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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

	)	
Notice of Market Dominant	)	Docket No. R2013-10
Price Adjustment	)	

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
COMMENTS ON THE UNITED STATES POSTAL SERVICE
NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT
(October 16, 2013)

INTRODUCTION

On September 26, 2013, the U.S. Postal Service filed a Notice of Market-Dominant Price Adjustment ("Notice") with the Postal Regulatory Commission pursuant to 39 U.S.C. § 3622, the Postal Accountability and Enhancement Act ("PAEA"), Public Law 109-435, and the Commission's rules promulgated thereunder (*see* 39 C.F.R. §§ 3010.1, *et seq.*). The CPI price cap applicable to the majority of this price adjustment is 1.696 percent, and the Postal Service intends to implement the price adjustments on January 26, 2014.

On September 27, 2013, the Commission issued Order No. 1842, opening this docket and setting October 16, 2013 as the deadline for public comment. These comments are filed jointly on behalf of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (hereinafter "Valpak"). Pursuant to Rule 3010.13(b), these comments focus on compliance of noticed prices with the requirements, factors, objectives, and policies of Title 39, and prior Commission orders.

COMMENTS

I. The Postal Service Has Again Failed to Provide Commission-Required Information about the Proposed Increases for Standard Flats.

In the Postal Service's Notice, its entire discussion of Standard Flats pricing consists of the following:

> In this price adjustment, Flats receive an above average price increase. In its 2012 Annual Compliance Report, the Postal Service proposed a three year schedule of above-average CPI increases for Flats, which the Commission approved in its 2012 Annual Compliance Determination. In that schedule the Postal Service agreed to increase Standard Flat prices by at least CPI x 1.05 in 2014, 2015, and 2016. The increase proposed in this filing more than complies with that schedule, by increasing flats by CPI x 1.067. [Notice, p. 24.]

This brief discussion fails to provide the important information regarding Standard Flats ordered by the Commission in its FY 2010 Annual Compliance Determination ("ACD"). The FY 2010 ACD remedial order required the Postal Service to "present a schedule of future above-CPI price increases for Standard Mail Flats … **updated with each subsequent Market Dominant Price Adjustment** and ACR until the revenue of the Flats product exceeds its attributable cost." P. 107 (emphasis added). That remedial order also required that:

> In subsequent Notices of Market Dominant Price Adjustments, the Postal Service shall report the following information:
>
> - an explanation of how the proposed prices will move the Flats cost coverage toward 100 percent, and
> - a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats product. [*Id.*]

In Docket No. ACR2012, the Postal Service actually "urge[d] the Commission to leave its FY 2010 ACD order unchanged…." Postal Service Reply Comments, p. 6. In response, the Commission concluded, "The approach advocated by the Postal Service does not require changes to the Commission's FY 2010 ACD directive." FY 2012 ACD, p. 116. Therefore, it is clear that FY 2010 ACD directive is still in force.

The Postal Service Notice merely references the three-year schedule that it presented in the FY 2012 Annual Compliance Report ("ACR"). The Postal Service failed to update the schedule of future above-CPI price increases. And, more importantly, it both failed to explain "how the proposed prices will move the Flats cost coverage toward 100 percent" and to provide "a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats products." Without this information, the Commission cannot measure or evaluate the progress, if any, the proposed prices and anticipated future pricing make towards solving the cross-subsidization problem of Standard Flats. Without providing after-rate anticipated coverages for Standard Flats, and explanatory narrative, the Commission and other parties can only guess when 100 percent coverage will be achieved under the baby steps proposed by the Postal Service.

Indeed, because the Postal Service is continuing the promotional incentives that it offered in Docket No. R2013-1, it explains that it does not need to make an adjustment to the price cap. *See* Notice, pp. 10-11. However, if the increase of Standard Flats were adjusted to take into consideration the new promotions being offered, that product's actual increase would be lower than CPI x 1.067, and indeed may be lower than the minimum increase it promised the Commission — CPI x 1.05.

The problem of Postal Service omissions of important Standard Flats information from its presentations is not new. In all four pricing and annual compliance dockets since the FY

2010 ACD,[1] the Postal Service has disregarded the Commission's remedial order. Valpak's Initial Comments in Docket No. ACR2012 provided the history of that noncompliance. *See* Docket No. ACR2012, Valpak Initial Comments, pp. 41-45. Now five dockets later, the Postal Service again ignores the Commission directive.

II. High Density/Saturation Products Continue to Pay High Cost Coverage that Is Grossly Unfair.

After PAEA, the Postal Service indicated that it would use its highly touted pricing flexibility to move toward demand-based pricing.[2] Coverages and elasticity of products in Standard Mail vary widely, as shown in Table 1. If product pricing were based on demand, however, the Postal Service would be expected to impose higher price increases on products with lower elasticity, especially if such products fail to cover their attributable cost, and lower price increases on products with higher elasticity, most especially those products that are highly profitable with coverages far above normal. Yet in this case, the Postal Service's proposed price changes are all within a relatively narrow band around the class-wide average of 1.609 percent, with little distinction as regards to coverage or elasticity (except for EDDM-R because of its unique circumstances). The Postal Service offers no rationale explaining its pricing decisions.

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[1] Docket Nos. R2012-3, ACR2011, R2013-1, and ACR2012.

