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ORDER NO. 66

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

Before Commissioners: Dan G. Blair, Chairman;
Mark Acton, Vice Chairman;
Ruth Y. Goldway; and
Tony Hammond

Notice of Price Adjustment — Docket No. R2008-1

REVIEW OF POSTAL SERVICE NOTICE OF MARKET DOMINANT PRICE ADJUSTMENT

Washington, DC 20268-0001
March 17, 2008

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SUMMARY

This is the first review of Postal Service price adjustments for market dominant products under the Postal Accountability and Enhancement Act, Pub L. 109-435, 120 Stat. 3198 (2006) (PAEA). The Postal Service filed a notice of price adjustment for its market dominant products on February 11, 2008. The planned adjustments are scheduled to take effect on May 12, 2008.

Based on a review of the notice and supporting materials, including public comments and updated information submitted by the Postal Service, the Commission finds that the planned price adjustments do not exceed the statutory Consumer Price Index-based price cap of 2.9 percent for the 12 months ending December 2007. Under the PAEA and the Commission's regulations, the Postal Service may "bank" the difference between the cap and its planned price changes for use within five years.

The percentage increase by class and the unused rate authority are shown in the table below.

	Rate Changes (%)	**Unused Rate Authority (%)**
First-Class Mail	2.886	0.014
Periodicals	2.724	0.176
Standard Mail	2.875	0.025
Package Services	2.875	0.025
Special Services	2.848	0.052

Under the PAEA, the Postal Service has extensive flexibility to vary rates within classes.

Interested persons were given the opportunity to comment on the notice of price adjustment. Most of the comments focus on planned increases for specific rate categories or products. None claims that the planned increase for any class violates the price cap.

Some comments address a separate statutory requirement that limits, subject to certain exceptions, workshare discounts to the costs avoided by the Postal Service. The Commission sought additional written justification from the Postal Service regarding 14 workshare discounts. Upon careful consideration of the justifications proffered by the Postal Service as well as relevant public comments, the Commission finds all but one of these discounts adequately supported. The lone exception is a discount of 1.4 cents for applying a barcode to certain Standard Mail letters that would save the Postal Service 0.3 cents.

To rectify this, the Postal Service will need to file, as contemplated by the Commission's rules, an amended notice of rate adjustment. Illustratively, as a convenience to the Postal Service, the Commission identifies minimal price adjustments that could resolve the problem, allowing all rate changes to go into effect as scheduled. The Postal Service may choose another solution for this problem if it prefers. Pages 33 through 37 of this Order provide a more complete discussion of this matter.

This Order comes 35 days after the Postal Service notice of price adjustment, fulfilling the intent of the PAEA for expeditious review of Postal Service market dominant rate filings while at the same time ensuring that the planned rate adjustments are consistent with the statute. The success of this inaugural market dominant price adjustment proceeding is due, in large part, to the Postal Service's efforts. Although the Commission identifies areas where additional analysis will facilitate future proceedings, it commends the Postal Service for promptly and diligently providing needed clarifications and supplementary explanations.

I. PROCEDURAL HISTORY

On February 11, 2008, the United States Postal Service filed a Notice of Market-Dominant Price Adjustment with the Commission pursuant to 39 U.S.C. § 3622(d)(1)(C) of the PAEA and 39 C.F.R. part 3010.[1] The Postal Service Notice announced its intention to adjust prices for all products in its market dominant business category on May 12, 2008, in amounts that are, on average, within a 2.9 percent statutory price cap for each class. The Notice is supported by four appendices containing new prices and fees, worksharing discounts and benchmarks, mail classification changes, and price cap calculations. The filing also includes six workbooks that demonstrate how the new prices for each class comply with the price cap. One of the workbooks, identified as USPS-R2008-1/NP1: Inbound Single-Piece First-Class Mail International – Letter Post (Input to Attachment USPS-R2008-1/1), was filed under seal.

The Postal Service submitted minor revisions on February 12, 2008, amending several incorrect Insurance fees reported in Appendix A, New Prices and Fees, and providing price charts for non-ancillary Special Services that were missing from Appendix A.[2]

Initial Commission action. The Commission provided public notice of the Postal Service's Notice in Order No. 59, dated February 14, 2008.[3] In the order, the Commission also (1) established Docket No. R2008-1 to consider the planned price adjustments; (2) appointed a public representative; and (3) established a 20-day period,

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[1] United States Postal Service Notice of Market-Dominant Price Adjustment, February 11, 2008 (Notice).

[2] United States Postal Service Notice of Filing Supplement to Appendix A, *New Prices and Fees*, to Notice of Market-Dominant Price Adjustment – Errata, February 12, 2008.

[3] Notice and Order on Planned Rate Adjustments for Market Dominant Postal Products and Limited Classification Changes, February 14, 2008.

ending March 3, 2008, for the submission of public comments on the planned price adjustments.

Protective conditions. The Commission received oral requests to access USPS-R2008-1/NP1: Inbound Single-Piece First-Class Mail International – Letter Post (Input to Attachment USPS-R2008-1/1), the non-public workbook the Postal Service submitted in support of its Notice. In response to the requests, the Commission issued Order No. 60 on February 21, 2008, establishing protective conditions governing the workbook's availability.

Commission Information Request. The Commission issued an information request on February 26, 2008, asking the Postal Service to clarify and expand its justifications for passthroughs greater than 100 percent.[4] The Postal Service filed its answer on March 4, 2008.[5]

Errata and supplemental material. On February 29, 2008, the Postal Service filed revisions that corrected values, links, and formulas in appendices A and B and in the workbooks for First-Class Mail, Periodicals, Standard Mail, and Package Services.[6] These revisions did not modify any price proposed by the Postal Service. The revisions, however, did change the overall percentage increase for First-Class Mail, Periodicals, and Package Services, thus affecting the amount of the banked percentage for those classes.

The Postal Service also submitted an additional workbook on March 13, 2008.[7] The workbook, identified as USPS-R2008-1/NP2: Materials Relating to the Periodicals Revenue Leakage Due to the Limited Circulation Discount, was filed under seal.

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[4] Commission Information Request No. 1, February 26, 2008; Notice of Errata to Commission Information Request No. 1, February 26, 2008.

[5] Response of the United States Postal Service to Commission Information Request No. 1, March 4, 2008 (Response to CIR No. 1).

[6] Notice of United States Postal Service of Errata to Market-Dominant Price Adjustment Filing, February 29, 2008 (Errata).

[7] Notice of the United States Postal Service of Filing of USPS-R2008-1/NP2, March 13, 2008.

The Commission rules provide for using cost data from the Postal Service Annual Report to the Commission in developing and analyzing rates. *See* 39 U.S.C. § 3652. The Postal Service did so in its filing. Since the filing, the Postal Service has become aware of errors, and has made corrections.

This presents the Commission with the question of to what extent it is proper or permissible to use Postal Service errata in its review of the planned rate adjustments.

The Commission did not receive comments on this issue from any interested person during this first rate case under the PAEA. Faced with the necessity to complete the review of planned price adjustments, it has determined to use errata, even though some errata have been submitted after the period for public comment. In the Commission's view, errata stand as though they were part of the initial filing. It would not be appropriate for the Commission to critique a rate on the basis of information that has been acknowledged as erroneous.

Comments. By March 3, 2008, the Commission received 13 sets of comments from 17 participants. The Commission appreciates the participants' contributions.

II. COMPLIANCE WITH THE RATE CAP

The PAEA limits changes in postage rates by an annual cap applied separately to each class of mail. Average rate increases may not exceed "the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates[.]" 39 U.S.C. § 3622(d)(1)(A). Application of this provision to a planned price adjustment involves the calculation of the cap and the calculation of the change in rates to verify that the adjustment is within the cap. The Commission issued rules for each of these calculations in Order No. 43, issued October 29, 2007. At the time of the Postal Service Notice of rate change, the cap was 2.9 percent.

The PAEA also allows for the calculation of an unused rate adjustment authority that can be used in future rate adjustments. The PAEA defines the unused rate adjustment as the difference between (1) the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year subject to the annual limitation …; and (2) the amount of the rate adjustment the Postal Service actually makes in that year. 39 U.S.C. § 3622(d)(2)(C)(i).

As discussed below, the Commission has verified that the price adjustments planned to go into effect on May 12, 2008, are within the applicable 2.9 percent cap limitation for each class of mail. They also create small amounts of unused rate authority that will be banked for possible use in future rate adjustments.

A. Calculation of the Rate Cap

The rate cap is calculated as the ratio of two 12-month CPI-U averages that are 12 months apart. The Commission rules present the calculation in three steps.

- First, a simple average CPI–U index is calculated by summing the most recently available 12 monthly CPI–U values from the date the Postal Service files its notice of rate adjustment and dividing the sum by 12 (Recent Average).
- Then, a second simple average CPI–U index is similarly calculated by summing the 12 monthly CPI–U values immediately preceding the Recent Average and dividing the sum by 12 (Base Average).
- The limitation is calculated by dividing the Recent Average by the Base Average and subtracting 1 from the quotient. The result is expressed as a percentage, rounded to one decimal place.

39 C.F.R. § 3010.21.

To keep the public aware of what the cap is at any point in time, the Commission publishes on its website, *www.prc.gov*, the values needed for the calculation of the annual limitation.

B. Calculation of Percent Change in Rates

Commission rules prescribe how to calculate the change in rates for the purpose of testing compliance with the annual cap limitation. Calculation procedures are defined for annual changes, for partial year changes, and for changes occurring over a period greater than a year. Since this is the first rate change under the PAEA, the annual rate change calculation procedures apply as specified in 39 C.F.R. § 3010.21.

For each class of mail, the percentage change in rates is calculated in three steps.

- First, the volume of each rate cell in the class is multiplied by the planned rate for the respective cell and the resulting products are summed.
- Then, the same set of rate cell volumes are multiplied by the corresponding current rate for each cell and the resulting products are summed.
- Finally, the percentage change in rates is calculated by dividing the results of the first step by the results of the second step and subtracting 1 from the quotient. The result is expressed as a percentage.

39 C.F.R. § 3010.23(b).

The formula for calculating the percentage change in rates for a class is as follows:

$$\text{Percentage change in rates} = \left(\frac{\sum_{i=1}^{N} (R_{i,n})(V_i)}{\sum_{i=1}^{N} (R_{i,c})(V_i)} \right) - 1$$

N = Number of rate cells in the class

i = denotes a rate category (i = 1, 2, …, N)

$R_{i,n}$ = planned rate of rate cell i

$R_{i,c}$ = current rate of rate cell i

V_i = Volume of rate cell i

39 C.F.R. § 3010.23(c).

Commission rules specify that the volumes for each rate cell shall be obtained from the most recent available 12 months of Postal Service billing determinants. The Postal Service may make reasonable adjustments to account for the effects of classification changes such as the introduction, deletion, or redefinition of rate cells. The Postal Service must identify and explain all adjustments. 39 C.F.R. § 3010.23(d).

C. Rate Changes for Docket No. R2008-1 and Unused Rate Change Authority

The rate changes announced in the Postal Service Notice have been found to be within the annual limitation of 2.9 percent for each class of mail. In addition to the new rates scheduled to be effective on May 12, 2008, the Notice contains the results of the calculation of the price adjustments consistent with Commission rules. The results calculated by the Postal Service for the five market dominant classes are reproduced in Table II-1. The calculations in support of these results are contained in Excel worksheets submitted with the Notice.

Table II-1
Docket No. R2008-1 Rate Changes

	Rate Change (%)		**Unused Rate Authority (%)**	
	Filed	Final	Filed	Final
First-Class Mail	2.889	2.886	0.011	0.014
Periodicals	2.710	2.724	0.190	0.176
Standard Mail	2.875	2.875	0.025	0.025
Package Services	2.876	2.875	0.024	0.025
Special Services	2.848	2.848	0.052	0.052

The Commission audited the worksheets filed with the Notice and in some cases reformatted the worksheets to link various inputs and independently perform the Postal Service's calculations. Through this audit process some errors were identified and brought to the attention of the Postal Service. This in turn led to the Postal Service submission of errata on February 29, 2008. The errata results were incorporated into the worksheets and rate change percentages recalculated. The results are slight modifications to the class level changes that are also shown in Table II-1. Upon recalculation the rate changes remain under the cap for each class of mail.

The unused rate authority for each class is 2.9 percent minus the recalculated rate change percentages. The unused rate authority as initially calculated and the recalculated values are also given in Table II-1. Since these unused rate authorities are banked for future use, it is important that they be calculated accurately. The recalculated values will be published on the Commission's website along with the monthly CPI-U-based cap so that the public will be aware of the limits on rate increases from both the cap and unused authority.

Volumes used in the rate change calculations are taken from the billing determinants for FY 2007 that are also part of the annual compliance reports filed by the Postal Service on December 28, 2007. Where new rate categories were implemented in FY 2007 as a result of classifications recommended in Docket No. R2006-1, the last rate case under the Postal Reorganization Act of 1970, Public Law 91-375, 84 Stat. 719, 39 U.S.C. § 101 *et seq*. (PRA), the Postal Service developed estimates of what the annual volume would have been. The volumes and calculations submitted by the Postal Service have been modified slightly by errata. The few changes introduced by the Commission are discussed class-by-class in the following section. The Commission's calculations are presented in library references PRC-R2008-1-LR1 through PRC-R2008-1-LR5, filed with this Order.

III. CLASS-SPECIFIC ISSUES

A. First-Class Mail

There are six products assigned to the First-Class Mail class: 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, as a class, by 2.886 percent. Errata at 1. It intends to bank the remaining 0.014 percent of unused pricing authority. *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	Rate Change (%)
Single-Piece Letters/Postcards	2.50
Presorted Letters/Postcards	3.55
Flats	1.93
Parcels	2.18
Outbound Single-Piece First-Class Mail International and Inbound Single-Piece First-Class Mail International (combined)	3.09

Notice at 13.

The Postal Service decision to increase the price of its flagship product (the price of a one-ounce, Single-Piece First-Class Mail Letter) from 41 to 42 cents, an increase of one cent, significantly influences the determination of most other prices within the domestic products in this class. *Id.* The Postal Service notes that the integer rounding constraint applied to this product results in a modest above-the-cap increase applied to

Presorted Letters/Postcards. The Postal Service's plan also includes increasing the nonmachinable surcharge applied to single-piece and non-automation presort letters from 17 to 20 cents, and decreasing the additional ounce price applicable to non-automation presort letters from 17 to 12.5 cents. *Id.* at 13-14.

The commenters addressing First-Class Mail compliance with the rate cap, Stamps.com, the Public Representative, National Postal Policy Council (NPPC), and Pitney Bowes, state that the Postal Service has complied with the First-Class Mail rate cap requirements.[8] Stamps.com Comments at 1; Public Representative Comments at 4; NPPC Comments at 3; and Pitney Bowes Comments at 3. The other commenters addressing First-Class Mail, American Postal Workers Union, AFL-CIO (APWU) and Major Mailers Association (MMA), offer no opinion on the Postal Service's compliance with the rate cap.[9]

The Commission finds the Postal Service's planned price adjustments for First-Class Mail comply with the rate 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, by 2.886 percent. The remaining 0.014 percent of unused rate authority shall be banked as provided for in 39 U.S.C. § 3622(d)(2)(C).

[8] Comments of Stamps.com (Stamps.com Comments); Public Representative Comments in Response to Notice of Price Adjustment for Market Dominant Postal Products and Limited Classification Changes (Public Representative Comments); Comments of National Postal Policy Council (NPPC Comments); Comments of Pitney Bowes Inc. in Response to Notice and Order on Planned Rate Adjustments for Market Dominant Postal Products and Limited Classification Changes (Pitney Bowes Comments), all filed on March 3, 2008.

[9] Initial Comments of American Postal Workers Union, AFL-CIO, on Notice of Price Adjustment (APWU Comments); Comments of Major Mailers Association (MMA Comments), both filed on March 3, 2008.

1. First-Class Mail Worksharing

The Postal Service discusses specific First-Class Mail worksharing discounts where the discounts vary from 100 percent passthroughs for reasons other than the tenth-of-a-cent rounding constraint. Notice at 26-27. The Postal Service plans a 103.3 percent passthrough for 5-digit automation letters, which in part reflects the Postal Service's decision to maintain the existing 2.2-cent discount. The Postal Service justifies this by arguing that it is "necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service through an incentive to create more efficiently-handled mailings." *Id.*

In its Response to CIR No. 1 at 3, the Postal Service contends that "any reduction in the discounts from what it has presented in its Notice 'would impede the efficient operation of the Postal Service'." It explains that predictable and stable prices are a very important component of efficiency, and that changing relationships year-to-year to follow the latest cost measurement could have adverse outcomes such as causing mailers to alter mail production or preparation yearly in light of the changed prices, or causing a chilling effect on worksharing business decisions and investments. *Id.* at 4-5. It further argues that cost avoidance figures must be viewed as estimates rather than absolutely precise figures, and absolute adherence to a strict 100 percent passthrough rule would lead to constantly changing prices to the detriment of mailers and the efficient operation of the Postal Service. *Id.* at 5-6. The Postal Service notes that the deviation from 100 percent in the 5-digit automation letters discount is small and suggests that such small deviations "should be of no regulatory moment[.]" *Id.* at 6-7.

For automation flats, the Postal Service has lowered the passthrough to 95 percent of avoided costs from the approximately 100 percent passthroughs provided in Docket No. R2006-1. Notice at 26-27. It notes that this results in slight price reductions for 3-digit and 5-digit flats. The Postal Service explains that it has retained passthroughs for business parcels similar to those in Docket No. R2006-1 (33 percent). *Id.* at 27. Finally, the Postal Service explains that it has reduced the price difference between non-automation presort cards and mixed automated area distribution center (AADC) automation cards from 2.1 to 1.9 cents. This results in a passthrough of 157.2 percent assuming a cost savings of 1.2 cents.[10] The Postal Service argues that any lower passthrough would result in an actual price reduction for the non-automation category. *Id.*

Pitney Bowes contends that the 103.3 percent passthrough for 5-digit automation letters would not be an issue had the cost estimates been inflated to reflect the cost increases between FY 2007 and the period in which the rates will be in effect. Pitney Bowes Comments at 5-6. Alternatively, Pitney Bowes agrees with the predictable and stable price arguments provided by the Postal Service in its response to Commission Information Request No. 1. *Id.* at 7.

The Public Representative contends that the Postal Service has not provided adequate explanation for setting the non-automation presort cards passthrough at greater than 100 percent (157.2 percent). Public Representative Comments at 9-10. Furthermore, it contends that the Postal Service has not provided adequate explanation for setting the business parcels discounts substantially below avoided costs (3-digit at 30.2 percent and 5-digit at 30.3 percent). *Id.* at 10.

MMA contends that “the reduced First Class workshare discounts that the Postal Service has proposed to implement in this case are unlawful because they violate elementary principles of due process and are not consistent with the objectives and policies of PAEA.” MMA Comments at 1. MMA suggests retaining the current automation discount differentials for this price adjustment cycle. *Id.* It further suggests placing more price increase burden on Single-Piece First-Class Mail in the future. *Id.* at 4.

MMA’s contention is premised on a belief that the cost savings estimates provided by the Postal Service are inaccurate and understate true cost savings. *Id.* It asserts that

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[10] The Postal Service calculates this passthrough as a percentage of the additional cost of non-pre-barcoded letters. This is a different method than applied by the Commission in Docket No. R2006-1. See PRC Op. R2006-1, ¶ 5294.

the Postal Service has made numerous, unexplained changes to model inputs that no party has been allowed to review or question, which have a material impact on the derived cost savings. *Id.* at 5. MMA finds flaws with the Commission's Docket No. R2006-1 methodologies. It asserts that when the flaws are corrected, "substantially" higher cost savings result. Specifically, it cites what it believes are problems with deriving processing cost savings and delivery cost savings. *Id.* at 7-8. MMA concludes by reviewing sections of the PAEA and asserting that the Postal Service's planned reductions in discounts are not consistent with its objectives, factors and policies. *Id.* at 9-15.

The Postal Service's Notice and the commenters present two worksharing issues that must be resolved in this Order: first, certain worksharing passthroughs exceed 100 percent; and second, MMA's contention that the Postal Service's planned reduction in certain worksharing discounts is unlawful.

The Postal Service plans to retain the current 2.2-cent discount for automation 5-digit presort letters, which exceeds the Postal Service's estimated cost avoidance of 2.1 cents presented in its Annual Compliance Report. The justifications provided in support of this position are to produce more efficient mail, to enhance stability and predictability of rates (and therefore efficiency), and that "the passthrough barely exceeds 100 percent." Response to CIR No. 1 at 6-7.

In comments filed related to the Postal Service Annual Report to the Commission, Docket No. ACR2007, MMA points out that in estimating the delivery cost portion of the avoided costs, the Postal Service made an error in the delivery point sequencing (DPS) percentage for 5-digit automation letters at carrier sequence barcode sorter (CSBCS)/manual sites. MMA ACR Comments at 16, n.13. The Postal Service acknowledges that error, and filed a correction to the Notice. Fifth Notice of the United States Postal Service of Minor Revisions to Materials Accompanying Its FY 2007 Annual Compliance Report – Errata (Item 19), March 12, 2008, at 1. With this error corrected, the total estimated cost avoidance for First-Class automation 5-digit letters is 2.2 cents. Because of this, the planned discount does not exceed the corresponding avoided cost.

The Commission finds the planned discount for First-Class automation 5-digit letters consistent with the worksharing requirements of the PAEA.

The Postal Service estimates a passthrough for non-automation presort cards of 157.2 percent. This passthrough is calculated using a cost avoidance methodology that has not been reviewed by the Commission, and is significantly different in approach than each of the other cost avoidances in the class.[11] The Postal Service compares the cost difference between non-automation presort cards and automation mixed AADC cards (1.2 cents, as calculated using the new method) to the corresponding planned rate differential (1.9 cents) to generate the passthrough.

Using the Commission's Docket No. R2006-1 rate design methodology, the worksharing related cost difference between non-automation presort cards and automation mixed AADC cards is 2.8 cents.[12] This represents the current approach to estimating the cost difference between the categories in question, and when compared to the planned rate differential of 1.9 cents, results in a passthrough of 67 percent. Thus, the passthrough for non-automation presort cards is consistent with the requirements of the PAEA.

Finally, MMA asserts that the changes to inputs into the cost avoidance models have caused the estimated avoided costs to decrease, and that this in turn has led the Postal Service to reduce the size of discounts for workshared First-Class Mail. It further contends that because the changes to the cost avoidance model have not been reviewed or questioned by parties, the resulting reduction of the discounts is unlawful. MMA Comments at 1.

The Postal Service's plan to set discounts below 100 percent or to reduce existing discounts, by itself, does not make the planned discounts unlawful. In support of its position, MMA calculates the passthroughs that would be implied by the planned

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[11] The parallel estimate of avoided cost for non-automation presort letters provided by the Postal Service uses the same new methodology.

[12] The 2.8-cent cost avoidance was not presented in the Postal Service's summary of worksharing passthroughs but appears in Docket No. ACR2007, USPS-FY07-10.

discounts if its modifications to the cost avoidance estimates were accepted. The resulting passthroughs are between 86 percent and 95 percent, depending on the discount. *Id*. at 9. Acceptance of MMA's cost avoidance methodology would not change the finding that the planned discounts are consistent with the worksharing limitations of the PAEA.

MMA also asserts that the planned discounts are not consistent with the objectives, factors and policies of the PAEA, and provides a discussion of the rationale underlying this conclusion. Given the limited time for the pre-implementation review of rate changes provided under the PAEA, the scope of the Commission's review focuses on the required provisions of the PAEA, and on issues that clearly contradict other objectives, factors, and policies of the PAEA. This is consistent with the scope contemplated by the Commission in the development of rules governing rate adjustment proceedings. *See, e.g.,* Order No. 43 at 13, n.8. Updates and modifications to cost avoidance models of a general nature are beyond the scope of a rate adjustment review and will be addressed in a future proceeding.   MMA has not made a persuasive argument that the methodology issues that it has identified rise to the level of requiring immediate resolution in this proceeding.[13]

[13] In anticipation of the likelihood that time constraints would restrict the scope of issues that could be meaningfully reviewed in this type of proceeding, the Commission adopted rule 3010.13(j), which distinguishes the status of findings of compliance with rate cap provisions from findings of compliance with other provisions of the PAEA.

2. Classification Changes

The Postal Service plans several classification changes to its Outbound Single-Piece First-Class Mail International product.[14] First, it plans to increase the number of price groups from six to nine, thus aligning the First-Class Mail price groups with those of Priority Mail International and Express Mail International. Notice at 14. Second, the Postal Service introduces shape-based pricing, which better aligns this product with its domestic counterpart. *Id.* Finally, the Postal Service applies the nonmachinable surcharge to nonmachinable international letters regardless of weight, which again aligns this product with its domestic counterpart. *Id.* at 14-15.

No comments address the classification changes. The Commission finds the classification modifications reasonable and shall incorporate the substance of these changes into the draft Mail Classification Schedule.

3. Additional Comments

Stamps.com comments on the timing of rate filings and potential new incentives for small businesses. It commends the Postal Service for providing more advance notice of the intent to adjust market dominant rates than the 45 days required by Commission rules, and requests that the Postal Service also provide as much notice as feasible when adjusting competitive rates. Stamps.com Comments at 1-2.

Stamps.com also proposes that future discounts be made available to small businesses and consumers to allow them to participate in worksharing. For competitive products, Stamps.com suggests discounted rates for online purchase of postage for

[14] It has been anticipated that the Postal Service may include classification changes as part of its price adjustment filings pursuant to part 3010 of the Commission's Rules of Practice and Procedure. Including classification changes in this manner is appropriate. However, the Commission will apply the rules established pursuant to part 3020 of the Commission's Rules of Practice and Procedure to consider all proposed classification changes. These rules control the proper assignment, modification, or removal of products within the market dominant and competitive product lists, and the maintenance of the Mail Classification Schedule.

Priority Mail and Express Mail. *Id.* at 3. For market dominant products, it suggests discounts for Single-Piece First-Class Mail mailers who use Coding Accuracy Support System (CASS)-certified software, and the creation of a new classification for low-volume or single-piece Intelligent mail. *Id.* at 3-4.

Although the Commission finds that these suggestions are beyond the scope of this price adjustment proceeding, it encourages the Postal Service to consider the views of its customers when developing new and innovative products and pricing discounts.

Several comments were received on policy or methodological issues that may be appropriately addressed in future proceedings, but are beyond the scope of this rate adjustment proceeding. Additionally, in all cases the comments indicate that the rates are in compliance with the rate cap provisions and do not ask the Commission to take immediate action as to these specific concerns at this time. These comments are summarized below.

NPPC comments on cost avoidance calculations. It expresses a concern about the timing mismatch (and the effects of inflation) between the cost avoidance estimates and the time period that the rates will be in effect. NPPC Comments at 4. Pitney Bowes shares this concern and suggests that there could be an adjustment to take into account the effects of inflation. Pitney Bowes Comments at 5. APWU objects to an inflation adjustment because an across-the-board inflation adjustment would increase discounts regardless of actual costs avoided. APWU Comments at 4.

NPPC contends that there is a rate preference for single-piece vis-à-vis presort First-Class Mail, which is exacerbated by the new planned rates. NPPC Comments at 4-5. Also, it asserts that the proposed rate adjustments within presort First-Class Mail are anomalous, noting a higher percentage increase for deeply presorted mail versus less presorted mail. *Id.* at 5-6. Finally, NPPC comments on the compression of the letter-flat differential, which reduces the price recognition of shape-related costs. *Id.* at 6.

APWU questions the Postal Service's flats and parcels worksharing methodology. It contends that the methodology does not isolate avoided costs that are specific to those pieces. APWU Comments at 3.

In Docket No. R2006-1 at ¶¶ 5079-90, the Commission did not adopt the Postal Service's proposal to de-link single-piece from worksharing rates within First-Class Mail. In this rate adjustment proceeding, Pitney Bowes offers support for a de-linked approach to rate design. Pitney Bowes Comments at 4. Both APWU and the Public Representative oppose the de-linking approach. APWU Comments at 2; Public Representative Comments at 8.

B. Periodicals

1. Support for Periodicals Price Increase

Impact of post-filing revisions. The Periodicals class, for purposes of the first price adjustment under the PAEA, consists of two products: Outside County Periodicals and Within County Periodicals. This division parallels the way the class was organized immediately prior to passage of the PAEA.

The planned overall percentage increase for the Periodicals class as a whole, the percentage increase for Outside County, and the amount of unused pricing adjustment authority identified in the Postal Service's initial filing were revised during the course of this case as the result of limited revisions affecting Outside County.[15] These revisions do not change the prices identified in its original filing, nor do they result in piercing the price cap.[16] Errata at 1; *see also id*. at 3-4. As shown in the following table, the effect is a small increase in the Outside County percentage price change; a small increase in the overall percentage price change for the class as a whole; and a corresponding reduction in the percentage of unused pricing adjustment authority.[17] The Within County percentage price change remains unchanged. *See* Notice at 4-5; Errata at 1.

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[15] The revisions correct an error in the formula for volume of destination dropshipped area distribution center (ADC) Outside County editorial pounds in the Postal Service's workpapers as initially filed and reflect a downward revision in the revenue leakage associated with the new Limited Circulation discount.

[16] *See* Notice, Appendix A, Attachment USPS-R2008-1/3.

[17] The unused rate adjustment authority associated with the revised overall percentage price change for Periodicals is 0.176 percent. PRC-R2008-1-LR2, tab "Summary_ALL," spreadsheet CAPCALC-PER-FY2008 PRC.xls.

Table III-2
Periodicals Rate Change

	As Identified In Original Notice (February 11, 2008) (%)	As Revised In Errata Notice (February 29, 2008) (%)
Within County	2.630	2.630
Outside County	2.713	2.728
Overall	2.710	2.724
Source: Adapted from Notice at 17; Errata at 4.		

Technical revisions. The Postal Service presented initial calculations supporting the planned price adjustment for Periodicals in USPS-R2008-1/3. The workpapers reflect use of the 2007 Mail Characteristics Study, reliance on data from two sources in pending Docket No. ACR2007;[18] and calculation of the revenue leakage for the new Limited Circulation discount using FY 2007 Periodicals mailing statement data.

Commission analysis of this library reference revealed many cells with hard figures that had not been linked to other cells (which hindered the quick review essential to successful completion of the Commission's responsibilities in this case) and an error in the cell for Outside County destination ADC dropship editorial pounds. The Postal Service later provided additional data (via revisions to USPS-FY07-14). It also expressed agreement with the Commission's assessment that there was an error in the volume for the referenced Outside County cell. It traced the error to a formula that inadvertently included only regular rate ADC dropship pounds from the tab Regular Rate, and corrected the formula to include values from the Nonprofit and Classroom tabs.

The Postal Service also revised downward its original revenue leakage estimate (of $3,745,379) associated with the new Limited Circulation discount. The purpose of the revision was to reflect elimination of Classroom and Nonprofit Publications, which already receive a discount. The corrected figure, which the Postal Service based on

[18] The sources are ACR USPS-FY07-4 (billing determinant data) and ACR USPS-FY07-14 (revenue, piece and weight by shape data).

actual postage statement data accounting for 95 to 98 percent of Outside County publications, is $3,404,203. This change alters the overall increase from 2.710 percent to 2.724 percent and reduces the unused price adjustment authority from 0.190 percent to 0.176 percent. Errata at 4; Notice of the United States Postal Service of Filing of USPS-R2008-1/NP2, March 13, 2008.

The Commission's workpapers incorporate the aforementioned revisions. They also provide additional summary tables and link hard data to appropriate supporting documentation. *See* PRC-R2008-1-LR2.

2. Statutory Preferences

Postal Service filing. Under PRA-based ratemaking, several statutory preferences were associated with the Periodicals class. The PAEA significantly modifies one of these preferences; retains two largely without change; and adds a new preference. The modified preference, which appears in 39 U.S.C. § 3626(a)(3), requires that prices for all Within County Periodicals reflect this product's preferred status relative to prices for regular Outside County Periodicals. The Postal Service regards this as a general standard which replaces the "50-percent markup rule" which previously governed the pricing of Within County Periodicals under the PRA. Notice at 24, n.18, H.R. Rep. No. 109-66, pt.1, at 67-68. It further asserts that the price adjustment it is making in this case continues to recognize the preferential status of Within County Periodicals, as the planned prices for this product "continue to fall well below those of regular Outside County Periodicals." *Id*. at 24.

39 U.S.C. § 3626(a)(4)(A) continues to require, as did a predecessor provision in the PRA, that Nonprofit and Classroom Periodicals receive, as nearly as practicable, a 5 percent discount from regular Outside County postage, except for advertising pounds. The Postal Service says it maintains this preference, consistent with past practice, by

giving Nonprofit and Classroom pieces a 5 percent discount on all components of postage except for advertising pounds and Ride-Along postage.[19]

39 U.S.C. § 3626(a)(5) requires that Science of Agriculture Periodicals (which are Outside County products) be given preferential treatment for advertising pounds. The Postal Service, again citing consistency with past practice under the PRA, says that it will continue to provide these publications with advertising pound prices for entry at the destination delivery unit (DDU), destination sectional center facility (DSCF), destination area distribution center (DADC), and Zones 1 and 2 that are 75 percent of the advertising pound prices applicable to regular Outside County Periodicals. *Id*.

39 U.S.C. § 3626(g)(4) sets out the only statutory preference with no direct link to PRA-era preferences. It requires that preferential treatment be accorded to the Outside County pieces of a Periodicals publication having fewer than 5,000 Outside County pieces and at least one Within County piece. The Postal Service gives effect to this requirement by implementing a new Limited Circulation discount, available to mailers with publications meeting the circulation test, equivalent to the 5 percent discount accorded Nonprofit and Classroom Periodicals. *Id*. at 25.

Commission review of the planned rates indicates that the Postal Service has appropriately interpreted and implemented the statutory preferences accorded to Periodicals mailers.

3. Mail Classification Schedule (MCS) Description Changes

The Postal Service, in recognition of Commission rule 3010.14(b)(9), identifies a proposed change to the MCS product description for Outside County Periodicals necessitated by the planned price adjustments and presents the change in Appendix C. The change revises the MCS to reflect the changes to the Domestic Mail Manual (DMM) that will be required to implement the new Limited Circulation discount mandated by

[19] Fees for repositionable notes are not discounted.

39 U.S.C. § 3626(g)(4). The Postal Service, as anticipated in its original filing, placed notice of this new discount on *www.usps.com* and published notice in the *Federal Register* shortly after submitting its Notice.[20] *Id*. at 37-38.

4. Worksharing

The Postal Service presents tables related to Periodicals in Appendix B. Two are workshare discount tables. The Outside County table shows discounts/surcharges, cost differentials, and presort passthroughs; the Within County table provides the same information for presorting, pre-barcoding, and dropshipping. Notice at 34. The remaining tables present bundle and container pricing. The Postal Service notes that in Docket No. R2006-1, this type of information was developed by passing through part of the respective costs, not cost differentials. In this case, however, it explains that the tables reflect bottom-up costs and price as a percentage of costs. It adds:

> This reflects the [new] price structure in Periodicals, which implicitly includes many incentives for cost-reducing mail preparation behavior, but has many elements that cannot be viewed as traditional ‘passthroughs,’ even though percentages are used to describe how much of a cost is recognized in a given price element.

Id. It notes that the language of section 3622(e) reflects the traditional understanding of passthroughs being based on avoided costs rather than bottom-up costs.

The Postal Service asserts: “In any event, for Periodicals the overriding objective was to avoid large price increases for all publications.” It claims the only way to achieve this objective was to change each element roughly by the amount of the cap, which overrides any individual decisions about passthroughs or cost recognition.” *Id*. It also

[20] The anticipated *Federal Register* notice appeared February 20, 2008. *See* 73 FR 9197. The Postal Service has filed notice of the new discount on its website under “News and Events” in the “New Prices May 12” entry.

justifies the passthroughs by noting that 39 U.S.C. § 3622(e) exempts passthroughs for discounts provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational (ECSI) value.

5. Other Issues

Pricing rationale. The Postal Service states that its pricing decisions for Outside County Periodicals were influenced by the fact that some customer groups, particularly smaller publications, experienced large price increases due to a significant restructuring implemented in July 2007. It says it therefore sought to limit the degree to which the increase for any one price element varies from the average increase for this product, on the assumption that this will reduce the possibility of substantially greater-than-average price increases for any one publication. *Id*. at 17-18. At the same time, the Postal Service maintains efficiency incentives at current levels, on grounds that this will allow time to continue studying the effect of the new structure. It believes this information, as well as the extra pricing authority generated by this increase, can be used to make future pricing decisions that will improve the profitability of Periodicals. *Id*. at 18.

Cost coverage. The Postal Service acknowledges that the FY 2007 Annual Compliance Report indicates that Periodicals is the only class of mail that did not cover its attributable costs in the last fiscal year. It observes, however, that the new Periodicals price structure was only in effect for a small part of FY 2007, and that the FY 2007 cost coverage is therefore based primarily on costs and revenues from Docket No. R2005-1 prices. It asserts that the anticipated price increase in May of this year, in conjunction with the July 2007 rate increase, and mailer response to the new structure's incentives should help move Periodicals toward cost-compensatory status. It also says it is working to further understand and reduce Periodicals costs, and has assembled a task force for that purpose, consistent with section 708 of the PAEA. *Id*. The Commission has considered this circumstance, but does not find it a reason to require the Postal Service to file an amended notice or to take other remedial steps in this case.

Postal Service filing; related considerations. Three factors, in addition to the Postal Service's acknowledgement that Periodicals cost coverage under the planned rates would fall short of full recovery of attributable costs, have led many commenters responding to Commission Order No. 59 (in terms of Periodicals) to focus on the implications of the shortfall for this (and future) cases. These factors are Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak) comments in the pending annual compliance review case (Docket No. ACR2007); lingering uncertainty over the scope of Commission review in this case; and the extremely compressed procedural schedule, which does not provide for a round of reply comments.

In Docket No. ACR2007, Valpak submitted comments pursuing, among other things, the shortfall in Periodicals cost coverage, and contending that current or planned rates for Periodicals are unlawfully low because they fail to produce enough revenue to cover the attributable costs of the class as a whole. One suggestion it makes is that the Postal Service should be required to increase Periodicals rates enough to eliminate the alleged shortfall, even if the increase exceeds the PAEA price cap.

A group of Periodicals mailers filing jointly in this case raise numerous observations and objections related to Valpak's Docket No. ACR2007 position, given concern that Valpak might raise the same suggestions here.[21] *See generally* ANM, et al. Comments; *see also* ABM Supplemental Comments.[22]

In this case, Valpak reiterates some of the main concerns about Periodicals cost coverage in Docket No. ACR2007, but nevertheless concludes that the instant

[21] Comments of Alliance of Nonprofit Mailers, American Business Media, Dow Jones & Company, Magazine Publishers of America, Inc., The McGraw-Hill Companies, Inc., and the National Newspaper Association, Inc., March 3, 2008 (ANM, et al. Comments).

[22] Supplemental Comments of American Business Media, March 3, 2008 (ABM Supplemental Comments). The ABM Supplemental Comments focus more narrowly on the expectation that Valpak would raise, in this case, its suggestion in Docket No. ACR2007 that if the Commission finds that the price cap 'trumps' the cost-coverage factor in 39 U.S.C. § 3622(c)(2), it nevertheless should ensure that Periodicals rate increases are targeted on those Periodicals that may not cover "their" attributable costs so as to elicit "supply side effects sufficient to eliminate the shortfall between revenue and costs." *Id*. at 1. ABM disagrees with this proposed solution, contending that the result would be unwise, ineffective and unlawful. *Id*. at 2.

PAEA-based review "is focused on ascertaining whether [price changes] conform with the cap, and is not, in the first instance, designed to ensure that there are no cross-subsidies after the pending adjustment takes effect."[23] It asserts that its understanding of Commission rules is that compliance with 39 U.S.C. § 3622(c) is only before the Commission on a provisional basis, subject to subsequent review, and not now before the Commission on the merits. *Id*. at 11, and 11 n.5, citing 39 C.F.R. § 3010.13(j). It concludes that Commission rules anticipate deferring final action on compliance with 39 U.S.C. § 3622(c)(2) until its compliance review for FY 2008. Accordingly, it says that it will await the 2008 compliance review for any problem of under-priced Periodicals to be addressed.

Public Representative's position on cost coverage. The Public Representative acknowledges that the Postal Service addresses Periodicals cost recovery and provides a rationale for the shortfall in proposed Periodicals rates, but asserts that there is uncertainty about how much the percentage of Periodicals attributable costs recovered will improve during FY 2008. It concludes that given the recent significant changes offering potential for improvement and other uncertainties, neither the Commission nor the Postal Service can estimate with any degree of certainty the outcome of these various changes on Periodicals cost recovery during FY 2008. Public Representative Comments at 7. Accordingly, it asserts that the planned Periodicals rate adjustments should not be found inconsistent with applicable law. *Id*. Therefore, it says that requiring an amended notice of rate adjustment pursuant to Commission rule 3010.13(c) would not be appropriate. *Id*. It continues that if the Periodicals situation does not improve after further experience with the new rate incentives, new processes, and new equipment, together with revenue from rate increases in this fiscal year, the Commission should then consider appropriate action. *Id*.

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[23] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Price Adjustment, March 3, 2008, at 9 (Valpak Comments).

C. Standard Mail

1. Introduction

There are six products assigned to the Standard Mail (Regular and Nonprofit) class: High Density and Saturation Letters, High Density and Saturation Flats/Parcels, Carrier Route, Letters, Flats, and Non-Flat Machinables (NFMs)/Parcels. The Postal Service proposes to increase the price for Standard Mail, as a class, by 2.875 percent. Notice at 15. It intends to bank the remaining 0.025 percent. The Postal Service reports the percentage price changes for individual products within Standard Mail as follows:

Table III-3

Standard Mail Product	**Rate Change (%)**
Letters	3.39
Flats	0.86
Parcels and NFMs	9.66
High Density/Saturation Letters	1.66
High Density/Saturation Flats and Parcels	2.09
Carrier Route Letters, Flats and Parcels	2.99
Note: Unchanged from the Postal Service Notice.	

Notice at 15.

As discussed above, the Commission finds that the Postal Service's proposed rate increase for Standard Mail is below the applicable price cap and is in compliance with the price cap rules set out by the Commission. 39 C.F.R. § 3010.14(b)(1) through (4).

2. Statutory Preferential Rates

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

3. Worksharing Issues

The PAEA directs the Commission to "ensure that [workshare] discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" unless certain criteria are met. 39 U.S.C. § 3622(e)(2). This statutory provision places restrictions on the Postal Service's flexibility to set workshare discounts. For purposes of workshare discounts within the Standard Mail class, the Postal Service should not offer a discount that exceeds 100 percent of the avoidable costs unless:

- The discount is associated with a new postal service, a change in an existing postal service, or with a new workshare initiative related to an existing postal service, and is necessary to induce mailer behavior that furthers economically efficient operation of the Postal Service and will be phased out over a limited period of time (Exception A);
- The amount of the discount above costs avoided is necessary to mitigate rate shock and will be phased out over time (Exception B); or
- Reduction or elimination of the discount would impede the efficient operation of the Postal Service (Exception D).

39 U.S.C. § 3622.

Commission rules require the Postal Service to justify any proposed workshare discount that exceeds 100 percent of the avoidable cost by explaining how it meets one or more of the 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 C.F.R. § 3010.14(b)(6).

In this current rate filing, the Postal Service identified six rate discounts within the Standard Mail class that had passthroughs exceeding 100 percent. These are the passthroughs from (1) non-automation machinable mixed automated area distribution center (AADC) letters to automation mixed AADC letters which has a proposed passthrough of 557.8 percent; (2) non-automation mixed area distribution center (ADC) flats to automation mixed ADC flats which has a proposed passthrough of 265.2 percent; (3) mixed bulk mail center (BMC) machinable parcels to BMC machinable parcels which has a proposed passthrough of 115.9 percent; (4) BMC machinable parcels to 5-digit machinable parcels which has a proposed passthrough of 116.0 percent; (5) the destination delivery unit (DDU) discount for parcels and not-flat machinables (NFMs) which has a proposed passthrough of 123.9 percent; and (6) the barcode surcharge for parcels and NFMs which has a proposed passthrough of 161.3 percent. The Postal Service's stated statutory justifications for these proposed passthroughs and the Commission analysis of the adequacy of those justifications are discussed below.

Non-automation machinable mixed AADC letters to automation mixed AADC letters. This passthrough gives a discount for having the mailer affix a barcode on the mailpiece rather than having the Postal Service perform this task. In Docket No. R2006-1, the Postal Service proposed to disaggregate by shape several rate categories and surcharges. The Commission recommended the classification changes that resulted in disaggregating the rate categories and surcharges; however, based on the accepted cost data, it recommended a rate differential for letters which was much closer to 100 percent passthrough than the 4.0 cents proposed by the Postal Service. The Governors accepted this recommendation. The resulting rate difference between a non-automation machinable mixed AADC letter and an automation mixed AADC letter was 0.3 cents.

The most recent annual report data show that the cost avoided for having the mailer add a barcode to a Standard Mail letter is 0.3 cents. Postal Service letter sorting equipment can readily apply barcodes in the course of processing this mail. Nonetheless, the Postal Service proposes to provide mailers with a 1.4-cent incentive if the mailer places the barcode on the mailpiece. This would result in a passthrough of 557.8 percent.

The Postal Service's proposed statutory justification for giving a 1.4-cent discount to avoid 0.3 cents of costs is Exception D. The Postal Service argues that increasing the discount "should encourage mailers to pre-barcode their mail, improve address hygiene, and make pieces more machinable" which "will further the economic efficient operation of the Postal Service." Notice at 28. The Postal Service recognizes that this discount has little impact in terms of the number of pre-barcoded pieces since in FY 2007 automation letters outnumbered non-automation letters by a ratio of 30 to 1. It also explains that widening the gap between automation and machinable letters here is done by increasing non-automation prices rather than lowering the automation prices. The Postal Service states it is concerned that retaining the small rate incentive to barcode might cause mailers to shift automation letters to non-automation rate categories. *Id.* at 28-29. *See also* Response to CIR No. 1 at 7.

The Commission finds the Postal Service's proposed justifications for a 557.8 percent passthrough inadequate. The Postal Service's proposed justifications are discussed in turn below.

First, the Postal Service's concern that a 0.3 cent discount will not be enough to encourage mailers to pre-barcode their mail is not persuasive, for the following reasons. The cost differential between non-automation machinable mixed AADC letters to automation mixed AADC letters was shown to be 0.3 cents. However, the Postal Service's proposal seeks to provide mailers with 1.4 cents for doing work to facilitate the savings. If the Postal Service can provide a service at a lower cost than a mailer, it should be the entity providing that service. It routinely applies barcodes to First-Class and Standard Mail letters. The Postal Service's concern might be understandable and justified under Exception D if the Postal Service had capacity issues such that it could not effectively process the large amount of mailpieces anticipated by an extremely low rate difference. This and similar explanations of unusual operational circumstances could provide a rational justification for linking the statutory exception raised by the Postal Service (impede the efficient operation of the Postal Service) to a discount in excess of 100 percent passthrough. However, here, the stated rationale—that the Postal Service believes that having a mailer place a barcode on a mailpiece is more efficient for postal operations than having the Postal Service perform the same activity at a lower cost—is clearly flawed and does not allow the Commission to conclude that the proposed 557.8 percent cost coverage is acceptable.

Moreover, the mixed automation AADC category contains a relatively small portion of Standard Regular Mail (approximately 3.9 percent) that consists largely of residual pieces*, i.e.*, that portion of mailings that lack the density to qualify for deeper presort discounts. Thus, the majority of mail that earns this discount is part of larger mailings that receive substantial discounts for presenting barcoded mail presorted to 3-digit and 5-digit destinations. The barcode is a prerequisite to earning these larger presortation discounts. It is not plausible to suppose that senders of large presorted mailings will omit the barcodes from a small portion of their mailing lists because the unit discount on residual pieces is small.

While the willingness of the Postal Service to offer discounts should depend on the potential for it to avoid costs, mailers' willingness to present mail that qualifies for a discount depends on the costs to the mailer. Throughout the years, mailers have occasionally complained about the cost of producing barcodes of sufficient quality to qualify for discounts from the Postal Service; however, such issues relate to the production of barcodes placed on entire mailing lists. Once a mailer qualifies for presort discounts, it is most efficient to present single mailings that are entirely pre-barcoded. Once a mailer becomes capable of applying barcodes, it is inexpensive to maintain that capability. Further, once a mailer obtains that capability, it will generally be most efficient for a mailer to barcode all of its mailings, even those smaller mailings that may not be susceptible to a deep level of presortation. Thus, the likelihood that mailers that are currently earning discounts for barcoding mixed AADC mail will cease to do so as a result of the Postal Service retaining the current 0.3-cent discount is miniscule.

Second, the Postal Service's argument that offering its proposed discount at a 557.8 percent passthrough will improve address hygiene is questionable. CASS certification, a requirement for barcode discounts, could have the effect of improving address hygiene. However, CASS certification is expensive, and truly small volume mailers may not find it economical to barcode even at the higher discount. Additionally, unlike First-Class Mail, Standard Mail is not forwarded or returned unless the mailer pays an additional fee. Since the additional fee covers most of the additional costs related to address hygiene, the majority of address quality costs are not mailpiece costs and are covered separately. Most importantly, the Postal Service has not quantified any address hygiene cost savings related to barcoding beyond what is reflected in the cost models. If this is a sufficiently important factor as to justify an exception to the 100 percent passthrough rule, these costs should be estimated in the Postal Service justification to provide support for the discount.

Finally, the Commission has concerns with the Postal Service's argument that encouraging barcodes makes mail more machinable. Machinability is not at issue for this passthrough. Both non-automation machinable mixed AADC letters and automation mixed AADC letters are required to be machinable, with nonmachinable letters paying a separate, higher rate. The issue with this passthrough is pre-barcoding, not machinability.

As discussed above, the Commission does not find the Postal Service's justifications for offering the proposed discount at a 557.8 percent passthrough to meet even the lowest standard of review. Accordingly, the Commission finds the planned prices associated with the Standard Mail automation mixed AADC letters inconsistent with 39 U.S.C. § 3622(e). An amended notice of rate adjustment should be provided to remedy this problem. *See* 39 C.F.R. § 3010.13(e).

The Postal Service has the authority to design changes to remedy this problem. The Commission stands ready to review whatever adjustment the Postal Service chooses with maximum expedition so that all new rates for Standard Mail can be implemented as scheduled on May 12, 2008.[24] Although the Postal Service has the responsibility to design rates that are consistent with the requirements of the PAEA, the Commission has considered whether the Postal Service has reasonable options for conforming its price adjustments to the PAEA without seriously disrupting mailers or undermining its financial health. The Commission finds reasonable options are available.

The Postal Service states that it developed this rate differential by increasing the price of non-automation letters to 1.4 cents more than the price of pre-barcoded (automation) letters. Notice at 28-29. A simple way to conform to the requirement of section 3622(e) would be to shrink the differential back to 0.3 cents by reducing the price for non-automation letters by 1.1 cents. This would have the effect of decreasing the price change for Standard Mail by approximately 1/10 of 1 percent (and increasing the banked amount for Standard Mail by that amount).

Non-automation mixed ADC flats to automation mixed ADC flats. This discount is available to flats that are both machinable and pre-barcoded.

The Postal Service's proposed statutory justification for seeking Commission permission to give mailers a 6.4-cent discount for ensuring that the Postal Service avoids a 3.8-cent cost is Exception D. The Postal Service argues that increasing the discount "should encourage mailers to pre-barcode their mail, improve address hygiene, and make pieces more machinable" which "will further the economic efficient operation of the Postal Service." Notice at 29. The Postal Service notes that this passthrough has little impact in terms of the number of pieces since in FY 2007 automation flats outnumbered non-automation flats by a ratio of 15 to 1. It also explains that widening the gap would increase the non-automation prices rather than lower the automation prices. The Postal Service is concerned that having such a small rate incentive to provide automation

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[24] The Commission's rules anticipate that this situation may occur and accordingly builds in additional time for the Postal Service to correct problems without disrupting the proposed effective dates. See 39 C.F.R. §§ 3010.13(a)(5), (c), (e) and (h),

compatible pieces might cause mailers to shift automation flats to non-automation rate categories. *Id.* at 29-30. *See also* Response to CIR No. 1 at 8. Expanding upon this rationale, the Postal Service explains that the barcoding of flats will enhance the Postal Service's ability to implement its Flat Sequence Sorting (FSS) system. Therefore, the Postal Service believes "looking forward, stronger, rather than weaker, incentives for barcoding flats may be initially necessary to create incentives for mailers to make the required infrastructure investments necessary to begin applying the barcodes for the Postal Service to achieve needed efficiencies" and assure mailers that their initial start-up investment costs, related to processing pieces on the FSS, are worthwhile. *Id.*

The Commission finds that the additional information provided by the Postal Service satisfies the statutory exceptions under 39 U.S.C. § 3622(e)(2)(D). The Postal Service's operational realities require mailer participation to successfully implement the FSS system and thereby enhance the overall efficiency of postal operations. The implementation of FSS has begun and is expected to occur systemwide in the near future. Increasing this discount to increase mailer participation is a valid justification.

Mixed BMC machinable parcels to BMC machinable parcels and BMC machinable parcels to 5-digit machinable parcels. These discounts give mailers a discount for presorting machinable parcels.

The Postal Service's proposed statutory justification for seeking Commission permission to give mailers a discount in excess of avoidable costs for presorting parcels is under Exception D. The cost avoidance information used to calculate these passthroughs is based on modeled costs. The Postal Service asserts that the avoided costs "are approximations that should serve as guidelines to develop reasonable parcel prices." Notice at 32; *see also* Response to CIR No. 1 at 9-10 ("the cost avoidance estimates for Standard Mail parcels … are uncertain.") This is due, in part, to a lack of data for pieces that previously were not clearly marked and defined. *Id.* Further, the Postal Service notes that setting the discounts at 100 percent passthroughs would require reducing the discounts from their present level, which may lead to fewer presorted parcels and greater movement of Standard Mail parcels to the BMCs, which the Postal Service believes is operationally inefficient.

Docket No. R2006-1 was the first time that the Postal Service disaggregated the Standard Mail parcel rates and costs. The Postal Service has yet to experience a full year of collecting cost data for these disaggregated categories. The estimated cost avoidances for both machinable BMC and machinable 5-digit parcels in FY 2007 have been developed using modeled costs. The models necessarily incorporate many assumptions due to the lack of actual cost data. The Postal Service contends that maintaining an attractive discount increases operational efficiency. The Postal Service should be given a reasonable amount of time to obtain accurate costs to measure the success of the discounts in increasing the efficiency of these processing operations. Therefore, the Commission finds the discounts to be justified in this instance. As the Postal Service gathers accurate cost data for these categories the passthroughs should be adjusted to reflect 100 percent or less of the avoided costs.

DDU dropship discount for parcels and NFMs. This DDU dropship discount gives mailers a rate reduction for dropshipping parcels and NFMs directly to the destination delivery unit.

The Postal Service’s proposed statutory justification for seeking Commission permission to give mailers a discount in excess of avoidable costs for presorting parcels is Exception D. The Postal Service believes that the most efficient way to process Standard Mail parcels is by having as many as possible entered at delivery units rather than at BMCs. Response to CIR No. 1 at 10. To achieve this goal, the Postal Service has proposed to increase the DDU dropship discounts passthrough above 100 percent.

The Postal Service also believes that the dropship cost avoidance estimates understate the costs avoided by parcels. The only available cost avoidance estimates are for Standard Mail as a whole class that are not broken down by shape. Notice at 33; Response to CIR No. 1 at 10. The Postal Service argues that reducing the discounts would be akin to “retrenching on the incentive structure built into the Postal Service’s rate proposals in Docket No. R2006-1, and would therefore reduce the transparency and predictability of the overall pricing incentive structure for parcels and NFMs." *Id.*

The estimated cost avoidance for DDU parcels may be understated. The cost avoidance estimate is based on the cost per pound of an average Standard Mail mailpiece regardless of shape. It is likely that parcels have a higher cubic foot per pound ratio and therefore incur greater transportation costs per piece than letters or flats. Therefore, the cost per pound, and related dropship savings, is probably higher for parcels than for flats or letters. The Commission finds the discount justified in this case. As the Postal Service becomes able to disaggregate dropship savings by shape the passthroughs should be adjusted to reflect 100 percent or less of the avoided costs.

Barcode discount for parcels and NFMs. The Postal Service's proposed statutory justification for seeking Commission permission to give mailers a discount in excess of avoidable costs for barcoding parcels is Exception D. Preliminarily, the Postal Service notes that the discount is identical to the current discount. Response to CIR No. 1 at 8. The Postal Service notes that it does not have models that directly estimate the costs avoided by pre-barcoding Standard Mail parcels and NFMs; instead it uses a cost savings estimate from the Parcel Post model. Notice at 33. Therefore, "true cost avoidance is unknown." Response to CIR No. 1 at 9. The Postal Service believes that pre-barcoding all Standard Mail Parcels and NFMs have "substantial efficiency benefits" and that a significant discount is needed to induce mailers to ensure that most parcels and NFMs are appropriately barcoded.

The Postal Service is not equipped to apply barcodes to parcels or NFMs. Under these circumstances, increasing discounts to attract additional barcoded volume may be appropriate as it will foster efficient operation. The Commission will monitor this issue. The claim of "no reliable cost avoidance data" is not a long-term justification. It is incumbent on the Postal Service to study this issue and obtain usable data.

4. Commenter Issues

Four comments specifically address planned Standard Mail price adjustments. Valpak, PSA, and NPPC's comments do not request relief from the Commission at this time.[25] DMA and PostCom joint comments center on the rate increases for the Standard Mail Parcels and NFM product. They believe that the 9.66 percent increase for the Standard Mail Parcels and NFM product is "excessively high." DMA-PostCom Comments at 3. DMA and PostCom ask the Commission to "direct the Postal Service to revise these proposed adjustments downward substantially, unless it is able to provide a convincing explanation that meets the applicable statutory standard." *Id.* at 4. They contend that the written explanation for the increase provided by the Postal Service is "wholly inadequate" and does not meet the requirements of Commission rule 3010.14(b)(7).

The Commission recognizes that this filing represents the initial Postal Service effort to seek rate adjustments under the Commission rules issued last October. The Commission expects the Postal Service will gain experience from both mailer comments and this review, and use this experience to improve its justifying rationale in future filings. For purposes of this initial rate case filing, the Commission finds that the Postal Service's explanation meets the minimum requirements of the PAEA and the Commission's rules and that the above average increases sought for categories that may not be covering their costs are appropriate in this case.

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[25] *See generally*, Valpak Comments and NPPC Comments; Comments of the Parcel Shippers Association on the Planned Rate Adjustment on Market Dominant Postal Products and Limited Classification Changes, March 3, 2008 (PSA Comments); Direct Marketing Association, Inc. and Association for Postal Commerce Comments on USPS Notice of Market-Dominant Price Adjustment, March 3, 2008 (DMA-PostCom Comments).

D. Package Services

Package Services mail, as defined in the Domestic Mail Classification Schedule in effect on the date of enactment of the PAEA, consisted of the following four subclasses: Parcel Post, Bound Printed Matter (BPM), Media Mail, and Library Mail. *See* 39 U.S.C. § 3622(d)(2)(A). In Order No. 43, the Commission accepted the Postal Service's proposal that Package Services mail consists of the following five products: Single-Piece Parcel Post, Bound Printed Matter Flats, Bound Printed Matter Parcels, Media/Library Mail, and Inbound Surface Parcel Post (at UPU rates). Order No. 43, ¶¶ 3029-31; Appendix A at 5.

1. Price Increases

The Postal Service indicates that the percentage change in prices for Package Services mail is, on average, 2.875 percent. Errata at 6-7. Thus, the Postal Service asserts that the increase complies with 39 U.S.C. § 3622(d)(1) because it is below the applicable 2.9 percent price cap. Notice at 4-5. For the five products classified as Package Services, the average price increase is as follows:

Table III-4

Package Services Product	Rate Change (%)
Single-Piece Parcel Post	3.30
Bound Printed Matter Flats	0.42
Bound Printed Matter Parcels	2.10
Media/Library Mail	4.54
Inbound Surface Parcel Post	2.62†

† Prices for Inbound Surface Parcel Post (at UPU rates) are determined by the Universal Postal Union. The Postal Service indicates that the prices are adjusted annually, with the most recent change taking place on January 1, 2008. *Id*. at 19, n.1.

At the prospective prices, banked (or unused) authority equals 0.025 percent.

The Postal Service provides a general discussion of its rationale supporting the prospective price increases, indicating that its focus was on “improving the profitability of Media/Library Mail and single-piece Parcel Post.” *Id*. Regarding Media/Library Mail, the Postal Service cites its low cost coverage and ECSI value as influencing price levels. *Id.* Prospective Single-Piece Parcel Post prices are influenced by a need to improve cost coverage. The Postal Service increases Intra-BMC prices more, on average, than Inter-BMC, 5.78 percent compared to 2.56 percent, respectively.

To remain below the price cap for the Package Services class, prospective BPM prices are set below the cap, with flats increasing, on average, by 0.42 percent, compared to parcels at 2.10 percent. The Postal Service indicates that the difference reflects flats’ lower processing and delivery costs and is “designed to encourage increased volume of lower-cost, flat-shaped catalogs.” *Id*. at 20.

The Commission confirms that prospective price increases for the Package Services class do not exceed the price cap, 2.9 percent, and thus satisfy 39 U.S.C. § 3622(d). In addition, the Commission finds that the prospective Library Mail prices satisfy 39 U.S.C. § 3626(a)(7), which requires that they be set as nearly as practicable 5 percent below the corresponding Media Mail rate.

2. Workshare Discounts

a. Media/Library Mail

The passthroughs for 5-digit Media/Library Mail are in excess of 100 percent.[26] The Postal Service, however, indicates its intent to reduce the excess passthroughs over time. *Id.* at 36.

In its Notice, the Postal Service justifies the excess passthroughs for 5-digit Media/Library Mail principally on a desire to mitigate rate shock. *Id.* In response to

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[26] *See* Notice, Appendix B, Media Mail and Library Mail.

Commission Information Request No. 1, the Postal Service amplifies its rate shock contention, noting that reducing the passthrough to 100 percent in one step would have increased the one-pound price by over 30 percent. Response to CIR No. 1 at 14. Under the circumstances, it deems that increase to be excessive and inconsistent with its desire to adjust prices in a predictable and stable manner. *Id*. In addition, it points to 39 U.S.C. § 3622(e)(2)(C), mail consisting exclusively of matter having ECSI value, as justifying the excess passthrough.

The Commission finds these rationales justify the 5-digit Media/Library Mail discounts.

b. Bound Printed Matter

The passthroughs for workshared BPM are in excess of 100 percent.[27] The Postal Service, however, indicates its intent to reduce the excess passthroughs over time. *Id.* at 35. In addition, in all cases except for BPM DDU parcels, the passthroughs are below FY 2007 results reported in Docket No. ACR2007.

Initially, the Postal Service justifies the excess passthroughs for BPM DBMC and DSCF (flats and parcels) principally in a desire to mitigate rate shock, contending that eliminating the excess passthroughs "in this round of price adjustments would cause excessively high increases for DBMC and DSCF flats and parcels." *Id*. In support of the increased passthrough for BPM DDU parcels, from the 105.4 percent reported in FY 2007 to 110.1 percent, the Postal Service states that its approach provides more efficient price signals and an incentive to dropship to the DDU. *Id.* at 21.[28]

In response to Commission Information Request No. 1, the Postal Service expands on its rationale supporting BPM workshare discounts. As a general matter, it

[27] *See* Notice, Appendix B, Bound Printed Matter Flats and Bound Printed Matter Parcels.

[28] *See also id.* at 35-36 (expressing the belief that (a) the most efficient way to process BPM parcels is to have them entered at the DDU, and (b) a larger discount is necessary to induce BPM parcel mailers to dropship to the DDU).

argues that discounts should not be considered in isolation, but rather relative to prices within and across categories of mail. Response to CIR No. 1 at 4. Taking these interrelationships into account would, according to the Postal Service "[ensure] that price relationships are not jolted each year, based on the latest cost avoidance figure, [and] therefore serve[ ] to incent stable mailer worksharing in the long-run, and allow[ ] for more efficient Postal Service operations." *Id.* at 5. In addition, it argues, generally, that cost avoidance estimates should not be viewed as "absolutely precise figures" due, principally, to year-to-year mail mix variations. *Id.*

Turning to the passthroughs for BPM DBMC and DSCF flats and parcels, the Postal Service augments its initial discussion, emphasizing the effects of eliminating the excess passthrough at one time and the need to consider the discounts relative to one another. *Id*. at 15-17.

Addressing the BPM DDU discount, the Postal Service reiterates its earlier claims regarding the need to encourage DDU-entered parcels, while elaborating on the need to maintain appropriate price signals among BPM workshare categories. *Id*. at 11. In that regard, it notes that rate shock concerns make eliminating the excess DBMC parcel passthroughs in one step infeasible, and further that its pricing decisions were influenced by a desire to maintain stable and predictable pricing relationships among BPM dropship categories.[29] *Id*.

Two sets of comments were filed in support of the prospective BPM DDU parcel passthrough. Both contend that the DDU passthrough should be measured relative to

[29] It also offers an alternate methodology for computing the passthroughs, asserting that if the passthroughs are calculated by comparing FY 2007 Annual Compliance Report costs avoided relative to DBMC and DSCF parcels rather than the historic benchmark of origin-entered parcels, the effective DSCF DDU discount represents a passthrough of 100 percent compared to 110.1 percent, while calculating the DSCF passthrough relative to DBMC parcels yields a passthrough of 98 percent. *Id.*

DSCF-entered parcels as the benchmark rather than origin-entered parcels.[30] Using the former as a benchmark would yield a passthrough of 100 percent at FY 2007 costs.

The Commission's rules, adopted pursuant to 39 U.S.C. § 3622(a) and implementing the modern system of rate regulation, require the Postal Service to provide justification for all workshare discounts that exceed avoided costs including specific reference to the applicable statutory authority, either section 3622(e)(2) or (3). *See* 39 C.F.R. § 3010.14(b)(6). As the Postal Service appears to recognize, its Notice fell short of what rule 3010.14(b)(6) requires. *See* Response to CIR No. 1 at 2-3, and 4. It did, however, amplify its justifications in response to Commission Information Request No. 1. On balance, the Commission concludes that the Postal Service has adequately justified BPM passthroughs in excess of 100 percent.

The need to consider price relationships within and among products is particularly acute with respect to Package Services. The three former Package Services subclasses exhibit markedly different demand and cost characteristics. In addition, rates for Media/Library Mail are, by statute, required to be uniform throughout the country. 39 U.S.C. § 3683. Data submitted in Docket No. ACR2007 reveal that, for FY 2007, costs for two products, Single-Piece Parcel Post and Media/Library Mail, exceed revenues. The Postal Service, correctly in the Commission's view, seeks to increase the contribution from these two products. That goal, in tandem with the price cap and the recognized need to reduce excessive passthroughs, constrains Postal Service pricing options.

The prospective BPM discounts are interrelated, a fact dictating that they be considered together. The Postal Service concludes that eliminating the excess DBMC passthroughs at one time would have generated double-digit percentage increases in

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[30] DMA-PostCom Comments at 3; PSA Comments at 9-10. PSA states that if the avoided costs are inflated to the time period in which the prices will be in effect (May 2008 to May 2009) the passthrough would be less than 100 percent. *Id*. at 10. DMA and PostCom urge the Commission to address this temporal issue. DMA-PostCom Comments at 2-3. This docket is not the appropriate forum to address the merits of that issue.

numerous rate cells, a result it characterizes as excessive. *Id*. at 15.[31] As the vast majority of BPM parcels are in this rate category, this conclusion has implications for the remaining dropship tiers, limiting what, in theory, might be done. More specifically, the need to consider the discount tiers relative to one another hinders the possibility of eliminating DSCF excess passthroughs. The Postal Service rejected that possibility, concluding that the change would be "too abrupt." *Id.* at 16. In its response to Commission Information Request No. 1, the Postal Service makes a similar point, albeit more generally:

> In the PAEA world, . . ., with the prospect of annual price changes and annual examination of relationships, absolute adherence to any strict 100 percent passthrough pricing rule could lead to a price structure whose incentives are constantly being jolted, to the detriment of mailers, and, therefore, the efficient operation of the Postal Service.

Id. at 5.

This rate shock argument, coupled with the commitment to phase out these excess passthroughs over time, satisfies the requirements of 39 U.S.C. § 3622(e)(2)(B) as to BPM.

The DDU parcel discount, viewed in isolation, would be problematic. More holistically, however, the prospective DDU discount is consistent with the other BPM dropship tiers. The need to mitigate rate shock for most dropshipped BPM parcel volumes has pricing implications for each of the remaining tiers, which, when coupled with the price cap constraint, limits the ability to further reduce the excess passthroughs at one time.[32] Thus while rate shock, as a justification for each individual excess passthrough may be a somewhat tenuous thread, in the broader context of considering

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[31] Compared to FY 2007 data, DBMC passthroughs for flats and parcels are reduced from 169 percent to 144 and 146 percent, respectively.

[32] The relative FY 2007 BPM parcels volume by dropship category gives credence to the justifications supporting the discount levels. The respective parcels volumes (in millions) are: DBMC – 165.2; DSCF – 33.4; and DDU – 4.5.

BPM discounts together it explains the prospective BPM passthroughs in this proceeding.

The Commission has closely considered the prospective BPM passthroughs. The Commission's conclusion is strongly influenced by the unique circumstances presented in this docket. This proceeding marks the Postal Service's first attempt to set market dominant prices pursuant to the modern system of rate regulation mandated by the PAEA. As a general matter, the Postal Service has endeavored to reduce the excess passthroughs. As to the future, it has expressed its intent to make BPM discounts consistent while reducing excess passthroughs over time. In sum, the justifications for the BPM discount levels are sufficient in this proceeding, with the expectation that future BPM excess passthroughs will be reduced.[33]

Concerning the issue of excess passthroughs generally, the Commission concludes with the following observations. Whenever it files a notice of rate adjustment, the Postal Service must, pursuant to Commission's rules, provide "[s]eparate justification for all proposed workshare discounts that exceed avoided cost[,]" including reference to the applicable statutory justification in 39 U.S.C. §§ 3622(e)(2) or (3). 39 C.F.R. § 3010.14(b)(6).

In this docket, the Postal Service had two opportunities to present its justifications. The justifications provided in the Notice were not adequate, which may reflect that this is the first proceeding under the modern system for regulating rates for market dominant products. The Postal Service's response to Commission Information Request No. 1 provided helpful elaboration. In future notices, the Postal Service must satisfy the rules and provide a more complete justification for any excess passthroughs.

Moreover, justifications premised on efficient Postal Service operations must be supported. For example, a claim that increasing the discount is needed to encourage more mailers to dropship to the DDU is not, without more, a compelling justification for

[33] Given its findings regarding Package Services workshare discounts, the Commission finds it unnecessary to address the merits of suggestions that it employ an alternative benchmark for measuring passthroughs.

increasing excess passthroughs. *See* Notice at 21; *see also* Response to CIR No. 1 at 11 (noting the reverse, *i.e.*, that a reduction in the discount would provide mailers with less of an incentive to enter mail at the DDU). First, the claim assumes that all other things are equal. Second, the claim merely states what is self-evident—lower rates in the form of larger discounts will, all other things equal, provide a greater "incentive" to use a discount. In and of itself, this does not equate to a more efficient operation. A further explanation of how and why the Postal Service will benefit even though the discount exceeds avoided costs is also necessary. In short, the justification should not simply be a conclusory statement.

3. Commenter Issues

The Alaska Commercial Company (ACC) submitted comments opposing the prospective Intra-BMC prices, arguing that the estimated 9.5 percent increase adversely affects rural Alaskans who depend on Alaska bypass mail for food and clothing.[34] ACC states that bypass rates increased by 12 to15 percent last year. It also compares the CPI cap, 2.9 percent, to the prospective increase in Alaska bypass prices, 9.5 percent. *Id.* at 1. ACC urges the Commission to review the effect of the prospective increase on rural Alaskans and increase prices on other classes of mail less dependent on "individuals' ability to purchase affordable food and everyday necessities of life." *Id.* at 2.

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[34] Comments of Alaska Commercial Company, March 3, 2008, at 1. In Docket No. R90-1, the Postal Service provided the following description of Alaska bypass mail:

> The bypass mail program was established to serve large volume mailers of grocery and household products in the state of Alaska. All bypass mail is entered at Anchorage and Fairbanks. Mail is palletized and shrink wrapped, with all parcels on pallets addressed to a single destination. The mailer tenders his mail at the air carrier's freight terminal where an on-site postal employee accepts and verifies the mail. A minimum of 1000 pounds per mailing per destination is required.
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> * * *
>
> All bypass mail is rated as intra-BMC zone 2 or 3 parcel post mail.

Docket No. R90-1, Evidentiary Hearing, June 8, 1990, Tr. 5/1262-63.

The Commission is sympathetic to the concerns raised by ACC. Nonetheless, the PAEA fundamentally alters the manner in which rates are established, according the Postal Service substantially increased pricing flexibility. Based on a review of the Postal Service's data filed in Docket No. ACR2007, preliminary indications are that revenues for Single-Piece Parcel Post, and in particular Intra-BMC mail, hover near costs. Under the circumstances, the Postal Service's efforts to increase the contribution from Single-Piece Parcel Post appear reasonable and not violative of applicable law.[35]

[35] A solution that provides relief to ACC may be elusive. The Postal Service is now subject to a price cap limiting its ability to raise revenue through rate increases.

E. Special Services

1. Introduction

Under the PAEA, all the products in the Special Services class are classified as market dominant. 39 U.S.C. § 3621. In Order No. 43, the Commission concluded that the Special Services class consists of the following products: (1) Ancillary Services; (2) International Ancillary Services; (3) Address List Services; (4) Caller Service; (5) Change-of-Address Credit Card Authentication; (6) Confirm; (7) International Reply Coupon Service; (8) International Business Reply Mail Service; (9) Money Orders; (10) Post Office Box Service; and (11) Premium Forwarding Service. Included within the Ancillary Services and International Ancillary Services products are numerous individual services.[36]

2. Price Increases

The Postal Service indicates that the percentage change in prices for the Special Services class is, on average, 2.848 percent. Notice at 4-5, and 21. Because the overall percent change for the Special Services class is less than the 2.9 percent statutory price cap, the Postal Service asserts that the planned price increases for each Special Services product are in compliance with the PAEA and the Commission's regulations.

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[36] The Ancillary Services product contains the following 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 Mail; (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.

The International Ancillary Services product contains the following four services: (1) International Certificate of Mailing; (2) International Registered Mail; (3) International Return Receipt; and (4) International Restricted Delivery.

Id. at 3. The Postal Service notes that the planned price adjustment of 2.848 percent produces a banked authority equal to 0.052 percent for the Special Services class. *Id.* at 5.

The Commission finds that the Postal Service correctly computed the overall adjustment of 2.848 percent for the Special Services class. PRC-R2008-1-LR5. This increase complies with the statutory price cap and, therefore, the planned price increases for the Special Services products and services are lawful under the PAEA. Based on the 2.848 percent increase for the Special Services class, the Commission determines that the Postal Service is banking the residual cap amount of 0.052 percent. *Id.*

Below are the average percentage increases, as calculated by the Commission, at the individual product levels that result in the overall 2.848 percent increase. The Commission urges the Postal Service to provide this additional information in future price adjustment filings.

Table III-5

Special Services Products	Change (%)
Ancillary Services	3.040
International Ancillary Services	6.100
Address List Services	3.129
Caller Services	2.320
Change-of-Address Credit Card Authentication	0.000
Confirm	16.601
International Reply Coupon Services	5.000
International Business Reply Mail Service	3.870
Money Orders	0.036
Post Office Box Service	2.962
Premium Forwarding Service	0.000

3. Commenter Issues

Three commenters address the planned price increases for the Special Services class: Growing Family, Inc.,[37] NPPC, and the Public Representative.

Growing Family argues that the planned increases for Collect on Delivery (COD) are unlawful because the average percentage increase of basic COD service is more than 3 percent. Growing Family Comments at 1-2. It disputes the Postal Service's explanation that the increase reflects COD's high "value of service," stating that the service is lacking. *Id.* at 2. In support, Growing Family summarizes the Commission's findings in Docket No. R2006-1 that the Postal Service's COD performance was poor and that the poor performance warranted a lower cost coverage than requested. It also contends that the Postal Service's performance has since deteriorated further. *Id.* at 2-4. Growing Family asserts that the overall price increase for basic COD service is excessive and fails to reflect the low "value of service." *Id.*

The PAEA provides the Postal Service pricing flexibility by applying the statutory price cap at the class level and not at the product, service, or individual fee level. 39 U.S.C. § 3622(d)(2)(A). The PAEA, therefore, permits the Postal Service to increase some products, services, and rate cells in a class more than the statutory cap, as long as the aggregate increase for the class does not exceed the cap. In this instance, while the increases at the product and services level are slightly above the cap,[38] the planned increase for the Special Services class is 2.848 percent, which is below the cap; therefore, the planned increases for COD are lawful.

The "value of service" factor is among numerous factors and objectives that the Postal Service is to consider when setting prices under the PAEA. *See* 39 U.S.C.

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[37] Comments on COD Price Adjustment by Growing Family, Inc., March 3, 2008 (Growing Family Comments).

[38] The planned increase for the Ancillary Services product is 3.040 percent. PRC-R2008-1-LR5. COD is a service within the Ancillary Services product. The planned aggregate increase for COD service is 3.573 percent. *Id.*

§ 3622(b) and (c); 39 C.F.R. § 3010.14(b)(7). Moreover, the “value of service” factor encompasses several matters, of which performance is only one. The Commission observes that rate adjustment reviews under the PAEA are not conducive to resolving disputes concerning the Postal Service’s performance.[39]

NPPC complains that several of the increases to individual fees[40] are problematic and are not justified by cost increases or any other appropriate ratemaking factor. NPPC Comments at 9. It acknowledges the proposed price changes are permitted because the aggregate increase for the Special Services class as a whole is less than the 2.9 percent price cap. *Id.*

The Public Representative suggests that the Special Services products’ revenues and costs should be allocated between the market dominant and competitive products. Public Representative Comments at 16. The Public Representative explains that if a Special Services product is used primarily with a competitive product, the market dominant products either bear the loss if the Special Services product fails to cover its costs or is unduly credited the revenue if the product is profitable. *Id.*

This first price adjustment review is not the appropriate forum to implement the Public Representative’s suggestion that the Special Services products’ revenues and costs be allocated between the market dominant and competitive products. Nonetheless, the theoretical wisdom of this suggestion is clear, and the Postal Service is urged to explore ways to reclassify Special Services so that costs and revenues can be allocated correctly between market dominant and competitive products.

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[39] The Commission recognizes Growing Family’s frustration with the performance problems of COD that existed in the past and perhaps continue to this day. The new ratemaking system does not allow for discovery, however, and the Commission has no evidence before it that the Postal Service’s performance has improved or deteriorated since Docket No. R2006-1.

[40] Specifically, NPPC lists the 33 percent increase for the electronic Address Correction Service fee; the 14.3 percent increase for the firm book Certificate of Mailing fee; and the 25 percent increase experienced by several Confirm fees.

A full review of the United States Postal Service Notice of Market-Dominant Price Adjustment, filed February 11, 2008, has been completed. With regard to the price adjustments contained therein, for the reasons set forth above

It is Ordered:

1. The price adjustments are within the annual limitation on changes in rates set forth in 39 U.S.C. § 3622(d) and 39 C.F.R. § 3010.11.

2. The price adjustments properly reflect the statutory preferences set forth in 39 U.S.C. § 3626.

3. Workshare discounts satisfy the requirements of 39 U.S.C. § 3622(e), with one exception, the prices associated with the planned discount for Standard Mail mixed AADC letters.

4. Except to the extent granted or otherwise disposed of herein, all outstanding requests in Docket No. R2008-1 hereby are denied.

By the Commission.

Steven W. Williams
Secretary