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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

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

Notice of Price Adjustment — Docket No. R2009-2

ORDER REVIEWING POSTAL SERVICE
MARKET DOMINANT PRICE ADJUSTMENTS

Washington, DC 20268-0001

March 16, 2009

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I. INTRODUCTION AND OVERVIEW

On February 10, 2009, the Postal Service submitted to the Commission its plan to change rates for all its market dominant products. This is the second time the Commission has reviewed such adjustments under the regulatory authority established by the Postal Accountability and Enhancement Act of 2006 (PAEA). For the reasons described below, the Commission authorizes all proposed rate adjustments except the new Confirm annual fees for mailing agents to take effect.

A primary focus of the PAEA was to alter the rate-setting process for the Postal Service. Previously, the Postal Service was entitled to rates that provided sufficient revenues to cover projected costs in a future test year. The PAEA replaced this model with a new process premised in historical, rather than projected, costs. It establishes a price cap ceiling on increases for market dominant classes (that provide roughly 90 percent of Postal Service revenues) and a floor under rates for the remaining (competitive) products.[1]

Formerly, Postal Service rate changes were based on the results of extensive evidentiary presentations tested in quasi-judicial proceedings that generally took 10 months to complete.[2] The PAEA requires that the Postal Service provide at least 45 days' notice before changing market dominant rates, and establishes a system for after-the-fact review of how the Postal Service is exercising its authority. Three types of regulatory oversight are pertinent.

First, the Commission is to provide an annual determination of compliance evaluating whether rates and service in the previous year met statutory standards.

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[1] The price cap is based on inflation during the previous year. The rate floor reflects costs during the previous year.

[2] Under the old model, any losses incurred awaiting final action on proposed rate increases would be recovered in subsequent rate cases. The new focus on regular, predictable, capped rate increases prevents catch-ups.

39 U.S.C. § 3653. Where appropriate, the Commission may order remedial action. Second, the Commission is to submit an annual report to the President and Congress as to whether the objectives of the PAEA are being met. 39 U.S.C. § 3651. Third, any interested person may file a complaint with the Commission that certain requirements of law are not being met, and the Commission may order remedial action. 39 U.S.C. § 3662.

The PAEA directed the Commission to establish a new ratemaking system. Following receipt of extensive public comment, the Commission promulgated regulations implementing the new rate adjustment process. *See* 39 U.S.C. §§ 3622(a), 3633(a), and PRC Order No. 43, issued October 29, 2007.[3] Commission rule 3010.7 requires the Postal Service to adopt a schedule for regular and predictable rate changes. The Postal Service has adopted a schedule of annual rate changes to be implemented in May, which is as soon as practicable after its fiscal year costs are developed. The public is given 20 days to comment after the Postal Service submits planned rate adjustments, and the Commission is to issue its decision 14 days later. *See* Commission rules 3010.13(a) and (c) respectively.[4]

Docket No. R2009-2 reviews rate changes filed by the Postal Service in February 2009, reflecting fiscal year 2008 costs as reported December 29, 2008, for implementation in May 2009. Following the schedule established by rules 3010.13(a) and (c), the Commission allowed 20 days for public comment and is issuing this decision within 14 days of receiving comments to allow the Postal Service to make necessary changes and implement new rates (with 45 days' notice) on May 11, 2009 as scheduled.

[3] Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007 (Order No. 43).

[4] The first Postal Service rate change filing was made on February 11, 2008 for implementation on May 12, 2008. The Commission allowed 20 days for public comment, issued a decision two weeks later identifying one problematic rate, and the Postal Service was able to adjust that rate, provide 45 days' notice, and implement as planned.

The Commission has reviewed the proposed rates to examine adherence to the requirements of Title 39. It finds that the proposed rates do not violate the rate cap in 39 U.S.C. § 3622(d); adhere to the extent practical to the formulae in 39 U.S.C. § 3626; and appear consistent with, or justified by an exception to, the workshare discount limitations in 39 U.S.C. § 3622(e).

Table I-1

Percentage Increase by Class and Unused Rate Authority

Class	Rate Changes %	Unused Rate Authority %
First-Class Mail	3.770	0.044
Standard Mail	3.781	0.081
Periodicals	3.961	0.015
Package Services	3.800	0.025
Special Services	3.825	0.027

Sources: Adapted from Postal Service Notice at 3-4, Response to Chairman's Information Request No. 2 at 6 (First-Class Mail), Response to Information Request No. 4 at 28 (Periodicals), and Response to Information Request No. 3 (Questions 4, 6 and 8) at 5, 8 and 14 (Special Services).

Commission findings in such circumstances may prove to be preliminary. Rule 3010.13(j) provides that Commission findings that a proposed rate adjustment is not inconsistent with 39 U.S.C. § 3622 are "provisional and subject to subsequent review."

The system for changing market dominant rates established in Order No. 43 allows limited periods for public comment and Commission evaluation. It replaces a model criticized as time consuming and expensive under which the Commission would attempt to fully explore and resolve factual disputes related to costs and operations and thoroughly evaluate legal arguments on statutory interpretation prior to allowing rate increases to take effect.

The limitations on Commission findings come into sharp relief in this case, as commenters raise complex issues of fact and law germane to the numerous rate regulation objectives and factors identified in the PAEA. Contested factual and legal issues of this nature generally can not be resolved fairly in such a short proceeding. In most circumstances, a reasonable hearing of contentions that rates within a class are “unreasonably burdensome” or “unduly discriminatory” as between types of mail or mail users, or “not justified by operational efficiency” will require more than two weeks of examination and analysis.[5]

The PAEA provides the Commission with new authority to impose appropriate remedies should it subsequently find rates not in conformance with applicable law or regulations. It does not contemplate continuing the past practice of extensive evidentiary proceedings before rate changes take effect.

The Commission, in establishing an expedited procedural schedule for reviewing rate changes in Order No. 43, understood that not all issues subject to litigation in 10-month cost-of-service rate cases could be resolved in a 45-day review. This new approach recognized that deferring litigation was a necessary and acceptable step for implementing a cap on rate increases that is expected to impose a new level of financial discipline on the Postal Service.

These same considerations apply to challenges that the Postal Service fails to apply accepted methodologies in designing rates. The Commission gave clear notice in its first annual compliance determination and in proposed annual reporting rules that the Postal Service should request advance Commission approval prior to changing

[5] Fairness and due process entails providing persons affected by a decision with a reasonable opportunity to offer contrary evidentiary presentations and legal arguments.

accepted analytical methods.[6] It pointed out that more thorough analysis and careful evaluations would result by allowing public comment and Commission consideration free from the financial pressures of rate adjustment requests or the deadlines for annual compliance determinations.

The Postal Service did submit requests in advance for some of the new costing methods supporting its current rate proposals; however, it also relies on new, legal definitional arguments to justify its use of workshare discount design methods that vary from past accepted practice. A number of commenters are sharply critical of the Postal Service for proposing rates that result from unilateral adoption of these new practices.

It has been suggested that the Commission should reject rates not justified by application of traditional workshare discount design practice. *See* Supplemental Comments of the Newspaper Association of America on Notice of Market-Dominant Price Adjustment, March 6, 2009 (NAA Supplemental Comments). The Postal Service contends its discount proposals are consistent with the law, and fully within the ambit of the pricing flexibility contemplated by the PAEA. *See* Response of the United States Postal Service to Chairman's Information Request No. 1, February 20, 2009 (Response to CHIR No. 1). The majority of commenters addressing this issue suggest that, in light of the severe financial circumstances currently facing the Postal Service and the turmoil that could result from a blanket rejection,[7] the Commission should allow rates to take effect as proposed, but immediately institute a rulemaking docket to properly evaluate these new rate design practices.

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[6] *See* Annual Compliance Determination FY 2007, March 27, 2008, at 10 (FY 2007 ACD); Docket No. RM2008-4, Notice of Proposed Rulemaking Prescribing Form and Content of Periodic Reports, August 22, 2008, at 26.

[7] As new workshare discount design practices are applied in both First-Class and Standard Mail, rejection could result in altering proposed rates for as much as 85 percent of all mail, and be extremely disruptive to mailers trying to adjust their practices by the May implementation date.

After thoughtful consideration, the Commission approves the proposed workshare discount rates and concurrently establishes a rulemaking to consider workshare rate design methodologies. More thorough reasoned evaluations of these issues will result when the Postal Service and interested parties have the opportunity to present their views in a complete and cohesive fashion, and the Commission has the opportunity to consider them apart from the pressures of a pending rate adjustment or compliance determination. If, at the conclusion of this rulemaking it appears that some rates are not in compliance with the law, the Commission will take appropriate action.

II. PROCEDURAL HISTORY

Background. On February 10, 2009, the United States Postal Service filed a Notice of Market-Dominant Price Adjustment with the Commission. [8] The Notice was submitted in conformance with 39 U.S.C. § 3622(d)(1)(C) of the Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3218 (2006) and Commission rules in 39 CFR part 3010. It announced the Postal Service's intention to adjust prices on May 11, 2009 for essentially all market dominant products by amounts which are, on average, within a 3.8 percent statutory price cap for First-Class Mail, Standard Mail, and Package Services. The planned adjustments are within 3.8 percent plus unused rate adjustment authority for Periodicals and Special Services.

There are two exceptions to the general implementation date. One is the full-service Intelligent Mail option, which the Postal Service plans to introduce on November 29, 2009. The other is Personalized Stamped Envelopes options, for which the Postal Service plans to establish an effective date by separate notice.

The Notice included three appendices presenting new prices and fees, worksharing discounts and benchmarks; mail classification changes; and price cap calculations.

Initial Commission action. The Commission, in a notice and order issued February 12, 2009, provided public notice of the Postal Service's filing; established Docket No. R2009-2 to consider the planned price adjustments; appointed public representatives; and set a 20-day period, ending March 2, 2009, for submission of public comments. It identified this as the second case involving an adjustment of market dominant prices under the ratemaking approach established in the PAEA, and is the first case in which unused rate adjustment authority is available for use in pricing.

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[8] United States Postal Service Notice of Market-Dominant Price Adjustment, February 10, 2009 (Notice).

Information requests. The Chairman issued six information requests during the course of the case seeking clarification or further explanation of certain aspects of the Postal Service's filing. Responses to some of the information requests result in revisions to the Postal Service's initial filing. These revisions did not cause planned adjustments to exceed annual limits on increases for any class of mail, but altered the annual percentage increases for First-Class Mail, Periodicals, and Special Services by a small amount.

Comments. The Commission received 30 formal comments categorized as responses to Order No. 180. Additional informal comments filed with the Commission's Office of Public Affairs and Government Relations appear in the Public Commenter File associated with this docket.

Two submissions, identified as supplemental comments, were filed on March 6, 2009. One addresses a Standard Mail worksharing discount issue; the other addresses a First-Class Mail worksharing benchmark issue. *See* NAA Supplemental Comments, and Statement of the United States Postal Service in Concurrence with Party Comments on the Notice of Price Adjustments, March 6, 2009.[9] An additional statement was filed March 9, 2009.[10]

[9] The Commission hereby accepts the comments filed beyond the March 2, 2009 deadline; however, the expedited nature of the Commission's review of planned adjustments, which is mandated by statute, limits the Commission's ability to consider submissions filed past the 20-day comment deadline. It therefore encourages all participants to adhere to the established schedule in the interests of a fair and orderly process and timely issuance of the required Commission order.

[10] Statement of Concurrence of the Greeting Card Association, March 9, 2009. The Greeting Card Association also filed on March 9, 2009 Motion of the Greeting Card Association for Leave to File Statement of Concurrence. The motion is granted.