[2] *See, e.g.,* USPS Fact Sheet on Pricing, March 2, 2010 ("Prices for mailing products (Market Dominant) should be based on demand for individual products and their costs....") http://about.usps.com/news/electronic-press-kits/delivering-future/dtf-FSpricing.pdf.

Table 1
Standard Mail Product Proposed Price Changes
by Former Subclass

Product	ACR2012 Coverage	Price Change (%)	Commercial Elasticity
Former Regular Subclass:			
Standard Letters	178.9%	1.614	0.437
Standard Flats	80.9%	1.809	0.437
Standard Parcels	85.5%	1.820	0.437
Former ECR Subclass:			
HD/Sat Letters	222.2%	1.322	0.704
HD/Sat Flats and Parcels	217.3%	1.412	0.704
Carrier Route	130.8%	1.666	0.704
EDDM-R	N/A	5.000	0.704
Average Standard Mail	149.0%	1.609	

Sources: FY 2012 ACD; Postal Service Notice; Elasticity from Postal Service filing with Commission on January 22, 2013.

The Postal Service provides no information on after-rates cost coverage from the CPI-based increase, so the only comparison of coverage available is from the FY 2012 ACD, and possible inferences that may be drawn from the statement of witness Nickerson's Exhibit for FY2014AR filed in Docket No. R2013-11.

III. Proposed Prices Fail to Optimize Contribution under the Price Cap by a Wide Margin.

In Docket No. ACR2012, the Postal Service offered a risk assessment from Christensen Associates in its Annual Compliance Report in an attempt to demonstrate that it would not be the best use of pricing authority to significantly increase the price of Standard Flats.[3] In that

[3] FY 2012 ACD, p. 111.

same docket, Valpak prepared and submitted a model for maximizing contribution from Standard Mail under the price cap.[4]

The Commission's analysis of both models observed that the Postal Service's reported elasticity of demand for Standard Mail products is not disaggregated to the product level: "The usefulness of both models would be significantly improved if estimates of own-price elasticity of demand were available by product." FY 2012 ACD, p. 116.

Following the FY 2012 ACD, Valpak improved its model to enable sensitivity analysis using various hypothetical elasticities for different products and provided this improved model to the Postal Service on June 19, 2013. The revised Valpak model confirms that Valpak's original point remains true: Standard Mail contribution is maximized by increasing the price of Flats, not tempering it. Indeed, even if Standard Flats has a higher own-price elasticity than that estimated by the Postal Service, this is all the more reason not to temper Flats price increases. Therefore, the primary rationale advanced by the Postal Service in the past for tempering prices of Standard Flats — that continuing to incur unnecessary losses would in some mysterious unexplained manner maximize contribution — remains incorrect.

IV. Generally Available Incentive Programs.

The Postal Service has proposed several promotions for Standard Mail (*see* Notice, pp. 8-10). Valpak believes that the pricing promotions are a constructive way for the Postal Service to exercise its pricing flexibility. There is hope that these promotions will help the Postal Service and mailers enter a new era, where technology will help promote use of the

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4 *Id.*, pp. 113-14.

mail, instead of just diverting it. Additionally, there is hope that the Postal Service will be able to gain insight about how and what kind of price changes affect mailer behavior. The Commission should approve the promotions except as discussed in section V, *infra*.

V. The EDDM Coupon Program Is Arbitrary and Encourages Unfair Competition with Postal Service Customers.

In the instant docket, the Postal Service is offering an unusual EDDM Coupon Program: "This program is designed to allow the Postal Service sales organization to distribute coupons to new small business customers. The coupons provide a $50 or $100 credit on postage for EDDM mailings." Notice, p. 8. Attachment D explains further:

> The Every Door Direct Mail (EDDM) Coupon Program will be targeted to prospects and new customers of Every Door Direct Mail (Retail and BMEU) service. Internal USPS personnel such as the Sales organization would have the ability to issue a coupon with a promotion code to targeted, qualified new customers that can be redeemed at the time of postage payment to receive a postage credit on a qualified EDDM mailing. Coupon redemption may be available in one of the following ways: online when an order is created and paid for on the EDDM Online Tool, or at the Post Office when an order is paid for at the Post Office location (order may have initiated through the Online Tool), or through PostalOne eDoc postage statement submission. [Notice, Attachment D, p. 10.]

The EDDM Coupon Program is not a continuation of previously offered promotions and is unlike any other promotion the Postal Service has ever offered. It would provide a credit towards postage that is offered entirely at the discretion of the Postal Service sales force. The Postal Service will be in a position to pick and choose arbitrarily which mailers receive the coupons. The coupons will not be offered based on objective criteria such as established volume or the presence of QR barcodes, and therefore there may be no way to measure its success.

The Postal Service continues to turn a blind eye to the inequity that EDDM-R represents to some of its major mailers. The Postal Service continues to use that product to cannibalize from shared mail mailers, putting a government monopoly directly in competition with its customers.

Now, the Postal Service wants to expand that program with a $3 million incentive. The EDDM Coupon Program raises important questions that should not be considered in the limited scope and compressed timeframe of a CPI-based price adjustment docket (with a government shutdown added for good measure). The Commission should withhold approval of the EDDM Coupon Program at this juncture and consider it in a separate docket.

Respectfully submitted,

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc.