The Postal Service further elaborated on this approach and its analysis on October 31, 2012, in response to Valpak's Motion to Strike the Standard Mail price adjustments. In addition, the Chairman issued five subsequent Chairman's Information Requests seeking clarity on how the Postal Service was calculating the rates. The Postal Service responded on October 24, 25, 26, and November 1, and 5, 2012. Most recently, in its filing in response to comments from Valpak and the Public Representative, the Postal Service explained, "it believes that the proposed prices…represent the best balance between the need to improve Flats' cost coverage and the need to protect the Postal Service's long-term contribution (and thus, financial stability). Of course, as volume trends and other factors change each year, the Postal Service will reevaluate its pricing proposals to ensure that they achieve the best balance." Reply Comments of the United States Postal Service, November 9, 2012, at 5.

As the law provides, the Commission will have the opportunity to assess the Postal Service's success in achieving this balance in future ACDs for the relevant fiscal year.

Moreover, as outlined in the second part of this dissent, the Commission clarified just three months ago in response to a remand from the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) that substantive explanations provided by the Postal Service (along the lines of those in the pending Notice) could be considered when it undertakes the remedial actions ordered in the 2010 ACD. However, the Commission today demands formulaic adherence to the original remedy devised more than a year and a half ago. In footnote 61 of today's Order, the

Commission makes just passing reference to the most legally significant finding: "**The Commission provisionally finds that the price increases proposed for the Standard Mail class satisfy the requirements of [law].**" (Emphasis added). Yet, the Commission is sending proposed rates back to the Postal Service until they reflect a level of price increases for Standard Mail Flats satisfying to the Commission. The approach of the Commission is a step back in time toward its ratesetting role that was abolished with the former Postal Rate Commission.

Until the Postal Accountability and Enhancement Act passed in 2006, former title 39 declared that the Governors were authorized "to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services" (former section 3621), but this authority was severely circumscribed by the active role given the Commission. Former section 3622(a) stated that "[t]he Postal Service may submit *such suggestions for rate adjustments* as it deems suitable." After submission of suggestions by the Postal Service, the statute required the Commission to make a "recommended decision" in accordance with the policies of title 39 and specific statutory factors. With respect to each Postal Service proposal, the Commission was obliged to exercise *its* best judgment as to which among a spectrum of lawful rates or classifications was the outcome most consistent with the statutory criteria. A "recommended decision" by the Commission was recommended in name only. In almost all cases, the Commission's decision was a final determination because the statute provided little scope for change by the Governors. As the U.S. Supreme Court explained, "Although the Postal Reorganization Act divides ratemaking responsibility between two agencies, the legislative history demonstrates 'that ratemaking . . . authority [was] vested primarily in [the] Postal Rate Commission.' . . . The structure of the Act supports this view." *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 820 (1983) (footnotes omitted).

In contrast, in the revised statute, the authority to establish reasonable and equitable classes of mail and rates of postage is vested primarily in the Postal Service. The legislative history and structure of the act support this revised view. While the contours of a modern system of regulation must be determined by the Commission, it would be inappropriate for the Commission to assume its former role of selecting from among a spectrum of lawful rates and classifications the set of rates which is, in its judgment, most consistent with statutory criteria. In its new role of regulator rather than ratemaker, the function of the Commission is to define the spectrum of lawful rates. Within this spectrum, the Postal Service is responsible for selecting the set of rates which, in its judgment, is most consistent with its statutory mission. The Commission may *reject* a given rate or classification as unlawful, but it should no longer *recommend* rates and classifications except in the most extraordinary cases.

Unfortunately, I believe that with this Order, the Commission is at risk of regressing to its past role vis-à-vis rates for Standard Mail.

II.

Nearly 20 months ago, on March 29, 2011, the Commission issued its FY 2010 ACD, which reviewed rates and fees in effect from October 1, 2009 through September 30, 2010. In its report, the Commission concluded that the Standard Mail Flats product was not in compliance with title 39, which prompted the Commission to order certain remedial measures. Less than a month later on April 27, 2011, the Postal Service filed a petition with the D.C. Circuit seeking review of the Commission's determination of non-compliance for the Standard Mail Flats product.

While the Court was still considering the matter, nearly a year later on March 28, 2012, the Commission's FY 2011 ACD noted that shortly after the close of the fiscal year, the Postal Service had announced a planned increase for 2012 in Standard Mail Flats rates of 2.209 percent, *which was slightly above the class average.* **"Ordinarily, the Commission would consider the Postal Service's subsequent filing. Given**

the pendency of the appeal before the D.C. Circuit, however, the Commission will hold action in this area in abeyance pending receipt of the Court's decision. Following that, the Commission will take action as appropriate." (Emphasis added). FY 2011 ACD at 16.

