

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

NOTICE OF MARKET-DOMINANT
PRICE ADJUSTMENT

Docket No. R2015-4

**RESPONSES OF THE UNITED STATES POSTAL SERVICE TO
CHAIRMAN'S INFORMATION REQUEST NO. 2**
(February 2, 2015)

The United States Postal Service hereby provides its responses to Chairman's Information Request No. 2, issued on January 27, 2015. Each question is stated verbatim and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. In its FY 2014 Annual Compliance Report (ACR), the Postal Service states that the discount for [First-Class Mail] 5-Digit Automation Flats will be reduced to match the cost avoidance over time in future price change filings, while taking into consideration other business and operational needs. FY 2014 ACR at 14. In this proceeding, the Postal Service proposes to increase the discount for First-Class Mail 5-Digit Automation Flats from 18.3 cents to 19.2 cents. The proposed discount exceeds avoided costs. The Postal Service states the excessive passthrough is justified pursuant to 39 U.S.C. § 3622(e)(2)(B).
 - a. Please explain how 39 U.S.C. § 3622(e)(2)(B) can be used to justify increasing a passthrough that already exceeds avoided costs.
 - b. Please explain how increasing the 5-Digit Automation Flats discount is consistent with the Postal Service's statement in the FY 2014 ACR that it plans to reduce the discount over time.

RESPONSE:

- a. The reasoning is the same whether the current discount increases or not.

Keeping the discount at the same level (18.3 cents) would increase the price for 5-Digit Automation Flats by 6.7 percent; reducing the discount to the level of avoided cost (15.2 cents) would lead to a 14.1 percent increase for this rate cell. Both of these outcomes are unacceptable given the size of the overall increase for First-Class Mail, the relative increase compared to less presorted price cells, and the cost coverage for First-Class Mail Flats (159.1 percent).
- b. The most finely presorted flats are already getting the highest increases (3-Digit Automation Flats at 4.7 percent and 5-Digit Flats at 4.5 percent), compared to the least presorted price categories such as Mixed ADC (0.0 percent) and ADC (1.7 percent) flats. Keeping the 5-Digit discount at 18.3 cents would cause the 5-Digit Automation Flats price to go up by 6.7 percent. This increase would have been too far above the overall increase of 1.949 percent for First-Class Mail, and the even lower increases for other less presorted Automation Flats mail, such as Mixed ADC and ADC.

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The Postal Service does not believe that giving much larger increases to the more presorted mail provides the right signal to the mailing community. Despite this circumstance, the Postal Service still intends to reduce this discount closer to estimated cost avoidance in future dockets.

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2. In Excel file "Attachment B.xlsx," tab "Standard Mail Prcls & Mkt Prcls," the Postal Service provides workshare discounts, avoided costs, and discounts for Standard Mail parcel categories. However, the discounts in this tab do not appear to have been calculated from the rates in Excel file "CAPCALC-STD-R2015-4.xlsx." Please provide a revised Attachment B Excel file with the correct discounts and passthrough calculations. Please also provide statutory exceptions for any revised passthroughs that exceed 100 percent as a result of the revised calculations.

RESPONSE:

See "*Revised_AttachmentB.xlsx*" filed with this response.¹ Tab "Standard Mail Prcls & Mkt Prcls" includes the correct prices. All the workshare discounts that were above 100 percent with the incorrect prices in the original Attachment B remain above 100 percent, and the same justifications for these passthroughs apply. The revised calculations do not push any new passthroughs above 100 percent.

¹ *Revised_AttachmentB.xlsx* also includes updates that were made in response to CHIR1, Q5. Accordingly, this file represents the most up to date version of Attachment B to the Postal Service's Notice of Market-Dominant Price Adjustment.

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3. The Postal Service discusses Standard Mail workshare discounts with passthroughs that exceed 100 percent. Notice at 45-51. For the following discounts, the Postal Service's discussions and statutory justifications compare the Docket No. R2015-4 passthroughs to the ones calculated using the Docket No. R2013-11 discounts (surcharge rates) and the FY 2014 avoided costs:
- Automation AADC Letters
 - Nonmachinable 5-Digit Letters
 - Automation 3-Digit Flats (commercial)
 - Nonautomation 3-Digit Flats (commercial)
- a. Please provide revised discussions and statutory justifications that compare the proposed Docket No. R2015-4 passthroughs to the passthroughs calculated using Docket No. R2013-10 discounts (non-surcharge rates) and FY 2014 avoided costs.
- b. Please provide any applicable statutory justifications for any passthroughs that are higher under the proposed Docket No. R2015-4 discounts compared to the ones calculated using the R2013-10 discounts, *i.e.*, increases in passthroughs that are already above 100 percent using the R2013-10 discounts.

RESPONSE:

- a-b. The passthrough for presort automation AADC letters compared to automation mixed AADC letters is 131.3 percent using the proposed prices and FY 2014 costs. This is an increase from the passthrough of 112.5 percent using Docket No. R2013-10 prices and FY 2014 costs. The passthrough for non-machinable 5-Digit letters declined to 136.9 percent using the proposed prices and FY 2014 costs. The passthrough using Docket No. R2013-10 prices was 143.1 percent. The passthrough for presorted automation 3-Digit Flats is 131.0 percent using the proposed prices and FY 2014 costs. This is an increase from the 119.0 passthrough using the FY 2014 cost avoidances with Docket No. R2013-10 prices. The passthrough for non-automation 3-Digit flats is 110.6 percent. This is a small increase over the passthrough using Docket No. R2013-10 prices of 108.5 percent.

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Of the four discounts for which the Commission asked for a revised discussion comparing passthroughs proposed in R2015-4 to passthroughs proposed in R2013-10, only one passthrough requires a revised discussion: automation AADC letters. For automation AADC letters, the intent was to bring the passthrough closer to 100 percent than it was previously. However, were the Postal Service to align the workshare discount with the avoided cost, it would be forced to increase prices by an additional 3.3 percent. The Postal Service believes that a price increase of this magnitude on such a high volume cell would constitute rate shock. Accordingly, the Postal Service justifies this passthrough pursuant to section 3622(e)(2)(B). The Postal Service will continue to move this passthrough toward 100 percent in future price adjustments.

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4. The Postal Service proposes that the passthrough from Nonautomation AADC Nonmachinable letters increase from 112.5 percent to 125.0 percent. Notice at 46. It further states that “[l]owering the AADC passthrough would require even larger price increases to keep the downstream entry points (ADC, 3-Digit, and 5-Digit) in line with the AADC price.” *Id.* at 47.
- a. Please explain why the Postal Service did not propose to retain the passthrough for Nonautomation AADC Nonmachinable letters at 112.5 percent. In the response, please discuss how lowering the price for this category avoids rate shock for other Standard Mail categories.
 - b. Please explain how increasing the passthrough for Nonautomation AADC Nonmachinable letters is consistent with 39 U.S.C. § 3622(e).

RESPONSE:

- a-b. The Postal Service chose not to retain the passthrough at the 112.5 percent level, because it did not want to propose price increases at other entry levels that were well above 10 percent, nor did it want to add to the number of passthroughs above 100 percent to avoid the steep price increases.

More precisely, when adjustments were made to lower the passthroughs for commercial non-automation non-machinable letters that were above 100 percent, all attempts resulted in price increases that were near double-digits for commercial non-automation non-machinable letters, and noticeably higher for the non-profit non-automation non-machinable letters. The Postal Service determined that the best way to keep the percentage increases for all non-automation non-machineable letter prices reasonable, was to lower the price of the mixed-ADC cells and keep the passthroughs and prices unchanged for the other entry levels in non-automation non-machinable.

Furthermore, the Postal Service did not want to propose price decreases, or to propose no price change at all, to non-automation non-machinable letters

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simply to improve passthroughs. When deciding on a set of prices, the Postal Service must consider a number of factors, in addition to generally aligning workshare discounts with avoided costs.

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5. The Postal Service proposes that the Automation 3-Digit Flats passthrough increase to 131.0 percent. Notice at 48. It also states “[l]owering this passthrough to 100 percent would result in higher blended prices in the new FSS cells, which would reduce the incentive for Flats mailers to prepare their mail for FSS processing.” *Id.* Please provide a rationale for increasing the passthrough for Automation 3-Digit Flats (from 119.0 percent under the R2013-10 discounts to 131.0 percent under the proposed R2015-4 discount) and provide a statutory justification for the increased passthrough.

RESPONSE:

The statutory justification used for increasing this passthrough is section 3622(e)(2)(A), because the workshare activity being discounted impacts the prices that are necessary to induce mailer behavior that is beneficial to efficient postal operations. If the Postal Service ignored the relationship between 3-Digit Automated Flats, 5-Digit Automated Flats, and the new FSS Scheme and non-Scheme price cells, and only concentrated on lowering the passthrough on 3-Digit flats to 100 percent, it would end up proposing a 3-Digit price that is higher than the current 5-Digit price. It would then have to lower the 5-Digit price to get any mailers to enter mail with 5-Digit presorting.

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6. The Postal Service states that the R2013-10 discount for Automation 5-Digit Flats was 9.3 cents. Notice at 48.
- a. Please confirm that the R2013-10 Automation 5-Digit Flats discount was 9.0 cents, not 9.3 cents. See Docket No. R2013-10, Response of the United States Postal Service to Order No. 1890, November 29, 2013, at 2. If not confirmed, please explain.
 - b. Please confirm that the Postal Service is increasing the discount for commercial Automation 5-Digit Flats from 9.0 cents to 9.1 cents in the instant docket. If not confirmed, please explain.
 - c. Please provide a rationale for increasing the passthrough for commercial Automation 5-Digit Flats (from 105.9 percent under the R2013-10 discount to 107.1 percent under the proposed R2015-4 discount) and provide a statutory justification for the increased passthrough.

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. The Postal Service was unaware it was raising the passthrough from 9.0 to 9.1 cents for 5-Digit Flats. It had mistakenly thought that it was lowering the passthrough from 9.3 cents to 9.0 cents. This does not, however, change the justification for keeping the discount above 8.5 cents (the new avoided cost). Without having to make drastic price cuts to other price cells (and possibly increasing their workshare passthroughs), the Postal Service cannot lower the discount from 9.1 cents to 8.5 cents on this high volume cell while keeping Standard Mail within the 1.966 percent price cap.

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7. The Postal Service states “the nonprofit passthroughs for automation 5-Digit flats and nonautomation 3-Digit Flats are 119.1 percent and 183.7 percent, respectively.” Notice at 48. However, Excel file “Attachment B.xlsx,” tab “Standard Mail Flats,” shows a passthrough of 105.9 percent for nonprofit Automation 5-Digit Flats and a passthrough of 119.1 percent for nonprofit Nonautomation 3-Digit Flats.
- a. Please confirm that the proposed passthrough for nonprofit Automation 5-Digit Flats is 105.9 percent and the proposed passthrough for nonprofit Nonautomation 3-Digit Flats is 119.1 percent. If not confirmed, please explain.
 - b. Please provide a rationale for increasing the passthrough for Nonautomation 3-Digit Flats (from 108.5 percent under the R2013-10 discounts to 119.1 percent under the proposed R2015-4 discount) and provide a statutory justification for the increased passthrough.

RESPONSE:

- a. Confirmed.
- b. The movement of 2.7 billion FSS Flat pieces from High Density, High Density Plus, Carrier Route, 3-Digit Flats, and 5-Digit Flats was extremely complex, and the Postal Service determined that it was essential to make sure that all 3-Digit Flat prices were higher than 5-Digit Flat prices, that all 5-Digit Flat prices were higher than FSS non-Scheme prices, and that all FSS non-scheme prices were higher than FSS Scheme prices. Similarly, the Postal Service was concerned about keeping prices successively higher at the entry points: Origin entry, DNDC entry, DSCF entry, DFSS entry, and DDU entry. Moreover, the Postal Service needed to increase the Standard Mail Flats prices by at least 105 percent of the price cap. Given these competing interests, the Postal Service was forced to make some tradeoffs when designing the new FSS pricing structure, including allowing some passthroughs above 100 percent to increase. However, given the economic importance of encouraging Flats mailers to prepare their mail for FSS

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processing, the Postal Service justifies the above mentioned passthroughs using section 3622(e)(2)(A).

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8. The Postal Service discusses Standard Mail Parcels workshare discounts that exceed avoided costs. Notice at 50. It does not provide statutory justifications for two of the discounts that exceed avoided costs: NDC Irregular Parcels and NDC Marketing Parcels. Please provide statutory justifications for these discounts.

RESPONSE:

The Postal Service justifies the two discounts pursuant to section 3622(e)(2)(B). In its efforts to align these discounts with avoided costs, the Postal Service has already increased prices by approximately 10 percent. The Postal Service believes that any additional increases on the affected price cells would result in rate shock for mailers. Nevertheless, the Postal Service will be mindful to continue moving these passthroughs toward 100 percent in future price adjustments.

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9. Pursuant to the Commission's directives in its FY 2010 Annual Compliance Determination at 107, please provide:
- a. An explanation of how the proposed prices for Standard Mail Flats will move the cost coverage for Standard Mail Flats towards 100 percent.
 - b. A statement estimating the effect that the proposed prices will have in reducing the subsidy of the Standard Mail Flats product.
 - c. All underlying workpapers and data used to respond to parts a and b.

RESPONSE:

- a. In a year when the price cap was 1.966 percent, the Postal Service increased Standard Mail Flats prices by 2.255 percent (15 percent above the price cap).² The Postal Service hopes that the additional revenues generated by this above average price increase will improve the product's cost coverage.

Another way this price adjustment helps Standard Mail Flats cost coverage is the restructuring of FSS prices. This restructuring is designed to give more meaningful price incentives for mailers to prepare Flats for FSS processing, and extra incentives for mailers to prepare flats on Scheme Pallets. The Postal Service is hopeful that this new pricing structure will drive mailers towards behaviors that will lower flats processing costs; resulting in an improved Standard Mail Flats cost coverage.

- b. The Standard Mail Flats increase of 2.225 percent is well above the minimum price increase (1.05 x CPI) approved by the Commission in FY 2013

² The Postal Service will provide documentation for this new 2.255 percent price increase in its response to CHIR 3, Q4. Although an amended CAPCALC file will not be submitted until the Postal Service files its responses to CHIR 3, this question is being answered as though the changes have already been made. The changes will not impact any proposed prices, but result in a Standard Mail Flats price increase of 2.255, rather than 2.466 percent.

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Annual Compliance Determination.³ The higher flats price increase, relative to other Standard Mail products, will help lower the subsidy. The Postal Service will be revising tab "LFP Revenue@New Prices" in file "CAPCALC-STD-R2015-4" as a result of CHIR 3, question 4. This revised CAPCALC file will show proposed Standard Mail Flats revenue of \$2,527,759,874, an increase of 2.255 percent. If the Postal Service had increased Standard Mail Flats by only 105% of the price cap, as required, the proposed Standard Mail increase would have been 2.064 percent and the proposed revenues would have been \$2,523,042,525. The higher than required increase results in an additional \$4,717,349 in Standard Mail Flats revenue. The new FSS price structure may also help reduce the subsidy by reducing Flats processing costs. However, this this is more difficult to quantify, as the Postal Service cannot predict how mailers will react to the new incentives to prepare Flats for FSS processing.

- c. The Commission already has the file "*CAPCALC-STD-R2015-4.xlsx*" used to quantify the additional revenues that higher Standard Mail Flat prices will provide. In CHIR no. 1, the Postal Service provided 10 additional files in response to Q3b, which outlined the FSS Flats migration that provides expected volume movement.

³ Annual Compliance Determination Report: Fiscal Year 2013, PRC Docket No. ACR2013 (March 27, 2014), at 54.

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- 10.** In its FY 2014 ACR, the Postal Service reports that the revenues for only two Standard Mail products did not cover attributable costs in FY 2014: Standard Mail Flats and Standard Mail Parcels. FY 2014 ACR at 17-19. In this docket, the Postal Service proposes approximately a 2.5 percent increase for Standard Mail Flats and approximately a 9.8 percent increase for Standard Mail Parcels. Notice at 21. Please explain why Standard Mail Parcels users can sustain a 9.8 percent increase, while Standard Mail Flats users can only sustain a 2.5 percent increase.

RESPONSE:

While it is possible that Standard Mail Flats mailers could sustain a slightly higher price increase, it would be impossible to increase Standard Mail Flats prices by an amount similar to Standard Mail Parcels while staying within the price cap. This is because Flats represents a significantly larger proportion of Standard Mail volume and revenue than Parcels. Were the Postal Service to implement a ten percent price increase for both Flats and Parcels, it could not stay within the price cap without also instituting unacceptable price decreases for letters, which would likely result in revenue losses. Moreover, as a practical matter, since Standard Mail Parcels' current prices are significantly lower, relative to costs, than Flats' prices,⁴ the Postal Service determined that a larger price increase for Parcels was necessary at this time.

⁴ In other words Parcels has a lower cost coverage. See Docket No. ACR2014, USPS-FY14-1 FY2014 Public Cost and Revenue Analysis Report (PCRA), file *Public_FY14CRA.xlsx*, tab "Cost1", cells R30 and R31.

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11. In USPS-LR-R2015-4/4, Excel file "R2015-4 Package Services Cap Calculations.xlsx," tab "MM & LM BDs," cell "G21," the Postal Service reports 131,781,834 postage pounds for Single-Piece Media Mail, Second through Seventh Pounds. In Docket No. ACR2014, library reference USPS-FY14-4, Excel file "FY 2014 Media Mail.xlsx," tab "Media BD_sp," cell "E21," the Postal Service reports 97,774,576 postage pounds for Single-Piece Media Mail, Second through Seventh Pounds. Please reconcile these differences and if necessary, file a revised Excel file "R2015-4 Package Services Cap Calculations.xlsx" with updated cap calculations.

RESPONSE:

The Docket No. R2015-4 Cap Calculation file has the correct numbers.

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12. In USPS-LR-R2015-4/4, Excel file "R2015-4 Package Services Cap Calculations.xlsx," tab "BDs for BPM Presort Parcels," cells "D24-D30; E24-E27; I24-I30; J24-J26," the Postal Service reports Basic and Carrier Route Presort Pieces for Non-Dropshipped and DBMC. In Docket No. ACR2014, library reference USPS-FY14-4, Excel file "FY 2014 BPM.xlsx," tab "Presort Parcels BD," cells "C16-C22; D16-D19; G16-G22; H16-H18," the Postal Service reports different values for Basic and Carrier Route Presort Pieces for Non-Dropshipped and DBMC. Please reconcile the values in the two files and if necessary, file a revised Excel file "R2015-4 Package Services Cap Calculations.xlsx" with updated cap calculations.

RESPONSE:

The Docket No. R2015-4 Cap Calculation file has the correct numbers.