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

Rate Adjustment Due To Extraordinary Or Exceptional Circumstances

Docket No. R2013-11

COMMENTS OF PITNEY BOWES INC.

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I. INTRODUCTION

On September 26, 2013 the United States Postal Service (Postal Service) renewed its request to increase prices for market dominant products under the provisions of 39 U.S.C. § 3622(d)(1)(E) and 39 C.F.R. § 3010.60 *et seq*.[1] The Postal Accountability and Enhancement Act (PAEA)[2] authorizes price increases on an expedited basis in excess of the CPI-based price cap in "extraordinary or exceptional circumstances" provided the Commission determines that "such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economic management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." 39 U.S.C. § 3622(d)(1)(E).

Pitney Bowes has consistently urged the Postal Service to use its pricing authority to promote productive efficiency in the postal system and the entire economy and ensure that postal services are provided at the lowest possible cost to mailers. The Postal Service should price its most efficient and profitable products to encourage mail volume retention and growth. The Postal Service should use pricing as a tool to promote universal, affordable mail service so that that mail remains a viable business communications medium and an important driver of commerce.

Numerous parties are submitting comments challenging the legal sufficiency and the econometric support for the Postal Service's Exigent Request. In the event the Commission determines that the Postal Service is entitled to some exigent rate adjustment, these comments focus on improving the proposed rate design for First-Class Mail Automation Letters.

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[1] *See* PRC Dkt. No. R2010-4R, Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059 (Sept. 26, 2013)(Exigent Request).
[2] *See* Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

The PAEA affords the Commission significant authority, and burdens it with significant responsibility, when it reviews an exigent request. Congress delegated this broad authority to review exigent requests because they are, by definition, outside of the "CPI price cap" - the defining feature of the modern rate system.[3] Section 3622(d)(1)(E) requires the Commission to determine whether the proposed exigent rate adjustments are "reasonable and equitable." For the reasons discussed below, the proposed exigent rate adjustments for First-Class Mail Automation Letters do not meet that standard. The proposed exigent rate adjustments for First-Class Mail Automation Letters fail to drive efficiency and fail to minimize end-to-end postage costs because key workshare discounts are not set equal to avoided costs.

Accordingly, the Commission should exercise its authority to modify the proposed rate adjustments for First-Class Mail Automation Letters. Doing so would promote fairness and productive efficiency, ensure nondiscriminatory access to the Postal Service's delivery network, and produce an adjustment that is "reasonable and equitable."

[3] *See* Dkt. No. R2010-4, Order No. 547 at 10-13 (discussing the importance of the CPI price cap as a means of simplifying the rate-setting process, improving accountability for the Postal Service, facilitating predictability and stability in setting rates, and incentivizing efficiency)(citing the testimony of former PRC Chairman George Omas a "major goal of postal reform . . . to provide . . . meaningful incentives that will encourage the Postal Service to be more economical and more efficient." (S. Hrg. 108-527 at 13)).

II. DISCUSSION

A. The PAEA Grants the Commission Broad Before-the-Fact Review Authority for Exigent Rate Adjustments

Section 3622(d)(1)(E) of the PAEA provides:

> [N]otwithstanding any limitation set under subparagraphs (A) and (C), and provided there is not sufficient unused rate authority under paragraph (2)(C), establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines, after notice and opportunity for a public hearing and comment, and within 90 days after any request by the Postal Service, that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

39 U.S.C. § 3622(d)(1)(E).

This provision has two parts, both of which empower and impose affirmative obligations on the Commission. The first part empowers and obligates the Commission to establish a set of procedures that it will use when reviewing an exigent request. The Commission has done that. *See* 39 C.F.R. § 3060 *et seq.*[4]

The second part vests the Commission with broad advance review authority with respect to exigent requests. The statute unambiguously states that an exigent rate adjustment may be implemented if and only if ("*provided*") the Commission determines that (1) an "extraordinary or exceptional circumstance" exists, (2) that the exigent request is "due to" the extraordinary or exceptional circumstance, and (3) that the exigent request is "reasonable and equitable and necessary." 39 U.S.C. § 3622(d)(1)(E). In the prior

[4] *See* Order No. 547 at 26 (citing Dkt. No. RM2007-1, Order No. 43 (Oct. 29, 2007)).

exigency case the Commission considered the first two questions. The third question presents an issue of first impression.[5]

The Commission has previously observed that its role in reviewing and approving a typical rate adjustment based on the annual limitation (CPI rate adjustment) is limited.[6] With respect to its role in a CPI rate adjustment, the Commission has drawn the analogy of a "referee whose duty is to determine when Postal Pricing has stepped "out of bounds"" relative to certain, limited objective, quantitative pricing standards prescribed in the PAEA. Dkt. No. RM2009-3, Order No. 536 at 18.[7]

This limited role for the Commission in CPI rate adjustments is balanced by the enhanced protections of the price cap. As the centerpiece of the modern rate system under the PAEA the price cap serves three critical functions: (1) it provides an incentive for the Postal Service to reduce costs and improve the efficiency of its operations, (2) it provides rate stability and predictability for mailers, and (3) it is "the primary mechanism for preventing the Postal Service from taking advantage of its monopoly position in markets that it dominates." Order No. 547 at 38.

The PAEA requires that the Commission play a different role when it reviews an exigent request. Section 3622(d)(1)(E) gives it greater authority and responsibility in

[5] In the prior exigency preceding the Commission did not reach the question of whether the proposed rates were reasonable and equitable and necessary. *See* Order 547 at 27. But the Commission made clear that the determination that "extraordinary or exceptional circumstances" have occurred is not by itself sufficient. *See id.* at 53-54. The requirements that there be "extraordinary or exceptional circumstances," that the size of the requested rate increase be causally related or "due to" the exigent circumstances, and that the requested rate adjustment be "reasonable and equitable and necessary" are all independent requirements. *See id*.

[6] *See*, 39 C.F.R. § 3010.10-29. Pitney Bowes has consistently advocated that the Commission has the authority under section 3622(a) in developing a modern rate system to require that workshare discounts fully reflect avoided costs, consistent with Commission precedent and the regulatory safeguards adopted in the majority of other liberalized network industries. *See e.g.*, Dkt. No. ACR2011, Comments of Dr. John Panzar submitted on behalf of Pitney Bowes (Feb. 3, 2012).

[7] *See* Dkt. No. RM2009-3, Order No. 536 at 16 ("These "out-of-bounds" lines consist of pricing restrictions in three areas -- the cap on class prices (*see* section 3622(d)), the limit on workshare discounts (*see* section 3622(e)), and revenue ceilings for the various categories of preferred mail (*see* section 3626).").

reviewing exigent requests than when it reviews CPI rate adjustments. Because the protections of the price cap are not present in an exigent request, the PAEA recognizes it is not enough for the Commission to simply enforce quantitative standards. More is required. In the absence of protections of the price cap the Commission must determine that the exigent request is causally related and proportionate to the exigent circumstance. It must also determine that the proposed exigent adjustments are "reasonable and equitable" - that they are fair, that they are efficient, and that they properly reflect cost savings due to worksharing. These are qualitative standards that require independent judgment and action on behalf of the Commission.

It is settled law that the Commission has the authority to deny or reject an exigent rate increase in its entirety under section 3622(d)(1)(E).[8] The Commission's authority to deny or reject an exigent request must include the power to modify or correct the proposed exigent rate adjustments. This follows from the statutory requirement that the Commission must determine that any exigent rate adjustment is "reasonable and equitable." The Commission has an obligation to ensure that the exigent rate adjustments promote efficiency and represent a fair allocation of the burden within and among various mailers. The Commission also has an obligation, in the absence of the protection of the statutory price cap, to protect against potential abuse of the Postal Service's monopoly and monopsony position.

[8] *See* Dkt. No. R2010-4, Order No. 547, Order Denying Request for Exigent Rate Adjustments (Sep. 30, 2010); *see also United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 (D.C. Cir. 2011)(denying in part and granting in part the Postal Service's petition for review of Order No. 547).

B. The Proposed Exigent Rate Adjustments for First-Class Mail Automation Letters are Not "Reasonable and Equitable"

As the Commission has previously noted, applying the exigency provision requires the interpretation of certain key terms, including the words "reasonable," "equitable," and "necessary." *Id*. at 24. Because these terms are not defined in statute the Commission must look to their ordinary or plain meaning.[9] According to the Merriam-Webster Online Dictionary the term "necessary" means "absolutely needed." http://www.merriam-webster.com/dictionary (Nov. 14, 2013). The "necessary" component is given additional context as "necessary" to maintain continued adequate postal services "under best practices of honest, efficient, and economical management." 39 U.S.C. § 3622(d)(1)(E). This is consistent with the Commission's interpretation of the term in relation to the causation requirement of the "due to" provision in section 3622(d)(1)(E). *See* Order No. 547 at 55-56.

The term "reasonable" means "fair and sensible." http://www.merriam-webster.com/dictionary (Nov. 14, 2013). The term "equitable" means "just or fair." *Id*. The ordinary meaning of the terms "reasonable and equitable" express normative judgments of fairness. The concept of "fairness" in postal ratemaking has an extensive regulatory history under the Postal Reorganization Act of 1970 (PRA). Considerations of cost reflective rates and equal unit contribution are consistent with the Commission's historical interpretation of the terms "fair and equitable" under the former section 3622(b)(1) of the PRA:

> [I]t seems fundamentally fair that mailers pay the costs they impose upon the Postal Service plus the same contribution per piece that all the mailers

[9] *See Sebelius v. Cloer*, ___ U.S. ___, 133 S.Ct. 1886, 1895 (2013)("[u]nless otherwise defined, statutory terms are generally interpreted in accordance with their ordinary meaning.").

> make within the same subclass. This is the definition of an ECP price. . . . the Commission now believes, with good evidence, that the neutral starting position should equal the per-piece contribution because this promotes productive efficiency.[10]
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> [W]hen discounts pass through 100 percent of avoided costs . . . the contribution made by that mailer to institutional costs is the same as the mailer would have made without worksharing. Thus, workshare mailers and non-workshare mailers provide the same contribution, which is fair and equitable.[11]

1. <u>The proposed exigent rate adjustments for First-Class Mail Automation Letters fail to promote efficiency.</u>

Developing a rate design that increases productive efficiency is an important goal regardless of whether the rates are the product of a CPI adjustment or an exigent adjustment. Unfortunately, the proposed exigent rate adjustments for First-Class Mail Automation Letters fail to drive efficiency and fail to minimize end-to-end postage costs because key workshare discounts are not set equal to avoided costs.

Competition fosters economic and technical efficiency, and since the 1970s competition in the U.S. postal market has taken the form of workshare discounts.[12] The Postal Service's end-to-end service for First-Class Mail Automation Letters may be viewed as a vertically integrated network with two components: an "upstream" segment where there is competition (mail processing) and a "downstream" delivery segment where there is no competition. The Postal Service offers price discounts to encourage mailers or mail

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[10] Dkt. R2006-1, Op. Rec. Dec. (Feb. 26, 2007) at ¶ 4032; *see also id.* at ¶ 5031 ("The Commission continues application of Efficient Component Pricing (ECP) as its basic methodology for designing rates that reflect costs. . . . This Commission finds that with minor adjustments necessary to give proper recognition to other policy considerations, this approach results in recommendations that are fair and equitable, and that balance the considerations of all mailers within a subclass.").

[11] *See* Dkt. No. R2001-1, Op. Rec. Dec., Vol. 1 (Mar. 22, 2002) at ¶ 3060 (citing PRC Op. Rec. Dec. R2000-1, ¶ 5060).

[12] *See* R. Cohen, M. Robinson, J. Waller, and S. Xenakis, Worksharing: How Much Productive Efficiency, at What Cost and at What Price? in *Progress Toward Liberalization of the Postal and Delivery Sector,* (Springer)(2006) edited by M. Crew and P. Kleindorfer.

service providers to engage in worksharing activities in the upstream segment.[13] *See* RM2007-1 Panzar at 7.

The primary purpose of worksharing is to increase productive efficiency by allowing mailers and mail service providers to perform upstream activities when their costs are lower than the Postal Services. When worksharing discounts are designed to maximize productive efficiency the resulting prices are called efficient component prices (ECP). Setting workshare discounts equal to the per unit avoided costs of the Postal Service will minimize the total costs and increase the overall productive efficiency of the postal sector by inducing mailers and mail service providers to perform the upstream workshare activities *if and only if* they can perform the work at a lower cost than the Postal Service. *See* RM2007-1 Panzar at 7-9. Conversely, setting workshare discounts at less than the per unit avoided costs of the Postal Service will exclude some equally efficient or more efficient mailers or mail service providers from performing the upstream workshare activities. *See* RM2007-1 Panzar at 14.

Setting workshare discounts equal to avoided costs promotes efficiency and fairness. Workshare prices are a form of deaveraging which should bring prices closer in line with costs. If workshare discounts are set at avoided costs, the Postal Service (and other mailers) should be indifferent to who does the work, because regardless of whether the mail is workshared or not the Postal Service collects the same unit contribution to institutional costs.[14]

[13] *See* Dkt. No. RM2007-1, Initial Comments of John C. Panzar on Behalf of Pitney Bowes Inc. in Response to Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking (Apr. 6, 2007)(RM2007-1 Panzar).
[14] *See* n. 10-11, *supra*.

Setting workshare discounts equal to avoided costs minimizes end-to-end postage costs for mailers. By lowering the total combined costs of the postal system worksharing discounts can be used to stimulate innovation and create additional demand for its most profitable postal products. Given the Postal Service's challenging financial circumstances these interests should be of paramount importance today.

In the prior exigency case, the Postal Service discussed the importance of First-Class Automation Mail Letters prices to its bottom line and its ability to provide cost-effective universal service:

> Presorted letters is the Postal Service's most profitable mail category . . . . Not only is this mail highly profitable, it also provides the single largest source of contribution to institutional costs. . . . Not only is this mail highly profitable and extremely important financially, it is highly vulnerable. Our customers are increasingly looking to nonmail alternatives to transact business with their customers, with the result that many presort First-Class Mail customers may respond to large price increases, not by simply sending fewer pieces (the traditional elasticity effect), but by abandoning hard copy mail altogether. Many presort First-Class Mail customers control large volumes of mail. If they respond by leaving the mail, large volumes of mail will disappear, most likely permanently threatening the ability of the Postal Service to offer cost-effective universal service.[15]

First-Class Mail Automation Letters continue to provide the single largest source of contribution to the institutional costs of the Postal Service. In the most recent year for which information is available (FY2012, Q4 through FY2013, Q3), 35.9 billion pieces were prepared either as First-Class Mail 5-Digit Automation Letters or as AADC/3-Digit Automation Letters (the benchmark for calculating the 5-Digit Automation letter cost avoidance). The retention and growth of this mail is essential.

[15] *See* Dkt. No. R2010-4, Statement of James Kiefer on Behalf of the United States Postal Service (Jul. 6, 2010) at 17.

Yet the combined effect of the proposed CPI and exigent rate adjustments would penalize these very same customers. The net effect of the Postal Service's proposed rate adjustments for 5-Digit Automation Letters is a *reduction* in the discount, relative to a straight 5.9 percent increase. That is because the 5-Digit Automation discount was reduced in the CPI adjustment to offset the anticipated increase in the discount in this case. In the CPI adjustment, the 5-Digit Automation Letter discount is reduced by 0.1 cents resulting in a passthrough that is substantially below avoided cost at 82.1 percent. The 5-Digit Automation Letter discount in the exigent rate adjustment is 89 percent of the avoided cost. By reducing the discount the Postal Service is increasing the price of the product the Postal Service has recognized as the most important to its largest, most price sensitive customers. This makes no sense. In view of the stated objectives of the exigent request, the pricing for First-Class Mail Automation Letters cannot be justified as reasonable, sensible or fair. *See* Taufique Stmt. at 2.

2. <u>The proposed exigent rate adjustments for First-Class Mail Automation Letters are exclusionary.</u>

The Postal Service's persistent movement away from setting discounts equal to avoided costs raises serious competition policy concerns. Because the Postal Service is involved in both the upstream mail processing and downstream delivery segments of its end-to-end service for First-Class Mail Automation Letters, it is a vertically integrated firm. The Postal Service's own mail processing operations "compete vigorously with the processing divisions of mailers and consolidators for the upstream portions of postal markets; even with respect to products, such as letter mail, for which the Postal Service has a statutory delivery monopoly." RM2007-1 Panzar at 14. Additionally, the Postal Service is the "only buyer of such services used in connection with the postal products for which it retains a statutory delivery monopoly." *Id*. at 15.

Because the Postal Service is the *only* buyer for upstream services in connection with market dominant products there is a temptation for the Postal Service to reduce worksharing discounts below avoided costs to "increase profits by exploiting its monopsony power in the market for upstream worksharing services."[16] Doing so would be a form of unfair competition:

> Reducing discounts below Postal Service avoided costs for any reason is a form of exclusionary pricing. This vertical price squeeze would exclude more efficient competitors from performing upstream services. This would have a short-term negative effect on the productive efficiency.[17]

Dr. Panzar also explains why setting workshare discounts below avoided costs also raises unfair competition concerns regarding predatory, below cost, pricing:

> Suppose, hypothetically, that the mail processing units of the Postal Service were a separate enterprise, call it the USMP. As is currently suggested by the Postal Service costing system, such an entity would have both institutional and volume variable costs. Again, by analogy to the Postal Service costing system, the USMP's per unit avoided costs can be viewed as the *marginal costs* of its "product." Now, suppose also that USMP competed with other [upstream suppliers] in an unregulated market for upstream services. Clearly, it would be a cause for concern if the equilibrium worksharing discount, the "price" in that upstream market, were less than USMP's avoided costs. If USMP were a private, profit-maximizing firm, such an outcome would arouse suspicions that some sort of predatory motives were involved.

Panzar RM2007-1 at 15.[18]

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[16] *See* Dkt. No. ACR2011, Comments of John C. Panzar on Behalf of Pitney Bowes Inc. (Feb. 3, 2012)(ACR2011 Panzar).

[17] ACR2011 Panzar at 5; *see also* Panzar RM2007-1 at 14, n.11 ("It is interesting to note that the leading advocates of the global price cap approach recognize the possibility that global price caps may provide the vertically integrated firm with an opportunity to engage in a "price squeeze." Their proposed practical solution is to complement the global price cap with the additional constraint that access prices (i.e., discounts) also satisfy ECPR.")(citations omitted)).

[18] *See Newspaper Assoc. of America v. Postal Regulatory Commission*, ___ F.3d ___, 2013 WL 6037191, at *12 (D.C. Cir. Nov. 15, 2013)(confirming Commission interpretation of "unreasonable" harm to the marketplace, pricing below cost as an example of anticompetitive pricing).

Potential predatory pricing and abuse of the Postal Service's monopoly position underscore the need for direct regulatory scrutiny of "prices" in the upstream competitive market. As Dr. Panzar correctly observed, because the "upstream processing markets in question are part of the production of market dominant services, the behavior of the Postal Service in such markets is exempt from scrutiny by the antitrust authorities. It is therefore the Commission's responsibility to prevent anticompetitive behavior on the part of the Postal Service." Panzar ACR2011 at 14. Setting discounts at less than costs avoided is pricing below cost. It is exclusionary. Section 3622(d)(1)(E) empowers the Commission to play an active role and correct such pricing.

3. <u>The Postal Service's justification of the reasonableness and equity of the exigent adjustments is inadequate.</u>

For the reasons discussed above, the proposed exigent rate adjustments for First-Class Mail Automation Letters are not "reasonable and equitable." The Postal Service asserts that the proposed rate adjustments are "reasonable" because they could have been higher (the Postal Service could have asked for more), and that they are "equitable" because they are generally across-the-board.[19] *See* Notice at 35; Taufique Stmt. at 10-13.

The Postal Service's appeal to its own moderation as a basis for concluding the exigent rate adjustments are "reasonable" falls short for several reasons. First, the Postal Service's contention that it is entitled to a much larger increase is very much in dispute. If the Commission were to find that the Postal Service was only entitled to a lesser increase, this rationale would necessarily fail. Second, the Postal Service makes no attempt to demonstrate that the specific rate design as applied to First-Class Mail Automation Letters

[19] *See* Dkt. No. R2013-11, Statement of Altaf Taufique on Behalf of the United States Postal Service (Sep. 26, 2013)(Taufique Stmt.)

or any other product is reasonable. Whether the exigent rate adjustments are reasonable, fair or sensible depends on the stated objective of the case. The Postal Service states that it is seeking the exigent rate adjustments as part of a broader effort to address its current and future financial needs. *See* Taufique Stmt. at 2. Given that goal, rate adjustments that fail to drive efficiency and fail to minimize net end-to-end mailing costs for the Postal Service's most price sensitive and profitable mail cannot be endorsed as reasonable, fair, or sensible.

The Postal Service's appeal to equality as equity similarly fails. Equal treatment is equitable only to the extent that all mail classes and products are similarly situated. They are not. Different products have different levels of contribution, different cost coverages, and different price sensitivities. Different products were also affected differently by the Great Recession. The previous exigent request was not structured as an across-the-board increase so across-the-board increases cannot be the only equitable rate design. Moreover, the Postal Service's own rate design includes systematic rules for deviating from an across-the-board increase at the rate cell level. *See id*. at 5. The Postal Service's concept of "equitable" also fails to address issues of fairness (equal unit contribution) or structure rates that will ensure the Postal Service does not abuse its monopoly position. As discussed in detail below, exigent rate adjustments that result in exclusionary, unfair and anticompetitive prices within First-Class Mail Automation Letters cannot be considered reasonable, equitable, fair, or just.

The paramount failure of the Postal Service's attempt to present its exigent rate adjustments as reasonable and equitable, however, is that it cannot explain why rates that exclude more efficient upstream providers of postal services are "reasonable or equitable."

No justification is offered because there is none. The PAEA grants the Commission the authority to correct deficiencies in the proposed exigent rate adjustments if it determines that they are not "reasonable and equitable." It should do so in this case.

C. The Commission Should Exercise Its Authority to Modify the Proposed Exigent Rate Adjustments for First-Class Mail Automation Letters

1. Modification of the proposed exigent rate adjustments for First-Class Mail Automation Letters is appropriate in this case.

The PAEA expressly prohibits workshare discounts above 100 percent of avoided costs. 39 U.S.C. § 3622(e)(2). The law does not set a floor for workshare discounts, but it also does not prevent the Commission from requiring that workshare discounts be set (wherever practicable) at 100 percent of avoided costs. The Commission has recognized that the workshare provisions in the PAEA validate long-standing Commission precedent endorsing efficient component pricing and the policy that, to the extent practicable, workshare discounts should fully reflect the per unit avoided costs of the Postal Service.[20]

Pitney Bowes has consistently argued that the Commission has the authority under section 3622(a) to, by regulation, require that the Postal Service set workshare discounts to reflect the full measure of avoided costs.[21] The Commission has been reluctant to assert its authority in the context of a CPI rate adjustment. But the context here is different. The PAEA grants the Commission broad authority to review and approve exigent rate adjustments prior to implementation. And the exigency provisions require the

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[20] *See* Dkt. No. RM2007-1, Order No. 43 (Oct. 29, 2007) at 41 ("efficient component pricing as a guiding principle in rate design"); Dkt. No. RM2009-3, Order No. 536 (Sep. 14, 2010) at 35, n.24 ("exceptions to the applicability of the cap on workshare discounts essentially codify the set of reasons the former Postal Rate Commission had used under the former law when it authorized exceptions to the ECP standard.") and 42 ("The Commission concludes that Congress meant workshare discounts to meaningfully reflect ECP rule").

[21] *See e.g.*, Dkt. No. ACR2011, Comments of Pitney Bowes Inc. (Feb. 3, 2012) at 6.

Commission to affirmatively determine that the exigent rate adjustments are "reasonable and equitable."

Setting workshare discounts at less than 100 percent of avoided costs leads to two negative outcomes. First, it is inefficient and counterproductive. Setting workshare discounts below avoided costs will exclude equally or more efficient upstream suppliers. It also represents a failure on behalf of the Postal Service to use its pricing authority to encourage the retention and growth of its most profitable and price sensitive First-Class Mail products. Second, the Postal Service's persistent practice of setting discounts below avoided costs is unfair and exclusionary. It is an abuse of the Postal Service's monopoly power in restricting access to its downstream delivery services and its monopsony power over upstream workshare services.

Because the Postal Service is generally statutorily immune from the scrutiny of competition authorities the Commission's role in preventing exclusionary below cost pricing in upstream competitive markets is essential. This is especially true in the context of an exigent rate adjustment in which the Postal Service is setting prices without the constraint of the CPI price cap and, thus, without the "primary mechanism for preventing the Postal Service from taking advantage of its monopoly position in markets that it dominates." Order No. 547 at 38.

The Commission should exercise its authority to modify the proposed exigent rate adjustments to First-Class Mail Automation Letters.

2. Modification of the proposed exigent rate adjustments for First-Class Mail Automation Letters is necessary to remedy a technical deficiency.

In addition to the policy reasons that justify modifying the exigent rate request for First-Class Mail Automation Letters, a modification is necessary to correct a technical deficiency in the Postal Service's filing. The proposed exigent rate adjustments incorrectly calculate the avoided costs for the MAADC to AADC rate.

The Postal Service appears to have used the hybrid volume-weighted average of automated area distribution center (AADC) and 3-Digit letters rate (the new benchmark for estimating the 5-digit automation)[1] to measure the cost avoidance between MAADC mail and AADC mail. This is incorrect. The Postal Service should have measured the cost avoidance between MAADC and AADC mail. Using the wrong benchmark (AADC / 3-Digit) to measure the cost avoidance between MAADC and AADC mail overstates the avoided cost estimate by 0.3 cents. As measured using the appropriate cost avoidance estimate, 2.6 cents, the MAADC to AADC passthrough is 111.5 percent. Thus, the MAADC to AADC passthrough violates section 3622(e)(2) and the Postal Service's own pricing rules in this case. 39 U.S.C. § 3622(e)(2); Taufique Stmt. at 5. At the same time, the AADC/3-Digit to 5-Digit discount fails to passthrough the full measure of avoided costs and is set at 89 percent. A "reasonable and equitable" rate design would set all passthroughs within First-Class Mail Automation Letters at 100 percent.

3. The Commission should adopt a revenue-neutral change in First-Class Mail Automation Letters prices that improves workshare prices without disturbing the overall across-the-board increase.

The proposed exigent rate adjustments reflect an overall across-the-board increase for all classes and products with certain deviations, as necessary, at the rate category level.

[1] *See* Dkt. No. RM2012-6, Order No. 1753 (Jun. 18, 2013) at 19.

See Taufique Stmt. at 3, 5. As shown in Table 1 below, to the extent the Commission accepts the across-the-board approach it is possible to develop an alternative rate design for First-Class Mail Automation Letters that is consistent with an across-the-board approach at the product and class level, while promoting fairness and efficiency by passing through 100 percent of workshare cost avoidances at the price cell level.

Table 1. First-Class Mail Automation Letter Cost Avoidances, Discounts, and Passthroughs

Presort Level		Cost Avoidance	USPS-Proposed		Alternative	
			Discount	Passthrough	Discount	Passthrough
		[1]	[2]	[3]=[2]/[1]	[4]	[5]=[4]/[1]
Mixed AADC		$0.045	$0.045	100%	$0.045	100%
AADC	[a]	$0.026	$0.029	111.5%	$0.026	100.0%
3-Digit		$0.006	$0.000	0.0%	$0.000	0.0%
5-Digit		$0.028	$0.025	89.3%	$0.028	100.0%

[1] USPS-R2010-4R/2, WP-FCM-R2010-4R_Rev.10.18.13.xls, "Passthrus FCM Bulk Ltrs, Cards"

[1][a] AADC automation letter cost avoidance in WP-FCM-R2010-4R_Rev.10.18.13.xls is incorrect. Correct cost avoidance taken from FCM Letter Cost Model PRCrev2.xls (See Directory of PRC Workshare Cost Avoidance Models)

[2] USPS-R2010-4R/2, "Passthrus FCM Bulk Ltrs, Cards"

[4] Table 2.

This alternative rate design is consistent with the Postal Service's rules for systematic deviations from an across-the-board increase at the rate category level - the MAADC to AADC passthrough no longer exceeds 100 percent and the AADC / 3-Digit to 5-Digit passthrough was increased, but does not exceed 100 percent. *See* Taufique Stmt. at 5.

Improving workshare prices within First-Class Mail Automation Letters by setting these discounts equal to 100 percent of the avoided costs of the Postal Service results in prices that improve efficiency and are reasonable and equitable. But it would also generate an additional $52 million from First-Class Mail Automation Letters and would result in an effective rate increase of approximately 4.6 percent. Therefore, an additional adjustment is necessary to maintain consistency with the across-the-board approach and to ensure a revenue-neutral change.

There are a number of possible adjustments that could be made within First-Class Mail Automation Letters to achieve a revenue-neutral change, including a reduction of the additional ounce or the nonautomation prices, or an increase in the Full Service Intelligent Mail barcode (FSIMb) discount. Pitney Bowes advocates a modest increase in the FSIMb discount for First-Class Mail Automation Letters. This is the preferred option because it does not affect the pricing relationships among workshare products or between them and First-Class Mail Single-Piece Letters, and because it will help achieve the Postal Service's goal of increased FSIMb adoption.

Table 2 below, illustrates a revenue-neutral change for First-Class Mail Automation Letters that improves workshare prices without disturbing the overall across-the-board increase.

Table 2. Alternative First-Class Mail Automation Letter Rate Design (Revenue in Thousands of Dollars)

Rate Category	Volume	USPS-Proposed		Alternative		Difference
		Price	Revenue	Price	Revenue	
	[1]	[2]	[3]=[1]*[2]	[4]	[5]=[1]*[4]	[6]=[5]/[3]-1
Mixed AADC	2,168,252	$0.435	$943,190	$0.435	$943,190	
AADC	8,161,742	$0.406	$3,313,667	$0.409	$3,338,152	
3-Digit	7,867,395	$0.406	$3,194,162	$0.409	$3,217,765	
5-Digit	19,895,054	$0.381	$7,580,016	$0.381	$7,580,016	
2 to 3.5 Ounces	266,787	$0.130	$34,682	$0.130	$34,682	
Full Service IMb	26,035,924	($0.003)	($78,108)	($0.005)	($130,180)	
Total			**$14,987,610**		**$14,983,625**	**-0.03%**

This alternative rate design would encourage the retention and growth of the Postal Service's most efficient and profitable First-Class Mail products. It aligns prices with costs, promotes fairness and productive efficiency, and minimizes the total combined costs for postal services. This alternative rate design is reasonable and equitable.

4. The alternative First-Class Mail Automation Letters rate design better reflects the objectives and factors of the modern rate system.

Commission rule 3010.14(b)(7-(8) requires the Postal Service's rate design witness to discuss how the proposed exigent rate adjustments are intended to achieve the objectives of section 3622(b) and take into account the factors of section 3622(c). *See* Taufique Stmt. at 26-33. With respect to First-Class Mail Automation Letters two specific goals are discussed. Prices were intended to "reflect the costs that the Postal Service avoids when customers presort and otherwise prepare their mail for automation processing (Factor 5)." *Id*. at 31. And the rate design for 5-Digit Automation Letters sought to minimize prices to "maintain automation letter volumes" and "to help forestall" the electronic diversion of price sensitive "commercial customers." *Id*. Regrettably, the rate design fails on both counts. The workshare discounts do not fully reflect avoided costs. The MAADC to AADC discount is too large (111.5 percent), and the AADC/3-Digit to 5-Digit discount is too small (89 percent). And because the Postal Service intentionally reduced the 5-Digit Automation Letters discount below 100 percent of costs avoided, the price for that product is higher than it should be; thus, the proposed exigent rate adjustments are unlikely to forestall price sensitive commercial mailers from exploring other alternatives.

As demonstrated above, it is possible to design a set of rates that generates approximately a 4.3 percent average rate increase for each product and class and passes through 100 percent of workshare cost avoidances. Such a rate design would be more effective in minimizing the total costs and increasing the overall productive efficiency of the postal sector and would be reasonable and equitable.

In comparison to the rate design proposed in this case for First-Class Mail Automation Letters, a set of rates that generates approximately a 4.3 percent average rate increase for each product and class and passes through 100 percent of workshare cost avoidances would also be more likely to: (1) "maximize incentives to reduce costs and increase efficiency" (Objective 1); reflect "the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service" (Factor 5); and (3) meet "the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services" (Factor 12).

The alternative rate design does not implicate rate shock concerns (Objective 2 and Factor 3) because, taking into account the larger FSIMb discount, the .1 cent increase in the AADC / 3-Digit rate results in only a .2 percent deviation from the Postal Service's proposed rate adjustments, and is offset by the .2 cent decrease, also taking into account the FSIMb discount, in the 5-Digit rate.

III. CONCLUSION

The PAEA grants the Commission broad authority to review, modify and approve exigent rate requests. Section 3622(d)(1)(E) requires that the Commission determine whether proposed exigent rate adjustments are "reasonable and equitable." For the reasons discussed above, the proposed exigent rate adjustments for First-Class Mail Automation Letters do not meet this standard. Accordingly, the Commission should exercise its authority to modify the proposed rate adjustments for First-Class Mail Automation Letters.

Respectfully submitted:

/s/

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