On April 17, 2012, the D.C. Circuit found the Commission's interpretation of the law "a reasonable one" in that "the ambiguous relationship between" several statutory provisions helped "tilt the scale to the Commission" in what otherwise "seems a close call." *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105 (D.C. Cir. 2012) at 1108. Yet, the Court remanded the case to the Commission for a definition of the extreme circumstances that trigger application of the law (section 101(d)), and for an explanation of the appropriateness of the particular remedy imposed by the Commission.

On August 9, 2012, the Commission issued its Order on Remand, Order No. 1427, to respond to the Court's Opinion. In explaining the remedy originally ordered in March 2011, the Commission for the first time explicitly clarified that the magnitude and duration of the shortfall and subsidization required either ameliorative steps to improve cost coverage, **"or an explanation justifying the failure to take ameliorative steps."** (Emphasis added). As the Commission explained, the Postal Service had failed to attempt to do either, leading to the finding of non-compliance for fiscal year 2010. *See* Order No. 1427 at 12.

Note that the Commission in March 2011 mandated an increase in cost coverage "through a combination of above-average price adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs." *Id*. at 13. In regard to this specific remedy, 17 months later, the Commission explained to the Court in the Order on Remand that its approach going forward **"…afforded the Postal Service an opportunity to tailor appropriate remedial actions under section 101(d)'s 'fair and equitable' standard to the**

specific circumstances of Standard Mail Flats." *Id*. (Emphasis added). The Court expressed concern that "the Commission's order implied that only 100% cost coverage, and nothing short of 100%, would bring Standard Flats into compliance with section 101(d)." The Commission responded that the Postal Service could be compliant at less than full cost coverage, "provided the Postal Service has either taken adequate steps toward elimination of the shortfall **or presented adequate reasons to explain the shortfall**." *Id*. (Emphasis added).

The Commission further explained: "ACDs involve a *post hoc* review of the Postal Service's prior fiscal year results, including, where relevant, remedial rate actions proposed or taken. **In the matter at hand, the Postal Service has the right to explain whether, and at what point, increased cost coverage for Standard Mail Flats might become infeasible or undesirable in light of the statutory cap and other statutory considerations. The Commission does not interpret section 101(d) to require "only 100% cost coverage, and nothing short of 100%, to satisfy the fair and equitable cost apportionment standard, provided an adequate explanation for failure to improve cost coverages is offered."** *Id*. at 14. (Emphasis added).

The Commission acknowledges in today's Order that the Postal Service's explanations are not restricted to an ACD, but are also appropriately considered when the Service proposes new rates. Therefore, the matter before the Commission is whether it finds the Postal Service's explanation sufficient, particularly in the context of the framework of current law. One year ago, in the first price change after the Commission's March 2011 ACD finding, the Postal Service proposed and then implemented an above-average increase for Standard Mail Flats. In this docket, the second proposed price change since that March 2011 ACD finding, the Postal Service seeks to raise rates for Standard Mail Flats and explains how it considers increases of a greater magnitude to be counterproductive. I find that the Postal Service has complied with the Commission's most recent mandates in regard to Standard Mail Flats for the pending Notice of Market Dominant Price Adjustment, consistent with the current statute and associated regulations for establishing postal rates.

Robert G. Taub
Commissioner

List of Commenters Addressing
Docket No. R2013-1 Notice
in response to Order No. 1501

Commenter	Abbreviation	Caption of Filing/Short Form	Filing Date
American Catalog Mailers Association	ACMA	Comments of the American Catalog Mailers Association (ACMA) (ACMA Comments)	November 1, 2012
Association for Postal Commerce	PostCom	Comments of the Association for Postal Commerce (PostCom Comments)	October 31, 2012
Greeting Card Association	GCA	Comments of the Greeting Card Association (GCA Comments)	October 31, 2012
Direct Marketing Association, Inc.	---	Joint Comments*	November 2, 2012
Mailing and Fulfillment Service Association	---	Joint Comments	November 2, 2012
National Association of Presort Mailers	NAPM	Comments of the National Association of Presort Mailers (NAPM Comments)	November 2, 2012
National Postal Policy Council	NPPC	Joint Comments	November 2, 2012
Newspaper Association of America	NAA	Comments of the Newspaper Association of America (NAA Comments)	November 1, 2012
Parcel Shippers Association	---	Joint Commenters	November 2, 2012
Pitney Bowes Inc.	PB	Comments of Pitney Bowes Inc. (Pitney Bowes Comments)	November 1, 2012
Public Representative	PR	Public Representative Comments in Response to United States Postal Service Notice of Market Dominant Price Adjustments (PR Comments)	November 1, 2012
David B. Popkin	Popkin	Comments of David B. Popkin (Popkin Comments)	October 31, 2012
		Additional Comments of David B. Popkin (Additional Popkin Comments)	November 7, 2012
Valpak Direct Marketing Systems, Inc.	Valpak	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price Adjustment (Valpak Comments)	November 1, 2012
Valpak Dealers' Association, Inc.	Valpak	*See entry above*.	November 1, 2012

* The term "Joint Comments" is used throughout this Order to refer to the filing captioned "Joint Comments of the Direct Marketing Association, Inc., the Mailing and Fulfillment Service Association, the National Postal Policy Council, and the Parcel Shippers Association." Similarly, "Joint Commenters" refers collectively to the individual associations sponsoring the Joint Comments.

List of Chairman Information Requests,
Responses of the United States Postal Service, and Related Filings

Chairman's Information Requests

Chairman's Information Request No. 1, October 23, 2012 (CHIR No. 1)

Chairman's Information Request No. 2, October 24, 2012 (CHIR No. 2)

Chairman's Information Request No. 3, October 24, 2012 (CHIR No. 3)

Chairman's Information Request No. 4, October 25, 2012 (CHIR No. 4)

Chairman's Information Request No. 5, October 31, 2012 (CHIR No. 5)

Chairman's Information Request No. 6, November 2, 2012 (CHIR No. 6)

Chairman's Information Request No. 7, November 5, 2012 (CHIR No. 7)

Responses to Chairman's Information Requests

Response of United States Postal Service to Chairman's Information Request No. 1 [Questions 1-4 and 6-20], October 26, 2012
(Response to CHIR No. 1, Questions 1-4 and 6-20)

Response of United States Postal Service to Chairman's Information Request No. 2, October 26, 2012 (Response to CHIR No. 2)

Response of United States Postal Service to Chairman's Information Request No. 3 November 1, 2012 (Response to CHIR No. 3)

Response of United States Postal Service to Question 5 of Chairman's Information Request No. 1, November 8, 2012
(Response to CHIR No. 1, Question 5)

Response of United States Postal Service to Chairman's Information Request No. 4, November 1, 2012 (Response to CHIR No. 4)

Response of United States Postal Service to Questions 6 and 8-13 of Chairman's Information Request No. 5, November 5, 2012
(Response to CHIR No. 5, 6, 8-13)

Response of United States Postal Service to Questions 1-5 and 7 of Chairman's Information Request No. 5, November 6, 2012
(Response to CHIR No. 5, Questions 1-5 and 7)

Response of United States Postal Service to Chairman's Information Request No. 6, November 6, 2012 (Response to CHIR No. 6)

Response of United States Postal Service to Chairman's Information Request No. 7, November 7, 2012 (Response to CHIR No. 7)

Replies to Postal Service Response

Reply of Alliance of Nonprofit Mailers to USPS Response to Chairman's Information Request No. 5, Question 2, November 8, 2012

Reply of Alliance of Nonprofit Mailers to USPS Responses to Chairman's Information Request No. 5, Questions 8-13, November 13, 2012

Motions for Late Acceptance of Responses[1]

Motion for Late Acceptance of Response of United States Postal Service to Question 5 of Chairman's Information Request No. 1, November 8, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 1,Question 5)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 3, November 1, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 3)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 4, November 1, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 4)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 5, Questions 1–5 and 7, November 6, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 5, Questions 1–5 and 7)

Motion for Late Acceptance of Response of United States Postal Service to Chairman's Information Request No. 5 [Questions 6 and 8–13], November 5, 2012
(Postal Service Motion for Late Acceptance, CHIR No. 5 [Questions 6 and 8–13]

[1] Each of these motions is granted.

List of Errata to Postal Service Filing

Errata to Notice (listed chronologically)

United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment, October 19, 2012

United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment, November 8, 2012

Correct Attachment A Pages for United States Postal Service Notice of Errata to Notice of Market-Dominant Price Adjustment [ERRATA], November 9, 2012

Errata to Library References (listed chronologically)

United States Postal Service Notice of Errata to USPS-LR-R2013-1/4, October 19, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/1, November 8, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/4 [Errata], November 8, 2012

United States Postal Service Notice of Errata to USPS-LR--R2013-1/2 [Errata], November 9, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/3 [Errata], November 9, 2012

United States Postal Service Notice of Errata to USPS-LR-R2013-1/5, November 9, 2012