III. COMPLIANCE WITH PAEA PRICING LIMITS

A. Background

General rule; exceptions. The PAEA designates a widely-used inflation-based consumer price index (referred to as CPI-U) as a key component for determining annual adjustments for the five market dominant classes of mail. The general rule, in brief, is that average price adjustments for each class of market dominant mail may not exceed the change in CPI-U over the most recent available 12-month period.

Notwithstanding the general rule, the PAEA allows price adjustments to exceed the change in CPI-U in two situations. One is when extraordinary or exceptional circumstances are found to exist; the other is when unused ("banked") price adjustment authority is available and the Postal Service elects to use it. *See generally* 39 U.S.C. § 3622(d)(1)(E) and 39 U.S.C. § 3622(d)(2)(C). Thus, the possibility exists that the Postal Service's total, or overall, pricing authority for each class in a given year may exceed the otherwise applicable inflation-based annual limitation. The PAEA does not establish a percentage limit for adjustments based on extraordinary or exceptional circumstances, but provides that price adjustments drawing on unused rate adjustment authority may exceed the change in CPI-U by the amount of available unused authority for any class, subject to a limit (per class) of 2 percentage points over the applicable cap.

B. Postal Service Representations

CPI-U authority. The Postal Service represents, in conformance with Commission rule 3010.14(b)(1), that it has inflation-based price adjustment authority of 3.8 percent based on the most recently available data from the Bureau of Labor Statistics. It says this percentage is based on a 12-month moving average of the Consumer Price Index—All Urban Consumers, U.S. All Items (the “CUUR0000SA0” series), and conforms with the figure posted on the Commission’s website. Notice at 3. Supporting calculations appear in *id*., Appendix C.

Unused price adjustment authority. The Postal Service also identifies, in conformance with Commission rule 3010.14(b)(2), the unused pricing adjustment authority available in this case, by class, from Docket No. R2008-1. *Id*. Based on the availability of this unused pricing authority, it asserts that it is authorized to raise prices for each class by the following percentages:

Table III-1

Price Adjustment Authority by Mail Class

Class	Price Adjustment Authority (%)
First-Class Mail	3.814
Standard Mail	3.862
Periodicals	3.976
Package Services	3.825
Special Services	3.852

Source: Notice at 4.

New prices. The Postal Service notes that the cap compliance calculation employs a Commission-defined method to construct a weighted average price change for each market dominant class. It notes that the resulting price change for each of the five classes, on average, must be less than or equal to the available price authority. *Id.* at 4. It presents new prices in Appendix A; provides accompanying workpapers demonstrating how these prices comply with the cap; and identifies resulting unused price adjustment authority by class. *See id*. at 6 and Appendix A. Class-specific workpapers provide an overview of the contents, a discussion of any necessary adjustments to FY 2008 billing determinants, and an explanation of revenue calculations. *Id*. at 5.

The Postal Service states that the planned adjustments for each class of mail are within its available overall price adjustment authority, *i.e.*, the change in CPI-U plus unused pricing authority from Docket No. R2008-1. It further notes that its pricing decisions in this case generate additional unused price adjustment authority in this case for First-Class Mail and Standard Mail. *Id*.

C. Commission Analysis

PAEA pricing authority. In practice, applying the statutory limitation to a planned price adjustment and verifying the consistency of the planned adjustment with the limitation requires two calculations: one to determine the appropriate cap and another to determine the change in rates. Commission rules address both calculations.

Rules 3010.21(a) and (b) provide that the annual price cap is calculated as the ratio of two 12-month CPI-U averages that are 12 months apart, describes the three-step calculation, and expresses the process as a formula.[11] 39 CFR § 3010.21(a) and (b). Rule 3010.23(b) identifies a three-step method for calculating the percentage change in rates. 39 CFR § 3010.23(b). It provides that volumes needed for the calculation for each rate cell are to be obtained from the most recent available 12 months of Postal Service billing determinants, but allows reasonable adjustments to account for the effects of classification changes, such as the introduction, deletion, or redefinition of rate cells; however, the Postal Service must identify and explain all adjustments. 39 CFR § 3010.23(d).

Findings. The Postal Service's Notice includes, consistent with Commission rules, the results of the calculation of the price adjustments, along with supporting worksheets. The Commission has audited the worksheets filed with the Postal Service's Notice and, in some cases, reformatted them to link various inputs and independently perform the Postal Service's calculations. Errors identified during the audit process were brought to the Postal Service's attention and led to the Postal Service's acknowledgment that certain corrections would be appropriate. Revisions reflecting these corrections have been incorporated into the original worksheets and rate change percentages recalculated. These result in slight downward revisions to the percentage changes presented in the Postal Service's original filing for First-Class Mail,

[11] Commission Order No. 43 (issued in Docket No. RM2007-1) provides a detailed discussion of the calculation.

Periodicals, and Special Services. Table III-2 includes the revised percentages and revised total remaining unused pricing authority available for future adjustments for these classes of mail.

The source of the volumes used in the rate change calculations are billing determinants for FY 2008, which are part of the Annual Compliance Report filed by the Postal Service on December 29, 2008 (FY 2008 ACR). The volumes and calculations submitted by the Postal Service have been modified by errata. Changes introduced by the Commission are discussed class-by-class in subsequent sections. Library references that the Commission is filing with the issuance of this Order contain the Commission's calculations.

Commission review of the Postal Service's filing, as supplemented through responses to information requests, supports a finding that the cap has been correctly calculated at 3.8 percent. The Commission has independently verified that the price adjustments announced in the Postal Service's Notice do not exceed PAEA pricing limitations. More specifically, the planned average adjustments for First-Class Mail, Standard Mail, and Package Services are at or below the statutory price cap of 3.8 percent. The planned average adjustments for Periodicals and Special Services exceed the index-based cap, as they reflect the Postal Service's decision to draw on most of the unused pricing authority available for these classes, but they do not exceed available pricing authority. Percentage changes for products within classes are addressed in later sections addressing each class of mail.

The Commission notes that the Postal Service's planned adjustments in this case create small amounts of unused rate authority. This authority may be used in future rate adjustments, subject to PAEA time limits.

Summary. The following table presents the Commission's consolidation of final pricing data associated with the May 11, 2009 planned adjustments. It shows (in Column B) that the index-based price cap is identical for all classes, but that unused pricing authority from Docket No. R2008-1 results in overall pricing authority that differs by class due to the carryover of unused pricing authority from Docket No. R2008-1 (Column D). The table also shows that planned adjustments for two classes (Periodicals and Special Services) exceed the inflation-based cap, but remain within overall pricing adjustment authority (Column E). Finally, it shows that there is unused pricing authority (of varying and relative small amounts) associated with each class for possible use in future adjustments (Column F).

Table III-2

Summary of Docket No. R2009-2 Pricing Information[1]

Column A	Column B	Column C	Column D	Column E	Column F
Class	Docket No. R2009-2 Statutory Price Cap (%)	Unused Authority from (R2008-1) (%)	Docket No. R2009-2 Total Available Price Adjustment Authority (%)	Planned Price Adjustments (%)	Total Unused Pricing Authority (available for future price adjustments) (%)
First-Class Mail	3.8	0.014	3.814	3.770	0.044
Standard Mail	3.8	0.062	3.862	3.781	0.081
Periodicals	3.8	0.176	3.976	3.961	0.015
Package Services	3.8	0.025	3.825	3.800	0.025
Special Services	3.8	0.052	3.852	3.825	0.027

[1] As originally filed, the Postal Service’s planned price adjustment for First-Class Mail was 3.771 percent, 3.966 percent for Periodicals, and 3.837 percent for Special Services. Notice at 5.

Sources: See Table I-1 *Sources*.

Note on future use of unused pricing authority. The PAEA allows the Postal Service to use unused pricing authority in any of the 5 years following the year in which such authority was generated, subject to several conditions. One is that the Postal Service shall use the unused pricing authority from the earliest year and then from each following year (approximating a "first-in, first-out approach"). 39 U.S.C. § 3622(d)(2)(C)(ii) and (iii). The following table breaks out the total unused pricing authority shown in Column F of the preceding table by year for each market dominant class of mail.

Table III-3

Schedule of Unused Pricing Adjustment Authority

Column A	Column B	Column C	Column D	Column E
Class	Unused Authority Generated in R2008-1 (%)	R2008-1 Unused Authority Applied to R2009-2 Adjustments (%)	Additional Unused Authority Generated in R2009-2 (%)	Remaining Unused Pricing Authority Available for Future Price Adjustments (%)
First-Class Mail	0.014	0.000	0.030	0.044
Standard Mail	0.062	0.000	0.019	0.081
Periodicals	0.176	0.161	0.000	0.015
Package Services	0.025	0.000	0.000	0.025
Special Services	0.052	0.025	0.000	0.027

Column B minus Column C plus Column D equals Column E.

Sources: See Table I-1 *Sources*.

Based on the year of generation of the unused pricing authority shown in Column E, the Postal Service's ability to draw on unused authority generated in Docket No. R2008-1 extends through 2013. Similarly, the ability to draw on unused authority generated in Docket No. R2009-1 (for First-Class Mail and Standard Mail) extends through 2014.

IV. CLASS-SPECIFIC ISSUES

A. First-Class Mail

Six products are 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 3.770 percent. Notice at 12; and Response to Chairman's Information Request No. 2, February 24, 2009, Question 2(f) (Response to CHIR No. 2). It intends to bank the remaining 0.044 percent of unused pricing authority (remaining 0.014 percent from Docket No. R2008-1, plus 0.030 percent from this docket). Notice at 6; and Response to CHIR No. 2, Question 2(f). The Postal Service reports the percentage price changes for individual products within First-Class Mail as follows:

Table IV-1

First-Class Mail Product	Rate Change (%)
Single-Piece Letters/Postcards	4.616
Presorted Letters/Postcards	3.080
Flats	3.882
Parcels	2.567
Outbound Single-Piece First-Class Mail International and Inbound Single-Piece First-Class Mail International (combined)	4.136

Source: Notice at 12.

The Postal Service asserts that the decision to increase the price of its flagship product (the price of a one-ounce, single-piece First-Class Mail letter) from 42 to 44 cents (an increase of 2 cents) is a major driver in determining most other prices within First-Class Mail. *Id.* It notes that the integer rounding constraint applied to the first ounce of single-piece letters results in some deviation from the average increase implied by the cap. However, by holding the additional ounce price and the non-machinable surcharge at current levels, the Postal Service contends that the 2-cent increase on the first-ounce price for letters is somewhat tempered.

The commenters addressing First-Class Mail and compliance with the rate cap, Pitney Bowes, the Public Representative, and Stamps.com, state that the Postal Service has complied with the rate cap requirements.[12] The other commenters addressing First-Class Mail offer no opinion on the Postal Service's rate cap compliance.[13]

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 3.770 percent. The remaining 0.044 percent of unused rate authority shall be banked as provided for in 39 U.S.C § 3622(d)(2)(C).

1. First-Class Mail Worksharing

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. By law, workshare discounts for First-Class Mail may not exceed 100 percent of the avoidable costs unless:

[12] Comments of Pitney Bowes Inc. at 2-3 (Pitney Bowes Comments); Public Representative Comments in Response to Notice of Price Adjustment for Market Dominant Price Adjustment at 2 (Public Representative Comments); and Comments at 1 (Stamps.com Comments); all filed on March 2, 2009.

[13] Initial Comments of American Postal Workers Union, AFL-CIO (APWU Comments), Comments of the Bank of America Corporation (BOA Comments); Comments of the Greeting Card Association (GCA Comments); and Comments of National Postal Policy Council (NPPC Comments); all filed on March 2, 2009.

- 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;
- The amount of the discount above costs avoided is necessary to mitigate rate shock and will be phased out over time;
- Reduction or elimination of the discount would impede the efficient operation of the Postal Service.

39 U.S.C. § 3622.

In addition, rule 3010.14(b)(6) requires the Postal Service to provide "[s]ubstantial justification for all proposed workshare discounts that exceed avoided costs." Each justification must reference the appropriate statutory exception.

Postal Service's workshare methodology change. The Postal Service, in the analysis presented in its Notice, chose not to use the established methodology for workshare discounts. Instead, the Postal Service opted to delink single-piece First-Class Mail from presort First-Class Mail, effectively abandoning established methodology and the bulk metered mail benchmark.[14] The predominant effect of this change is to no longer consider Automation Mixed AADC letters a workshare discount relative to the bulk metered mail benchmark.

In the Postal Service's justification for this change, it notes that single-piece and presort have been defined as separate products. It contends that the workshare provisions of 39 U.S.C. § 3622(e) do not apply between products. Thus, it argues, the

[14] The issue of delinking recently was litigated under the Postal Reorganization Act (PRA) in Docket No. R2006-1. *See* PRC Op. R2006-1 at ¶¶ 5079-90. The Commission did not adopt the Postal Service's proposal to delink single-piece from workshare rates within First-Class Mail. In Docket No. R2007-1, the Commission used a bulk metered mail benchmark and a linked methodology to analyze the First-Class Mail rate adjustments. Again, in the FY 2007 United States Postal Service Annual Compliance Report, December 28, 2007 (FY 2007 ACR) the Commission rejected the Postal Service's attempt to deviate from the bulk metered mail benchmark. *See* FY 2007 ACR at 63.

workshare link that previously existed between single-piece First-Class Mail and presort First-Class Mail legally no longer exists under the PAEA. Response to CHIR No. 1 at 2-3.

Alternatively, the Postal Service argues that if the workshare requirements of 39 U.S.C. § 3622(e) were applied in this instance, the exception found in 39 U.S.C. § 3622(e)(2)(D) (reduction or elimination of the discount would impede the efficient operation of the Postal Service) would be applicable because "hitting the 100 percent target would most likely require large swings in other, non-workshare related, prices." *Id.*

The Postal Service concurs with past Commission statements that the merits of changes to an established analytical methodology should be resolved outside of a price adjustment docket. The Postal Service contends that applying the standards of 39 U.S.C. § 3622(e) in this docket between single-piece and presort in a way that requires changes to the prices set forth in the Notice is not appropriate. *See* Response to CHIR No. 1.

Comments addressing the Postal Service's workshare methodology change. APWU contends that the "Postal Service filing in this case departs significantly from the workshare discount requirements of 39 U.S.C. § 3622(e)." APWU Comments at 1. It concludes that "[o]n the record in this case, the Commission must find that the Postal Service has proposed rates that violate section 3622(e)." *Id.* at 6.

In delinking First-Class Mail rates, APWU notes that the Postal Service is taking an action that the Commission has "repeatedly declined to approve." *Id.* at 2. It contends that there is no justification in the record for this change, and urges the Commission to uphold and enforce its previous decisions concerning the bulk metered mail benchmark. *Id.* at 2-3. APWU then suggests that the Commission entertain evidence and comments on whether the proposed workshare discounts could be temporarily justified on the grounds of rate shock, and incrementally brought back into compliance in future rate proceedings. *Id.* at 6.

GCA believes that the Commission's reasons for prescribing the bulk metered mail benchmark remain sound and should be accepted as the calculation method employed by the Postal Service. GCA Comments at 2. It contends that classifying single-piece and presort First-Class Mail as separate products does not entail abandonment of the bulk metered mail benchmark.[15] *Id.* GCA supports the initiation of a separate docket for further consideration of the benchmark issue.[16]

The Public Representative comments that the Commission consistently has treated presort and single-piece First-Class Mail as interrelated and has not ruled otherwise. The Public Representative contends that the Postal Service's justification for its approach is not new and is without foundation. The Public Representative urges the Commission to (1) reject the Postal Service's attempt to introduce its workshare methodology in this docket, and (2) reiterate the Commission's position on the use of the bulk metered mail benchmark. The Public Representative suggests that the Postal Service be directed to file a request to address this issue separately, contending that "[t]o do so otherwise is to deny mailers an opportunity to comment on the requested change." Public Representative Comments at 9-12.

NPPC concurs with the Postal Service's argument that presort and single-piece First-Class Mail are separate products, and that the rate differentials between the two products are not limited by 39 U.S.C. § 3622(e). NPPC Comments at 1-3. It further argues that cost and demand differences between the two products indicate that the

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[15] *See also* Docket No. ACR2008, Reply Comments of Newspaper Association of America, February 13, 2009, incorporated by reference in Docket No. R2009-2, Comments of the Newspaper Association of America on Notice of Market-Dominant Price Adjustment, March 2, 2009, at 22, n.23 (NAA Comments). NAA's comments concerning Standard Mail workshare discounts are informative and supportive of arguments opposing the Postal Service's change in First-Class Mail workshare methodology.

[16] Statement of Concurrence of the Greeting Card Association, March 9, 2009.

rate differentials proposed by the Postal Service actually are too small. NPPC does not ask the Commission to adjust the rate imbalance it identifies in this docket, but urges the Commission to approve the first-ounce single-piece increase and the smaller increases for presort letters and cards as proposed by the Postal Service.

Bank of America and Pitney Bowes agree with the Commission and the Postal Service that the issues of delinking and the treatment of workshare-related cost avoidances between separate products should be considered in a separate proceeding where public comment could be fully evaluated. BOA Comments at 5; Pitney Bowes Comments at 8-9. Because there is no opportunity to consider the merits of these issues in this docket, BOA and Pitney Bowes contend that the Commission should not disturb the proposed price adjustments. BOA Comments at 2; and Pitney Bowes Comments at 9. BOA further argues the merits of retaining more profitable presort letters and cards in light of the economic challenges facing the Postal Service. BOA Comments at 2-3.

Commission analysis of proposed methodological change. The predominant First-Class Mail issue in this docket is the methodology used to evaluate compliance with the workshare requirements of 39 U.S.C. § 3622(e). The Postal Service did not use the established analytical methodology. In the previous rate adjustment docket, even though the Postal Service did not use the established methodology, when the established methodology was employed, the prices were in compliance with the requirements of 39 U.S.C. § 3622(e). In the instant docket, however, application of the accepted methodology could result in the reallocation of hundreds of millions of dollars of postage from one group of mailers to another.

The Postal Service viewed its changes as being within the pricing flexibility newly provided under the PAEA. However, the Commission finds introduction of new methodologies without prior opportunity for comment and review to be inappropriately exclusionary and potentially disruptive. (Deviating from accepted methodology risks that the rates may be found unlawful.) Under this scenario, the Postal Service jeopardizes the predictable rate-setting process established only 15 months ago, and risks causing disruption in the marketplace by having to introduce yet another set of prices at a later date.

The selection of workshare methodologies goes beyond pricing prerogatives. The PAEA established guidelines because workshare discounts directly influence the allocation of resources of both the Postal Service and mailers. A consideration when establishing methodologies is to allocate these resources in the most economically efficient manner. In this docket, the Postal Service deviates from the established workshare methodologies in both First-Class Mail and Standard Mail without providing an analysis of the economic impact of its decisions.

The Postal Service bases its decision to introduce a new workshare methodology on its definition of the word "product" and its statutory interpretation of the workshare requirements. Other than in the limited timeframe of this rate adjustment, interested participants have not had an opportunity to thoroughly analyze or comment on the Postal Service's unilateral decision. Likewise, the Commission has not had an opportunity to appropriately consider the views of interested parties or review the Postal Service's arguments in light of the PAEA.

A rulemaking proceeding will be initiated to consider the legal and technical merits of the Postal Service's method for calculating First-Class Mail rates.[17] The Commission previously has stated that it is appropriate to consider these issues outside of the limited time frame of a rate adjustment. Thus, these issues will be considered in a separate proceeding. Most participants commenting on these issues and the Postal Service appear to concur with this approach.

[17] In addition, the rulemaking will afford interested persons, including the Postal Service, an opportunity to present alternative workshare discount rate design and cost calculation methodologies.

The Commission recognizes the rate-setting flexibility accorded to the Postal Service under the PAEA and Order No. 43. However, in this docket, the Postal Service chose not to obtain advance review of its new First-Class workshare discount design methodologies. As explained in Chapter I, the Commission finds this decision is inconsistent with the system of ratemaking contemplated by the PAEA and implemented in Order No. 43. Further discussion of the ramifications of the Postal Service's actions appear in the separate opinions authored by individual Commissioners. The Commission directs that the Postal Service seek advance review of workshare discount design methodologies before incorporating them in future rate cases.

The Postal Service contends that if established workshare methodologies were applied in this case, its First-Class automation discounts are justified by 39 U.S.C. § 3622(e)(2)(D), the exception that authorizes discounts if reductions in that level of discount would impede the efficient operation of the Postal Service. The Postal Service has provided relatively little support for this contention; however, it stands on this record. The Commission finds, for purposes of this decision, that these rates are not inconsistent with the requirements of § 3622.

It is worth noting that this decision, approving rates and establishing a separate rulemaking proceeding, is the most responsible way to respond to the Postal Service's decision to forego advance review of its new workshare discount design methodologies. The Postal Service asserts that the potential solution of rejecting rates would be extraordinarily disruptive to the entire mailing community. Response to CHIR No. 1, Question 1. Whenever the Postal Service develops potential rate changes of that magnitude, affecting almost all mailers and a major portion of Postal Service revenues, public notice and the opportunity for comment would be in order.[18] Under this scenario, rate changes would likely have to be deferred beyond the May 11, 2009 planned

[18] *See* rule 3010.13(b). If First-Class automation rates are eventually found to violate 39 U.S.C. § 3622, the Postal Service will be given an opportunity to design lawful rates, which also will be subject to notice and comments.

implementation date. In the current economic situation, when the Postal Service has indicated it expects to lose billions of dollars this fiscal year, delay may have serious repercussions.

Workshare passthroughs that vary from 100 percent of avoided costs. Table IV-2 summarizes the workshare discounts that vary from passing through 100 percent of avoided costs as identified and discussed by the Postal Service.

Table IV-2

Type of Worksharing	Benchmark	Passthrough %
Automation Letters		
Automation Mixed AADC Letters	Bulk Metered Mail Letters	128.9[1]
Automation 5-Digit Letters	Automation 3-Digit Letters	91.7
Automation Flats		
Automation ADC Flats	Automation Mixed ADC Flats	145.2[2]
Presorted/Business Parcels		
Presort 3-Digit Parcels	Presort ADC Parcels	17.9
Presort 5-Digit Parcels	Presort 3-Digit Parcels	59.7
Non-automation Letters and Flats		
Non-automation Presort Letters	Bulk Metered Mail Letters	43.3
Non-automation Presort Letters	Automation Mixed AADC Letters	188.2[3]
Automation Cards		
Automation AADC Cards	Automation Mixed AADC Cards	83.3
Non-automation Cards		
Non-automation Presort Cards	Automation Mixed AADC Cards	187.5[3]

Source: Notice, Appendix B; and Attachment to Response to CHIR No. 2, Question 6.

[1] As discussed above, the Postal Service contends that the requirements of 39 U.S.C. § 3622(e) do not apply.

[2] The Postal Service notes the methodological changes described in Docket No. RM2008-2, Proposal 8, and asserts that using a 100 percent passthrough would lead to significantly higher prices for automation flats. It cites the need to mitigate the price increase and states that future price adjustments will be more reflective of new cost information. 39 U.S.C. § 3622(e)(2)(B).

[3] The Commission notes that the cost avoidances for non-automation presort letters and non-automation presort cards are calculated by the Postal Service using an unapproved methodology. Using the established methodology, the associated discounts do not exceed the avoided costs.

Comments addressing workshare issues. Pitney Bowes notes that the 2.2-cent rate differential between 3-digit and 5-digit automation letters produces a passthrough of only 91.7 percent. It asserts that the Postal Service fails to justify this “substantial departure” from efficient rate design. Pitney Bowes requests that the Postal Service be directed to either correct or justify the proposed 5-digit automation letters workshare discount. Pitney Bowes Comments at 3-5.

The Public Representative comments on three workshare discounts that exceed 100 percent passthroughs: automation ADC flats (145.2 percent), non-automation presort letters (188.2 percent), and Mixed AADC non-automation presort cards (187.5 percent). The Public Representative notes the Postal Service’s rationale of preserving or enticing volume, but contends that the Postal Service fails to demonstrate what, if any, volume increases will be achieved or migration of volume prevented by its actions. Thus, the Public Representative concludes that the Postal Service does not provide sufficient justification to allow discounts in excess of 100 percent of costs avoided. Public Representative Comments at 24-25.

2. Classification Changes

The Postal Service plans First-Class Mail classification changes which provide a 0.3-cent discount for mail meeting the requirements of the full-service Intelligence Mail barcodes (IMb) option. Notice at 14. The discount will be provided within the presorted Letters/Postcards (automation letters and postcards only), and Flats (automation flats only) products.

The Postal Service contends that the full-service IMb option will not result in the Postal Service avoiding any additional worksharing-related costs. Thus, it concludes that the full-service IMb option is not worksharing. It argues that the price is “a policy-based differential to promote adoption of full service so that the promise of Intelligent Mail can be more fully and expeditiously realized.” Response to CHIR No. 2, Question

2 (d and e). The Postal Service asserts that it does not expect the incentive to become permanent, and envisions that eventually it will no longer be relevant or meaningful and thus will be phased out. Response to Chairman's Information Request No. 3, March 2, 2009, at 15-26.

Including an Intelligent Mail discount also affects the calculation of the rate cap. To account for this effect, the Postal Service asserts it has made "reasonable adjustments to the billing determinants to account for the effects of classification changes such as the introduction, deletion, or redefinition of rate cells." *See* rule 3020.23(d). The Postal Service assumes full-service IMb option adoption rates of 54 percent for automation letters, 40 percent for automation flats, and 54 percent for automation cards starting November 29, 2009, the first day this discount will be available. The Postal Service bases these estimates on its managers' "knowledge of mailers and their readiness to adapt to the requirements for the full-service option." Response to CHIR No. 2, Question 2 (b and c).

NPPC argues that the proposed discount may not stimulate additional use of the service, noting that to benefit from the full-service IMb option, a mailer must make large capital investments. NPPC Comments at 4-7. It also comments that costly unfunded mandates, including complying with Intelligent Mail requirements, distort the CPI-based index.

Pitney Bowes contends that the Intelligent Mail rate incentive is a rate design element and not a workshare discount subject to 39 U.S.C. § 3622(e). Pitney Bowes Comments at 5-8. It argues that by definition the incentive is not being provided for presorting, handling, or transportation. Furthermore, it is not a discount for barcoding because both POSTNET/Basic IMb and full-service IMb pieces must be pre-barcoded to qualify as automation letters. *Id.* at 6. Alternatively, if the rate incentive were considered a discount, Pitney Bowes argues that the discount could be justified under

39 U.S.C. § 3622(e)(2)(A) as a new postal product or workshare discount, or as leading to greater efficiencies and improved service performance. *Id.* at 7-8.

Whether as urged by the Postal Service on policy grounds or on the alternate grounds suggested by Pitney Bowes, the Commission finds the proposed discounts justified. The substance of the proposed classification change will be incorporated into the draft Mail Classification Schedule.

The Postal Service plans to split the Outbound Single-Piece First-Class Mail International Postcard category for “Canada and Mexico” into distinct rate categories for “Canada” and for “Mexico.” Notice at 46. No comments address this issue. The Commission finds the classification modification reasonable and shall incorporate the substance of this change 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 discounts be made available to small businesses and consumers to allow them to participate in worksharing. For example, it suggests a new discount for single-piece First-Class Mail mailers who use Coding Accuracy Support System (CASS)-certified software to meet the basic IMb requirements and provide a cleansed destination address. *Id.* at 3.

GCA expresses interest in the relationship of rate increases between single-piece First-Class Mail and presort mail. GCA Comments at 1 and 2. Although it draws no conclusions based on two years’ experience, it believes that a consistent tilt in favor of presort mail may signal an infringement of the statutory requirement of a "just and reasonable schedule of rates and classifications." *Id.* at 2. GCA urges the Commission to also examine future rate changes from this perspective. *Id.*

NPPC asks the Commission to direct the Postal Service to establish a more reasonable rate for presort First-Class Mail that does not meet Move Update address hygiene requirements. NPPC Comments at 7-10. Currently, non-compliant mail is charged the single-piece rate. NPPC contends that this rate is disproportionate to the costs imposed on the Postal Service and therefore unjust and unreasonable within the meaning of U.S.C. §§ 404(b), 3622(b)(8), and 3622(c)(5). *Id*. at 7.

The discount suggestions identified above are beyond the scope of this price adjustment proceeding. The Postal Service may consider the views of its customers when developing new products and pricing discounts.

4. International Mail

Within the First-Class Mail class, the Postal Service proposes to increase prices for the First-Class Mail International (FCMI) product by 4.136 percent. For Outbound Single-Piece First-Class Mail International, the proposed price increase is 4.6 percent, which is intended to increase contribution and improve cost coverage. Notice at 14.

Prices for Inbound Single-Piece First Class Mail International are calculated to increase by 1.934 percent.[19]

In response to Chairman's Information Request No. 3, Question 1, the Postal Service filed supplemental data that when evaluated resulted in a small decrease in the percentage change in price for Outbound Single-Piece FCMI compared to the Postal

[19] Inbound Single-Piece First Class Mail International is offered by the Postal Service pursuant to its international treaty obligations as a member of the Universal Postal Union (UPU). With the exception of inbound FCMI from Canada, prices are set by the UPU. Prices are adjusted on a calendar year basis, with the most recent price change occurring January 1, 2009.

Service's original estimated increase of 4.571 percent. This revised price increase, plus correction of an error that decreased the calculated price change for Inbound Single-Piece FCMI to 1.921 percent, results in a revised increase in the percentage change in price of 4.134 percent for the First-Class Mail International product. *See* PRC-R2009-2-NP-LR1, Cap Compliance Calculations for First-Class Mail International.

A minor classification change is made in Outbound Single-Piece First-Class Mail International to divide the current "Canada and Mexico" postcard category into two distinct price categories. This change is approved.

B. Periodicals

1. Basis for Periodicals Price Adjustments

Planned adjustments. The Periodicals class, which includes publications such as magazines and newspapers, consists of two products: Outside County and Within County. Notice at 19. This division parallels the way the class was organized immediately prior to passage of the PAEA.

The Postal Service's original planned percentage increases for the Periodicals class as a whole and for each of its two component products were revised slightly downward during the pendency of this case as the result of several corrections. The corrections have no impact on prices. The revised percentage increases are 3.961 percent for the Periodicals class as a whole, 3.971 percent for Outside County and 3.730 percent for Within County. Original and revised percentages are shown in the following table.

Table IV-3

Summary of Docket No. R2009-1 Percentage Increases for Periodicals

	Original %	Revised %
Periodicals Class (as a whole)	3.966	3.961
Outside County Periodicals	3.973	3.971
Within County Periodicals	3.802	3.730

Source: Adapted from Notice at 8 and Response to CHIR No. 4 at 28.

The change in the Postal Service's planned percentage for the Periodicals class as a whole led to a slight offsetting change in the remaining total unused pricing authority generated for Periodicals, increasing it from 0.010 percent to 0.015 percent.

Relationship to CPI-U cap. The overall percentage increase for Periodicals is slightly greater than the CPI-U cap of 3.8 percent because it reflects the Postal Service's decision to draw on most of the unused ("banked") price adjustment authority generated in last year's annual adjustment for Periodicals (Docket No. R2008-1). *Id*. at 4-6, 19. Application of some or all unused pricing authority to the instant rate adjustment is authorized under 39 U.S.C § 3622(d)(2)(C)(ii). However, even with the Postal Service's use of essentially all available pricing authority for Periodicals, cost coverage for the class is approximately 84 percent.

The following table, based on the Postal Service's acceptance of certain corrections to its original filing, summarizes the basis for the Postal Service's planned overall Periodicals price increase in terms of considerations related to the statutory price cap and unused pricing authority.

Table IV-4

Summary of Docket No. R2009-2 Rate Adjustment for Periodicals Class as a Whole (based on revisions to original filing)

Component	%
R2009-2 Statutory Price Cap *(from Notice, Appendix C)*	3.800
Available Periodicals Unused Pricing Authority *(from Docket No. R2008-1)*	0.176
Overall Statutory Pricing Authority for Periodicals *(for use in R2009-2)*	3.976
R2009-2 Periodicals Adjustment (After Revisions)	3.961
Remaining Unused Pricing Authority Available for Future Use, Subject to PAEA Conditions	0.015

Source: Adapted from the Notice at 8 and Appendix C, and Response to CHIR Request No. 4 at 28.

Summary of revisions to original filing. The Commission's workpapers incorporate revisions submitted by the Postal Service to reflect corrections acknowledged after the Postal Service's Notice was filed. They also provide additional summary tables and link hard data to supporting documentation.

2. Compliance with Statutory Preferences

Background. Under the ratemaking approach used during the PRA era, some Periodicals mail was eligible for certain statutory rate preferences. The PAEA modified one of these preferences, added a new preference, and retained two preferences without change.

The modified preference requires that prices for all Within County Periodicals reflect this product's preferred status relative to prices for regular Outside County Periodicals. 39 U.S.C. § 3626(a)(3). This preference replaces the "50-percent markup rule" for Within County Periodicals under the PRA. Notice at 26, n.19 (internal citation omitted). The new statutory preference 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. 39 U.S.C. § 3626(g)(4).

One of the preferences retained without change requires that Nonprofit and Classroom Periodicals (part of Outside County) receive, as nearly as practicable, a 5 percent discount from regular Outside County postage, except for advertising pounds. *Id*. at 3624(a)(4)(A). The other requires that Science of Agriculture Periodicals (also part of Outside County) receive preferential treatment for advertising pounds. *Id*. at 3626(a)(5).

Postal Service representations. The Postal Service states that its price adjustment continues to recognize the preferential status of Within County Periodicals because prices for this product under this adjustment are well below those of regular Outside County Periodicals. Notice at 26. Moreover, the Postal Service says it implemented the new preference for Within County Periodicals by introducing, in 2008, a Limited Circulation discount for mailers with publications meeting the statutory circulation test. The discount is equivalent to the longstanding 5 percent discount available to Nonprofit and Classroom Periodicals. Thus, the Postal Service asserts that the planned adjustments continue to recognize the preferential status of Within County Periodicals. *Id*. at 27.

The Postal Service also states that the planned rate adjustments maintain the rate preference for Nonprofit and Classroom Periodicals pieces at a 5 percent discount on all components of postage except for advertising pounds and ride-along postage. 39 U.S.C. § 3626(a)(4)(A)-(B). Similarly, it claims that the adjustments continue to provide Science of Agriculture publications with advertising pound rates for destination delivery unit, destination sectional center facility, destination area distribution center, and Zones 1 and 2 that are 75 percent of the advertising pound rate for regular Periodicals. *Id*. at 26.

Commission assessment. No commenter takes issue with this aspect of the Postal Service's filing. Commission review of the planned rates indicates that the Postal Service has appropriately interpreted and implemented the statutory preferences accorded to Periodicals under the PAEA.

3. Description of Mail Classification Schedule Changes

Background and Postal Service representations. Commission rule 3010.14(b)(9) requires the Postal Service to provide Mail Classification Schedule product description changes for each product. In compliance with this rule, the Postal Service states that, for certain categories of Within County and Outside County Periodicals, it is extending eligibility for the full-service IMb option to qualifying pieces of Within County and Outside County Periodicals, along with no-fee Address Correction Service (ACS). *Id*. at 20, 45.

The Postal Service's filing includes related classification language supporting these changes.

Pursuant to the Postal Service's plan, certain Periodicals categories would be eligible for "no fee" ACS if the new IMb option is elected. Two categories in each product are eligible: automation and Carrier Route letters and flats in Within County Periodicals, and barcoded and Carrier Route letters and flats to Outside County. The discount is 0.1 cents per piece for each eligible piece that complies with full-service IMb option requirements. *Id*. at 20, Appendix A at 39-40. The Postal Service indicates that the relatively small differential is influenced by the fact that Periodicals mailers must use ACS, at 25 cents per address change, but will qualify for no-fee ACS if they elect the new full-service IMb option. Thus, it considers the planned differential a substantial incentive. It maintains that the price differential is sufficiently attractive, adds value to the mail, and increases operational efficiency. 39 U.S.C. § 3622(c)(1) and (7); *Id*.

The Postal Service estimates annual IMb adoption rates for Outside County at 63 percent for Automation Letters, Carrier Route Basic, and High Density categories; at 69 percent for Automation Flats; and at 80 percent for Saturation. It estimates a uniform adoption rate of 40 percent for all eligible Within County categories. Response to CHIR No. 2, Question 3.

Commission assessment. The Commission considers the Postal Service's adoption estimates acceptable in this situation, given that a new option is being introduced. The discount, although small in the absolute sense, is more attractive when paired with the no-fee ACS option, as this saves mailers the otherwise applicable 25-cent fee.

4. Worksharing Justifications

Background. The Within County rate structure has remained relatively unchanged for some time and retains the traditional concept of worksharing; however, the Outside County structure, which was adopted as a result of Docket No. R2006-1 (the last general rate case under the PRA), incorporates other concepts as well, such as cost differentials and surcharges. The Postal Service's Appendix B tables reflect the differences between the two structures. The Outside County table shows discounts/surcharges, cost differentials, and presort passthroughs, while the Within County table presents presorting, pre-barcoding, and dropshipping data. Other tables present bundle and container pricing. Notice at 29-45; *see also id*., Appendix B.

Section 3622(e) of Title 39 requires that the Commission ensure that worksharing discounts do not exceed avoided costs unless certain circumstances pertain. One of these is when the discount is provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational (ECSI) value. 39 U.S.C. § 3622(e)(2)(C). Commission rule 3010.14(b)(6) further requires the Postal Service to explain discounts set substantially below 100 percent of avoided costs.

Postal Service representations. The Postal Service generally asserts that it established the structure of Periodicals worksharing discounts by limiting the extent to which price increases for individual publications differ from the average, while strengthening incentives for efficient preparation by reflecting a higher percentage of costs in prices that had minimal impact on publications likely to experience above-average increases. Notice at 40-41. It also cites four considerations related to Periodicals passthroughs that exceed 100 percent: they are few in number; often apply to low volume categories such as automation letters; would result in price swings if not set above 100 percent; and are justified by 39 U.S.C. § 3622(e)(2)(C), which excludes passthroughs for ECSI classes from operation of the general "avoided costs" rule. *Id*. at 40.

Public Representative's position. The Public Representative notes that Outside County barcoded letters have three products with passthroughs in excess of 100 percent: automation ADC letters (235.3 percent), automation 3-digit letters (1000 percent), and automation 5-digit letters (333.3 percent). Public Representative Comments at 26. It observes that Periodicals mail did not cover its attributable costs in FY 2008, adding: “Yet the Postal Service believes the excessive passthroughs are acceptable even though it is in conflict with the requirement that each class of mail cover its costs.” *Id*. It notes that the Postal Service uses the ECSI rationale to justify these passthroughs, agrees that Periodicals mail has social value of the type claimed by the Postal Service, but claims that these excessive discounts, especially the largest one, are not needed. *Id*.

Commission assessment. Under the Postal Service’s plan, Within County passthroughs remain almost unchanged, so discounts are nearly unchanged. Thus, several rate categories continue to have very low passthroughs. In particular, passthroughs for 3-digit and 5-digit presorting and the pre-barcoding discount for Basic automation flats and 3-digit automation flats are all below 20 percent. At the same time, these categories have some of the highest cost avoidances in Within County, ranging from 7 to 14 cents per piece, compared to 1 to 3 cents per piece for other rate categories. Most other rate categories experience increases close to the product average of 3.73 percent.

In Outside County, most of the passthroughs for the traditional categories are now reasonably close to 100 percent, after an initial adjustment period for implementation of the new structure following Docket No. R2006-1. The automation letters category, on its face, is the notable exception. However, upon examination, two of the passthroughs (for ADC letters and 5-digit automation letters) reflect lower passthroughs compared to the existing situation. The passthrough for 3-digit automation letters (as the Public Representative observes) does increase substantially even though the cost difference narrows; however, the Postal Service asserts that it is important to note the relatively small volume of mail involved (less than .3 percent of Periodicals). It also observes that the rate design for Periodicals is very complex, and that this element, including the resulting discount, was part of an iterative process needed to balance several goals, such as staying within the cap and keeping overall postage changes within a narrow band. It characterizes this particular discount as a byproduct of that process. It also says that due to the very small volume, it does not contend that any section of 3622(e)(2), other than the ECSI exception, necessarily applies. Response to CHIR No. 3 at 4.

The Commission acknowledges that the ECSI exception generally provides the Postal Service with leeway in establishing passthroughs, and notes that the sophistication of the Outside County structure, especially relative to Within County, may make it difficult to fully align passthroughs with costs. The Commission is not convinced that the stated pricing objective of keeping overall postage changes within a narrow band is always an appropriate justification.

5. Other Matters

The Postal Service acknowledges that even with use of essentially all available pricing authority, the Periodicals class will not generate revenue sufficient to cover attributable costs, as cost coverage for the class is approximately 84 percent. In addressing this situation, it characterizes the Periodicals class as “challenged” and notes that it is the only class that did not cover its attributable costs in FY 2008. Notice at 19. And, while it asserts that it is cognizant of Periodicals’ special situation in terms of both the class’s value to the public and its failure to cover costs, it maintains that the “new prices are designed to balance the effect on individual publications, while taking advantage of the new price structure to create relationships that will improve the efficiency of the Periodicals product.” *Id*.

The Postal Service further explains that in the initial PAEA-based price change (Docket No. R2008-1), it kept increases for all price components within Periodicals as close to the cap as was feasible to minimize the possibility that any group of publications would incur major price changes. It then says the planned price package refines price relationships to encourage efficiency and containerization, while limiting the price increases for individual publications. It notes that the actual price paid by a given publication is the combination of many price elements, and asserts that it has taken care to adjust the individual price elements in a manner that limits the resulting postage increases. *Id*.

The Postal Service adds that it is using "the flexibility of the container-bundle-piece price structure" to limit the extent to which price increases for individual publications vary from the average. It says that it is "strengthening" incentives for efficient preparation by reflecting a higher percentage of costs in prices that have minimal impact on publications otherwise likely to experience above-average increases. As an example of this approach, it notes that the percentage of costs reflected in prices was increased for pallets but not for sacks. *Id*. at 40-41.

Commenters' views. The Commission received comments on the shortfall in Periodicals cost coverage from the Public Representative and from Valpak.[20] Public Representative Comments at 4, 30-31 and Valpak Comments at 19-34.

Public Representative's position. The Public Representative contends that because the Periodicals class, even after the planned price adjustment, will again fail to recover attributable costs, appropriate steps should be initiated toward alleviating this situation. Public Representative Comments at 4. It notes that the Public Representative in Docket No. R2008-1 suggested:

> If the Periodicals situation does not improve after further experience with the new rate incentives, new processes, and the installation of new equipment, together with revenue from the proposed rate increases during this fiscal year, then the Commission should consider appropriate action. The remedial steps may be taken either pursuant to a rate

[20] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on the United States Postal Service Notice of Market-Dominant Price), March 2, 2009 (Valpak Comments). The Commission also has received comments on Periodicals issues in pending Docket No. ACR2008.

> adjustment filing or an Annual Compliance Review or even pursuant to a complaint filing to bring Periodicals revenue in line with Periodicals attributable costs.

Id. at 26 (internal citation omitted).

The Public Representative further notes that in Order No. 66, the Commission accepted the Postal Service's planned rate adjustment and did not find a reason to require an amended notice or take other remedial steps.[21] *Id*. at 30, citing Order No. 66 at 28. In this case, the Public Representative says the earlier comments remain valid, and asserts that procedures to realign Periodicals rates to recover attributable costs should be addressed and a resolution initiated. *Id*.

Valpak comments. Valpak, in relatively extensive comments, advances several arguments on the issue of Periodicals cost coverage. Two of these relate to the showing, or explanation, the Postal Service should be expected to provide to the Commission. For example, Valpak asserts that in instances where a class fails to fully cover attributable costs, as with Periodicals, the Commission should require more explanation from the Postal Service than might be the case if such costs were fully covered. It maintains that the Postal Service has failed to meet the standard it advocates, and asserts that the Commission therefore should not deem the planned adjustment compliant. Valpak Comments at 19-22. A related argument is that the Postal Service must demonstrate, in less-than-full-coverage situations, that demand effects resulting from the planned price adjustment, including stronger incentives to reduce costs, will achieve, or move substantially toward, compliance with the PAEA. Valpak again maintains that the Postal Service has failed to make the requisite demonstration. *Id*. at 24-30.

Valpak further argues that consideration of the ECSI mail is a factor in allocating institutional costs, and not a reason to justify less-than-full cost coverage. *Id*.

[21] Docket No. R2008-1, Review of Postal Service Notice of Market Dominant Price Adjustment, March 17, 2008 (Order No. 66).

at 22-24. It also points, more broadly, to the possibility that failure to increase coverage in Periodicals may adversely affect other mailers, mail recipients, and the overall viability of the Postal Service. *Id*. at 31-34.

Commission assessment. The Postal Service's planned adjustment for Periodicals, viewed only as a matter of technical compliance with statutory pricing limits, can be viewed as being in compliance with PAEA annual limitations and Commission rules implementing those provisions. This is because, at 3.961 percent, the adjustment exceeds the inflation-based index of 3.8 percent, but does not exceed the larger percentage that is available as a result of unused pricing authority carried over from Docket No. R2008-1. Yet, under the planned adjustment, even at the maximum level, it is undeniable, as the Postal Service, Valpak, and the Public Representative note, that Periodicals fails to cover attributable costs by a substantial amount, and therefore also fails to make any contribution to institutional costs. This shortfall can be seen, as Valpak seems to suggest, as raising a broader and more nuanced question of statutory compliance, given that § 3622(c)(2) maintains the "attributable cost floor" provision that was a hallmark of pricing under the PRA.

The Commission appreciates commenters' views on the Periodicals' shortfall. It is seriously concerned that the Periodicals class, based on available data, has not covered attributable costs over the past year, and will not do so under the Postal Service's planned adjustments. This necessarily means that the class will not make a contribution to institutional costs. The Commission is also concerned that the Postal Service's stated pricing objective of keeping increases "around the average" may impede progress toward full cost coverage, as it fails to more fully implement the recently-adopted Periodicals rate structure.

It does not appear that broader questions of Periodicals cost coverage can be adequately addressed or settled in this proceeding, given the sweeping nature of the problem and the very short period for review. The pending ACR case appears to be a better forum for considering those issues. In addition, other matters, such as Valpak's suggestion that the Postal Service should be held to a stricter standard when explaining planned adjustments that result in a cost coverage shortfall, may need to be addressed after the conclusion of this proceeding, along with any other refinements that may be warranted based on the additional experience this case has provided with the new ratemaking approach for market dominant products.

Notwithstanding these conclusions, the Commission reiterates that it views the Periodicals cost coverage situation as a serious concern. It agrees with observations that continued shortfalls may pose serious problems for mailers, recipients of mail, and the Nation's postal system as a whole.

C. Standard Mail

1. Introduction

There are six products within Standard Mail: Letters; Flats; Parcels and Non-Flat Machinables (NFMs); High Density and Saturation Letters; High Density and Saturation Flats and Parcels; and Carrier Route. The Postal Service proposes to increase rates for Standard Mail, on average, by 3.781 percent. Notice at 5. It intends to bank the remaining 0.019 percent. The Postal Service reports the percentage price changes for individual products within Standard Mail as follows:

Table IV-5

Standard Mail Product	Rate Change (%)
Letters	3.829
Flats	2.306
Parcels and NFMs	16.425
High Density/Saturation Letters	1.248
High Density/Saturation Flats and Parcels	2.233
Carrier Route Letters, Flats and Parcels	4.310
Note: Unchanged from the Notice.	

Source: Notice at 14.

As discussed above, the Commission finds that the Postal Service's proposed rate increase for Standard Mail is below the applicable price cap. 39 CFR § 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 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 conform with this statutory preference.

3. Worksharing Issues

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

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

In this current rate filing, the Postal Service identified 13 rate discounts within the Standard Mail class that have proposed passthroughs exceeding 100 percent. These are the passthroughs from:

(1) Non-automation Machinable Mixed ADC Flats to Automation Mixed ADC Flats, which has a proposed passthrough of 221 percent;

(2) Mixed BMC Machinable Non-barcoded Parcels to Mixed BMC Machinable Barcoded Parcels, which has a proposed passthrough of 194 percent;

(3) Mixed ADC Irregular Non-barcoded Parcels to Mixed ADC Irregular Barcoded Parcels, which has a proposed passthrough of 194 percent;

(4) Mixed ADC Non-barcoded NFMs to Mixed ADC Barcoded NFMs, which has a proposed passthrough of 194 percent;

(5) Mixed BMC Machinable Parcels to BMC Machinable Parcels, which has a proposed passthrough of 204 percent;

(6) BMC Machinable Parcels to 5-digit Machinable Parcels, which has a proposed passthrough of 117 percent;

(7) Origin Parcels to DSCF Parcels, which has a proposed passthrough of 159 percent;

(8) Origin NFMs to DSCF NFMs, which has a proposed passthrough of 175 percent;

(9) Origin Parcels to DDU Parcels, which has a proposed passthrough of 198 percent;

(10) Origin NFMs to DDU NFMs, which has a proposed passthrough of 224 percent;

(11) The dropship discount for DSCF Parcels (pound-rated), which has a proposed passthrough of 180 percent;

(12) The dropship discount for DDU Parcels (pound-rated), which has a proposed passthrough of 200 percent; and

(13) (13) Non-automation Machinable Mixed ADC Letters to Automation Mixed AADC Letters, which has a proposed passthrough of -36 percent.[22]

The Commission identifies four additional rate discounts within the Standard Mail class that have proposed passthroughs exceeding 100 percent:

(1) High Density Letters to Saturation Letters, which has a proposed passthrough of -145 percent;

(2) Carrier Route Parcels to High Density Parcels, which has a proposed passthrough of -7 percent;

(3) Non-automation Mixed ADC Non-machinable Letters to Non-automation ADC Non-machinable Letters, which has a proposed passthrough of 101 percent; and

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[22] A negative passthrough results when a discount is given and a negative cost avoidance is calculated.

(4) Non-automation ADC Non-machinable Letters to Non-automation 3-digit Non-machinable Letters, which has a proposed passthrough of 101 percent.

The Public Representative encourages the Commission to reject the "excessively high passthroughs for Standard Mail." Public Representative Comments at 25-26. The Public Representative notes that it is not efficient for the Postal Service to offer discounts in excess of what it would cost the Postal Service employees to perform certain tasks.

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

The Postal Service's proposed statutory justification for giving a 6.2-cent discount to avoid 2.8 cents of costs is § 3622(e)(2)(D) because the discount will encourage pre-barcoding of flats and enhance the Postal Service ability to implement its Flats Sequencing Sorting (FSS) system. Notice at 32. The Postal Service is reducing the current discount of 6.4 cents to 6.2 cents, but believes reducing the discount further "would send the wrong signals to flats mailers and remove the strong incentive to prebarcoded flats," which may impede the future efficient operation of the Postal Service. *Id*.

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 remains in progress and is expected to occur system-wide in the reasonably near future. The Postal Service is reducing the discount, and believes increasing mailer participation is a valid justification for the discount to remain higher than avoided cost.

Mixed BMC Machinable Non-barcoded Parcels to Mixed BMC Machinable Barcoded Parcels, Mixed ADC Irregular Non-barcoded Parcels to Mixed ADC Irregular Barcoded Parcels, and Mixed ADC Non-barcoded NFMs to Mixed ADC Barcoded NFMs. These passthroughs give discounts for having the mailer affix a barcode to mailpieces, eliminating the need for the Postal Service to barcode the pieces.

The Postal Service's proposed statutory justification for increasing the discount further in excess of avoidable costs for pre-barcoding parcels is § 3622(e)(2)(D).

The Postal Service states that only a small fraction of Standard Mail parcels remain without barcodes, and the higher passthrough is required "to spur the last holdouts to conform to the parcel shipping industry standard and apply routing barcodes." *Id.* at 39. The Postal Service states that if all incoming Standard Mail parcels were pre-barcoded, it could eliminate some infrastructure costs for sorting facilities with a net cost savings. *Id.*

Mixed BMC Machinable Parcels to BMC Machinable Parcels. This discount is for presorting machinable parcels, eliminating the need for the Postal Service to perform initial sorting.

The Postal Service's proposed statutory justification for giving a 40-cent discount to avoid 19.6 cents of costs is § 3622(e)(2)(D) because parcels using "BMC-presorted containers can be inducted into the BMC secondary parcel sorting system and bypass the primary parcel sorters." *Id.* at 38. The Postal Service believes that this path allows for the most efficient processing, and therefore a strong incentive is required to induce mailers to take it. *Id.*

The Postal Service claims the discount, from management's view, is necessary to give incentive to mailers to perform the additional presort required for efficient operation of the Postal Service. Response to CHIR No. 4 at 7. The Postal Service also claims that the avoided cost reported in the FY 2007 ACR does not capture all the cost savings from "bypass[ing] the primary parcel sorters." *Id.*

BMC Machinable Parcels to 5-digit Machinable Parcels. This discount is for presorting machinable parcels to the 5-digit level.

The Postal Service's proposed statutory justification for giving a 43.9-cent discount to avoid 37.5 cents of costs is § 3622(e)(2)(D). The Postal Service deems it necessary to encourage mailers to undertake investment to avoid BMC parcel sorting. Notice at 39. The Postal Service notes that the discount increases by 3.9 cents from the FY 2007 ACR, in part due to an increase of avoided costs of 3.1 cents in the FY 2008 ACR. *Id.* The Postal Service claims that the avoided cost, based on managers' assessments, is greater than reported in the FY 2008 ACR. Postal Service Response to CHIR No. 4 at 5. The Postal Service claims this increase of the worksharing discount, above the avoided costs, is necessary based on the "business needs of the Postal Service" since the FY 2008 ACR reported avoided cost is only an estimate of the true avoided cost. *Id*. at 10. The Postal Service also claims that the FY 2008 ACR shows only 74 percent of machinable parcels avoid BMC sorting, so a larger discount is necessary to spur parcel shippers to presort. *Id*. at 6.

Origin Parcels to DSCF Parcels, Origin NFMs to DSCF NFMs, Origin Parcels to DDU Parcels, and Origin NFMs to DDU NFMs. These dropship discounts are for entering parcels and NFMs at destination sectional center facilities and destination delivery units.

The Postal Service's proposed statutory justification for increasing the discount above avoided cost is § 3622(e)(2)(D). It believes the costs are anomalous since "parcel-shaped Standard Mail pieces tend to be less dense in handling and transportation than other shapes of mail and that they therefore avoid…more costs than the average Standard Mail piece….” Notice at 37. The Postal Service notes that it has preliminary data segregating dropship costs by shape, which suggests the validity of the argument that parcel-shaped Standard Mail pieces avoid more cost. *Id*.

The Postal Service’s proposed justification for different dropship discounts for different categories (and within products) of mail is its pricing flexibility under § 3622(b)(4). Postal Service Response to CHIR No. 4 at 10. The Postal Service believes flexibility is justified in this instance to:

> [T]ailor prices to discrete groups and categories of mail based on the business needs of the Postal Service, its understanding of the cost and market characteristics of different subgroups of mail within and across products, and what discounts are appropriate to encourage desired mailer behaviors.

Id.

High Density Letters to Saturation Letters and Carrier Route Parcels to High Density Parcels. These passthroughs give discounts for a greater level of presort for mailpieces.

The Postal Service does not accept “that either shape or density can be defined as worksharing.” *Id.* at 13. The Postal Service believes that worksharing only “occurs when customers undertake activity that the Postal Service would otherwise do.” *Id.* at 12. Valassis/SMC agrees with the Postal Service that these “discounts” should not be treated as worksharing.[23]

The Commission, however, has consistently treated such discounts as worksharing. *See* FY 2007 ACD.

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[23] Comments of Valassis Direct Mail, Inc. and the Saturation Mailers Coalition, March 2, 2009, at 7-8 (Valassis/SMC Comments).

The Postal Service offers an alternative justification (to its premise that these discounts are not worksharing) that these passthroughs are justified under §§ 3622(e)(2)(D) and 3622(e)(2)(A). Response to CHIR No. 4 at 15. The Postal Service states its belief that the cost data for these categories are anomalous. *Id*. at 14. Table IV-6 below represents the cost data the Postal Service believes are anomalous.

Table IV-6

Product	Discount (cents)	Avoided Cost (cents)	Passthrough (%)
Letters			
High Density	6.9	16.6	41
Saturation	1.1	(0.8)	-145
Parcels			
High Density	12.5	(168.5)	-7
Saturation	0.8	167.8	0

The Postal Service states that it would have to disrupt longstanding price relationships (*e.g.,* pricing Saturation letters higher than High Density letters) if it were to set passthroughs at 100 percent of avoided cost. *Id.* at 14-15.

Non-automation Non-machinable Mixed ADC Letters to Non-automation Non-machinable ADC Letters and Non-automation ADC Non-machinable Letters to Non-automation 3-digit Non-machinable Letters. These discounts are for presorting letter mail, bypassing initial Postal Service sorting.

The Postal Service set these discounts at 100 percent of avoided costs; however, due to corrections in the cost calculation in the FY 2008 ACR, the avoided costs are recalculated to 8.6 and 4.3 cents (respectively), with a proposed discount of 8.7 cents and 4.4 cents (respectively). *See* Response to CHIR No. 3 at 6-7.

Commission analysis. The Commission finds that all of the proposed workshare discounts in Standard Mail appear consistent with or have been justified by an exception under 39 U.S.C. § 3622. *See* 39 CFR § 3010.13(j).

4. Commenter Issues

Nine commenters addressed issues related to Standard Mail. The Commission acknowledges the comments' important role of supplementing the record and informing the Commission's decision.

Standard Mail flats cost coverage. Bank of America comments that the below average increase for Standard Mail flats, coupled with a larger increase for Standard Mail letters, is inequitable and inefficient. Bank of America asserts that a lower adjustment for Standard Mail flats (which do not cover costs) shifts the cost coverage burden to Standard Mail letters. *Id.* at 5. Bank of America believes the Commission should find that the proposed rates for Standard Mail flats violate § 3622(b)(1) because they do not reduce costs or increase efficiency. *Id.*

Bank of America also comments that this perceived "price break" for flats is in essence a subsidization of the catalog industry. *Id.* at 4. Catalogers, Bank of America claims, do not exhibit different price sensitivity than other marketing mail, and do not have any greater a multiplier effect[24] than financial marketing mail. *Id.* at 5-6. In essence, Bank of America believes, the Postal Service's nominal increase for Standard Mail flats is an undue preference for the catalog industry when difficult economic conditions effect all industry. *Id.* at 4. Bank of America asks that the Commission order Standard Mail flats to cover their attributable cost. *Id.* at 7.

On similar lines, Valpak questions the propriety of the Postal Service giving a below-average increase to a category of mail which is not covering its attributable cost.

[24] Examples of the multiplier effect are catalog orders spurring volume in parcel shipping, or credit card solicitations spurring volume of First-Class Mail statements and payments.

Valpak Comments at 14. Valpak notes that in the last rate adjustment, the Postal Service proposed a lower than average increase for flats to mitigate the large increase from Docket No. R2006-1. *Id*. Valpak notes that the Postal Service offers the same justification for the nominal increase for Standard Mail flats in the present case. *Id.* at 17-18. Valpak asserts that the purpose of the below average rate increase, to maintain the viability of the cataloging industry, is not adequate justification. *Id.* While Valpak acknowledges the increased pricing flexibility the PAEA affords the Postal Service, it expresses concern that the transparency called for by the PAEA requires the Postal Service to be more forthcoming with the factors it considers when setting its prices. *Id*. at 17. Valpak concludes that the rates proposed for Standard Mail flats are not consistent with the objectives and factors in § 3622. *Id.* at 17-18.

American Catalog Mailers Association (ACMA) comments that the catalog industry is still suffering from “rate shock” from the changes implemented in Docket No. R2006-1.[25] ACMA encourages the Commission not to “second guess” the Postal Service’s proposed rates. *Id*. The increase in Standard Mail flats rates from Docket No. R2006-1, according to ACMA, led to a substantial drop in Standard Mail flats volume. *Id.* at 2. ACMA also lauds the Postal Service for using a market-based rate-setting system and moving away from a focus on attributable cost. *Id*. at 3.

Commission analysis. The Commission is concerned with the failure of Standard Mail flats to cover costs. In the two most recent rate adjustments, the Postal Service has proposed rates for Standard Mail flats which are below average for the class. The most recent increase is below average in spite of the failure of Standard Mail flats to cover costs in FY 2008. A pattern of preference for a category of mail not covering its attributable costs could be viewed as contrary to § 3622(b) or (c). While the Commission recognizes that the PAEA affords the Postal Service greater flexibility in

[25] Comments of the American Catalog Mailers Association, March 5, 2009, at 1 (ACMA Comments).

rate design, and it accepts the Postal Service's justification for the proposed rate increase for Standard Mail flats, it will monitor the situation with interest. The Commission strongly encourages the Postal Service to set rates for Standard Mail flats which, at a minimum, recoup attributable cost and make the requisite contribution towards institutional costs.

High Density flat to Saturation flat worksharing discount. The Postal Service submitted additional information on how this worksharing discount would be calculated. *See* Postal Service Response to CHIR No. 4 at 13-17. The Postal Service calculates the discount as 2.6 cents, with an avoided cost of 2.48 cents, resulting in a passthrough of 104.8 percent. *Id*. at Appendix B. NAA claims that this 0.12-cent difference between the avoided cost and the discount "should be rejected as a facial violation of Section 3622(e)." NAA Comments at 22. NAA claims that the Postal Service's proposed justifications for this discount are not legally viable. NAA Supplemental Comments at 6.

In the course of Docket No. ACR2008, however, the Commission has identified necessary adjustments to the cost calculation for worksharing unit cost avoidance between High Density flats to Saturation flats provided by the Postal Service. In response to a Commission information request, the Postal Service confirmed certain changes to cost calculation in the "D Report" for Standard ECR High Density and Saturation in order to accurately assign costs by rate category.[26] Similarly, the Postal Service confirms that it "inadvertently changed the computational methodology used to develop the Saturation Flats Without DALs estimate."[27] The Commission uses the established methodology in calculating Saturation flats unit costs with DAL costs removed. Based on these adjustments, and several minor calculation corrections, the Commission calculates the avoided cost between High Density flats and Saturation flats

[26] Docket No. ACR2008, Response of the United States Postal Service to Commission Information Request No. 4, February 20, 2009, at 6.

[27] Docket No. ACR2008, Response of the United States Postal Service to Motion of Valassis and SMC for Leave to Respond to the Postal Service's Reply Comments, February 19, 2009.

to be 2.564 (rounding to 2.6) cents. This corrected cost avoided leads to a projected passthrough of 100 percent of avoided costs. The Commission, therefore, finds this discount in compliance with 39 U.S.C. § 3622.

Saturation incentive. Several comments address the rate incentive to grow Saturation mail volume. Valassis/SMC approves of the proposed incentive, and expresses the hope that the incentive will become permanent and increase to grow Saturation mail volume. Valassis/SMC Comments at 2-3. Valpak also approves of the proposed Saturation mail incentive as a mechanism to grow Saturation mail volume. Valpak Comments at 6-8 Valpak also expresses an interest in monitoring the program to see if it is adequate to grow Saturation mail volume. *Id.* The Postal Service describes the reasons that it anticipates the incentive will grow Saturation mail volume. *See* Response to CHIR No. 4 at 17-22.

NAA, however, comments that the saturation incentive discriminates against High Density mailers. NAA Comments at 7. NAA believes this discount exacerbates the large price difference between High Density and Saturation. *Id.* NAA also believes the discount will probably not grow new volume, but will result in a transfer of volume from High Density mail such as newspapers' total market coverage advertising. *Id.* NAA believes this discount represents the Postal Service favoring one competitor over another in the marketing mail category. *Id.* at 5. NAA asks that the Commission to rule these rates discriminatory and unlawful, as they violate the § 3622 objective and factors. *Id.* at 10.

The Public Representatives comment that this incentive may create a special classification, and believes the Postal Service should supply more detailed information on the incentive program. Public Representative Comments at 27-28. The Public Representatives believe that since "this program includes specific eligibility requirements that differ from those applicable to current mailers of the Standard Mail covered by the program…" it should be justified as a special classification. *Id*. at 28.

Such a justification would require the Postal Service to discuss the program in light of each of the objectives and factors in §§ 3622(b) and 3622(c). *Id.* At a minimum, the Public Representatives claim, even if the program is not a special classification, more explanatory descriptions should be provided by the Postal Service. *Id.*

Commission analysis. The Commission approves the Postal Service's attempt to grow volume in the profitable Saturation category. Such initiatives are consistent with the flexible system created by the PAEA. The discount is not a worksharing discount so the Commission's review in this docket is confined to the §§ 3622(b) and 3622(c) objectives and factors. However, the Postal Service should carefully consider the amount of new volume created by such an incentive, versus the amount of volume redistributed from existing mail volume, as well as the effect of rate increases on businesses such as newspapers. 39 U.S.C. § 3622(c)(3).

The Commission finds, for purposes of this review, that the Postal Service's explanations concerning the proposed discount comport with the objectives and factors in § 3622. More extensive, focused consideration of the impact on multiple business segments is not possible with the limited record that can be developed during this expedited analysis.

Move Update surcharge. Several comments address the new $0.07 surcharge for Standard Mail which has not been updated with the Postal Service's change-of-address database. NPPC comments that the costs incurred by a failure to update addresses is not related to the amount of the surcharge. NPPC Comments at 7. NPPC also asserts that the error rate (requiring that 70 percent of addresses in the mailing reflect those change of addresses in the Postal Service database to be deemed sufficiently accurate to avoid the surcharge) is too narrow. *Id.* Similarly, PostCom comments that the surcharge is excessive compared to the costs incurred by the Postal Service.[28]

Commission analysis. The surcharge is designed to provide an incentive to mailers to enter Move Update compliant mail and to increase the efficiency of Postal Service operations. Given the limited record available in this expedited review, the surcharge has not been shown to be inconsistent with applicable law.

Standard parcels and NFMs. PSA comments extensively on the rate increase for Standard Mail parcels and NFMs.[29] PSA believes the 16.4 percent increase for Standard Mail parcels and NFMs is out of line with the objectives and factors of § 3622. *Id*. at 3-4. PSA notes that the increase is larger than 16.4 percent when the elimination of the SCF 3-digit and 5-digit discounts is considered. *Id.* at 4-6. The elimination of those discounts causes parcel mail that is origin entered to pay the higher BMC presort rate. *Id*. PSA, however, asks that the Commission find these rates in compliance with the price cap for the purposes of this case only, and institute a rulemaking to determine how *de facto* rate increases should be taken into account for purposes of cap compliance, *e.g.,* when discounts are eliminated, rate categories are changed or eliminated, and requirements for a rate or discount are changed. *Id.* at 7-8.

Commission analysis. The Commission finds the proposed rate increase for Standard Mail parcels and NFMs to be compliant with the PAEA. The Commission is sympathetic that numerous factors influence the effective rate paid by a mailer, and the Commission will take under consideration PSA's suggestion that it institute a rulemaking.

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[28] Comments of the Association for Postal Commerce, March 2, 2009 at 2 (PostCom Comments).

[29] Parcel Shippers Association Comments in Response to Notice of Price Adjustment and Limited Classification Changes, March 2, 2009 (PSA Comments).

D. Package Services

The Package Services class includes five products: Single-Piece Parcel Post, Bound Printed Matter Flats, Bound Printed Matter Parcels, Media/Library Mail, and Inbound Surface Parcel Post. In FY 2008, Media/Library Mail, and Single-Piece Parcel Post failed to cover their costs; however, the Postal Service points out that the class as a whole had a positive cost coverage. Notice at 21. In an effort to address the cost coverage issues, the Postal Service's rate design focuses on increasing the prices of the lowest performing segments of the group.

1. Price Increases

The percentage change in prices for Package Services mail is, on average, 3.8 percent. In developing the new rates, the Postal Service has chosen not to utilize the .025 percent of unused rate authority remaining from FY 2008. *Id*. at 5-6. 39 U.S.C. § 3622(2)(C)(ii) grants the Postal Service this authority. The 0.025 percent of unused rate authority from Docket No. R2008-1 will expire in four years.

The Postal Service justifies the proposed rate increases by identifying its overall goal as to improve product profitability. It notes that Bound Printed Matter (BPM) flats have a healthy cost coverage, and it plans to offset the need for higher price increase for lower performing products by reducing the average price of BPM flats. *Id*. at 21.

The Commission confirms that the prospective price increases for the Package Services class comply with 39 U.S.C.§ 3622(d) and 39 CFR § 3010.11. In addition, the Commission finds that the prospective Library Mail rates satisfy 39 U.S.C. § 3626(a)(7), which requires that they be set as nearly as practicable to 5 percent below the corresponding Media Mail rates.

2. Workshare Discounts

a. Media/Library Mail

The passthroughs for 5-digit Media/Library Mail are in excess of 100 percent. *Id*. at 41. In its Notice, the Postal Service justifies the excess passthroughs for 5-digit Media/Library Mail principally with its desire to mitigate rate shock. *Id*. The Postal Service contends that 39 U.S.C. § 3622(e)(2)(B) allows for such action. The Postal Service considers several factors when evaluating potential rate shock. These factors include the size of the change in rate or rates in question, the size of the change in rates of other rate cells or pricing elements for the same or related mail categories, and the length or time between pricing changes.

The Postal Service also states that with appropriate mitigation of the potential price increase for 5-digit presort customers, the passthroughs at planned rates would be 154.2 percent for Media Mail and 145.8 percent for Library Mail. *Id*. at 42. These passthroughs are still significantly lower than last year's calculated passthroughs. The Postal Service believes that this demonstrates that the discounts are moving towards compliance with § 3622(e)(2). In addition, it points to 39 U.S.C.§ 3622(e)(2)(C), mail consisting exclusively of matter having ECSI value, as justification for the excess passthroughs. *Id*.

The Commission finds these rationales justify the greater than 100 percent worksharing discounts for 5-digit Media/Library Mail.

b. BPM Flats and Parcels

The destination bulk mail center (DBMC) dropship discounts for BPM flats and BPM parcels each exceed 100 percent. *Id*. at 43. The Postal Service justifies the greater than 100 percent passthroughs for BPM flats and parcels dropshipped at the DMBC principally by its desire to mitigate rate shock. It plans to reduce excessive discounts over time to meet the statutory limitations. The Postal Service notes that unlike last year, destination sectional center facility (DSCF) and destination delivery unit (DDU) dropship discounts have passthroughs at, or just below, 100 percent.

The Commission finds the Postal Service rationales for its proposed passthroughs acceptable.

3. Mail Classification Change

The Postal Service discusses its plan to simplify the single-piece Parcel Post rate structure. It references 39 U.S.C. § 3622(c)(6) which encourages simple and identifiable relationships between the rates or fees charged. It also references 39 U.S.C. § 3622(c)(12) which recognizes the need for the Postal Service to increase its efficiency. The Postal Service explains that current prices for single-piece Parcel Post vary based on whether a parcel travels through one or more than one BMC and maintains that this distinction has little to do with market perceptions or operational requirements. *Id.* at 21.

The proposed structure would merge the Intra-BMC and Inter-BMC prices to create a single price (at each weight level) in each zone. The Postal Service contends that this is “the same structure that applies to Priority Mail, and our competitors’ prices, and will make the Postal Service’s pricing clearer to retail customers.” *Id*. at 22.

The Postal Service explains that the pricing structure is to be simplified further by incorporating the non-machinable surcharge into the base prices for single-piece Parcel Post. The current Parcel Post price structure includes a surcharge for non-machinable parcels because they can not be sorted by BMC mail equipment. However, the Postal Service believes that this surcharge has not changed customer practices. Therefore, it plans to add the surcharge into the base prices. *Id*.

The Commission received several comments regarding the impact of the rate increase proposed for single-piece Parcel Post on residents of Alaska.

a. Comments of Elected Alaskan Officials

The Governor of Alaska's comments shed light on the implications of the proposed increase. She states that the new increase will further raise the high cost of living in Alaska and could effectively cripple the already fragile bypass mail system. She points out that the increase has an exponentially greater impact on Alaskans than those in other states due to the reliance of Alaskans on the bypass mail system for food and supplies.[30]

The Alaska Congressional Delegation expresses concern with the pending rate increase. While the delegation acknowledges the Postal Service's current financial situation, it points out that the residents of rural Alaska are experiencing severe economic challenges stemming from double-digit unemployment and the high cost of basic goods such as milk and gasoline.[31]

Members of the Alaska State Legislature urge the Postal Service not to raise single-piece Parcel Post rates. They note that rural Alaska is suffering through an energy crisis which threatens the health and safety of its residents.[32]

b. Additional Comments

The Alaska Commercial Co. (ACC) contends that the proposed increase will have a dramatic and damaging affect on rural Alaskans.[33] ACC lists the direct freight cost increases for certain goods if the proposed rate schedule takes place. The

[30] Comments of the Honorable Sarah Palin, Governor of Alaska, March 2, 2009.

[31] Comments of the Alaska Congressional Delegation, Senators Lisa Murkowski and Mark Begich and Congressman Don Young, March 2, 2009.

[32] Comments of the Alaska State Legislature, State Senators Lyman Hoffman, Albert Kookesh, Donald Olson and Gary Stevens; and State Representatives Woodie Salmon and Bob Herron, March 2, 2009.

[33] Comments of Alaska Commercial Co., March 3, 2009 (ACC Comments).

increases include $1.50 for a gallon of milk, $.22 for a dozen eggs, and $1.30 for a 10-pound bag of flour.

ACC argues that Alaska bypass mail deserves a separate rate structure. It claims that bypass mail saves the Postal Service operational expenses because bypass mail is not inducted, handled, processed or staged through a postal facility.

Like other commenters the Association of Village Council Presidents Regional Housing Authority disapproves of the rate increase.[34] They argue that an increase will make construction projects more expensive and activities more difficult to conduct due to added costs.

Individual commenters voice objections. One commenter notes that since Alaska is made up of 500,000 square miles of roadless area, the majority of her groceries are brought into this area by the postal system via airfreight. She adds that an increase in the mail rate would make living in this area "impossible."[35] Another disapproves of the increase because she fears it will force families in her community to move to cities.[36] A small business owner in Gelena, Alaska contends that an increase in rates will mean further markups of retail items to cover costs, and layoffs for her employees,[37] while another commenter argues that the Postal Service is providing a public service.[38]

This mail classification change will cause individual rate cells for Intra-BMC, on average, to increase more than Inter-BMC prices. This change will have a particularly adverse impact on residents of rural Alaska who receive groceries and other essential goods mailed at Intra-BMC rates. Chairman's Information Request No. 6 requested

[34] Comments of Association of Village Council Presidents Regional Housing Authority, March 2, 2009.

[35] Comments (unsigned), March 2, 2009.

[36] Comments of Stephanie Mandregan, March 2, 2009.

[37] Comments of Agnes Sweetsir, March 2, 2009.

[38] Comments of The Scotton Family, February 28, 2009.

information on whether the Postal Service is actively working to implement administrative changes that would reduce the impact of proposed rate increases on parcels destined for Alaska.

In its response, the Postal Service indicates that it is working with shippers and air carriers in Alaska to change and simplify the acceptance of bypass mail.[39] New procedures eliminate the requirement that goods be combined into distinct 70-pound packages. It also allows mailers to divide the total weight of palletized items by 70 to determine the minimum number of packages that could have been created and applies the 70-pound single-piece Parcel Post rate to this quantity. The Postal Service believes this will reduce shippers' costs and offset the effect of the rate increase. While the prices are increasing for these individuals, the transportation costs within Alaska remain subsidized by other mail products.[40]

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. ACR2008, preliminary indications are that revenues for the single-piece Parcel Post product are below cost. Under the circumstances, the Postal Services proposal to merge Inter- and Intra-BMC prices does not appear to violate applicable law.

4. Other Issues

Chairman's Information Request No. 4 requested the Postal Service to provide adjusted FY 2008 billing determinants to reflect the classification change made in Docket No. MC2008-3. In its response, the Postal Service presents a variety of

[39] Response of the United States Postal Service to Chairman's Information Request No. 6, March 12, 2009 (Response to CHIR No. 6).

[40] In FY 2008, only 7.02 percent of costs associated with transportation of mail products in Alaska was attributed to products, while the remaining costs were added to institutional costs. *See* Docket No. ACR 2008 USPS-FY08-32, 'CS14.xls' tab: Inputs-Adjustment Factors, cell: E17.

scenarios where the volumes may have shifted due to the classification change for BPM flats and parcels. Response to CHIR No. 4, Question 1-12. The Postal Service believes that any adjustment would be arbitrary and that a costly survey would have to be administered to obtain accurate data. Response to CHIR No. 6 at 26.

The Commission notes that the Postal Service made several other similar adjustments without survey data, such as acceptance rates for IMb. *See* Response to CHIR No. 2 at 19. Commission rules require the Postal Service to make reasonable adjustments to billing determinants when a classification change is made within that year. 39 CFR § 3010.23(d). With respect to BPM, the Postal Service's response only provides possible scenarios to the Commission. Also, it fails to make any actual adjustments.

The Commission finds that reasonable adjustments could have been made in this case, but also finds that there would not have been any appreciable impact to the 2008 rate cap calculations.

In Docket No. MC2008-3, the Postal Service stated that an "administrative change" occurred in 2007, resulting in a *de facto* mail classification change for BPM in 2007. Therefore, the results of this change may have already been accounted for in the FY 2008 BPM billing determinants. In future annual compliance determinations, the Commission will calculate the percentage increase in rates using actual volumes and prices and be able to review rate increases with more confidence.[41] Upon consideration of these facts, the Commission does not make any adjustments to BPM flats or parcels billing determinants.

The price change for Inbound Service Parcel Post at UPU rates is included in the rate cap calculation for Package Services. The Postal Service explains that it does not

[41] Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 35-36.

have the ability to unilaterally change those rates, which are established by the Universal Postal Union. The price increase for Inbound Surface Parcel Post is 5.027 percent. Notice at 20.

E. Special Services

1. Introduction

The following products are classified as market dominant special services: (1) Ancillary Services;[42] (2) International Ancillary Services;[43] (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; and (10) Post Office Box Service.[44]

2. Price Increases

The percentage increase in prices for the Special Services class is, on average, 3.825 percent.[45] The unused rate authority for Special Services was 0.052 percent as determined in Docket No. R2008-1.[46] The addition of that banked amount to this year's inflation-based price adjustment authority of 3.8 percent gives a total available current

[42] The Ancillary Services product contains 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.

[43] 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.

[44] Whereas Order No. 43 originally included Premium Forwarding Service, that service was moved to the Competitive Product List during FY 2008. *See* Docket No. MC2008-4, Order Granting Postal Service's Request to Transfer Premium Forwarding Service to the Competitive Product List, July 16, 2008. The Postal Service mistakenly included Premium Forwarding Service in the list of Special Services contained on pages 22-23 of its Notice. The rates for Premium Forwarding Service were not, however, adjusted in this docket.

[45] The original increase reported by the Postal Service was 3.837 percent. Notice at 22-23. The Postal Service subsequently corrected supporting data. *See* PRC Library Reference PRC-R2008-1-LR5. This changed the overall average percentage increase to 3.825 percent.

[46] *See* Order No. 66 at 1; and Docket No. R2008-1, Review of Postal Service Amended Notice of Market Dominant Price Adjustment, April 9, 2008, at 2.

price adjustment authority for Special Services of 3.852 percent. The planned price adjustment of 3.825 percent produces a new banked authority of 0.027 percent for the Special Services class.

The Postal Service asserts that the planned price increase for each Special Service product is in compliance with the PAEA and the Commission's regulations because the proposed overall percentage price increase for the Special Services class is less than the current price adjustment authority.

Commission Order No. 66 urged the Postal Service to calculate and provide the average price increases at the individual product level. Order No. 66 at 54. The Postal Service provided a summary worksheet that listed the weighted average price increases. The following table is based on that worksheet, as adjusted to update and correct various data.

Table IV-7

Special Services
Average Price Increase by Product

Products	Weighted Average Price Increase %
Ancillary Services	3.63
Address List Services	4.69
Caller Service	4.50
Confirm Service	149.22
Change-of-Address Credit Card Authentication	0.00
Money Order	3.94
Post Office Box Service	3.79

In future filings the Postal Service should attempt to provide billing determinants and costs for anticipated changes in post office box reclassifications that result in the migration of post office boxes from one fee group to another.[47]

3. Commenter Issues

Seven commenters address the planned price increases for the Special Services class: The Platinum Coalition, a group composed of the users of Confirm service;[48] representatives of five of the members of the Platinum Coalition filing separately;[49] and NPPC. All seven commenters oppose the proposed increase in the 12-month subscription price for Platinum tier Confirm service purchased by mailing agents from its current level of $23,500 to $250,000, an increase of 963.8 percent.

The Platinum Coalition bases its challenge on several grounds. First, it argues that the proposed prices for Platinum tier Confirm service discriminate against mailing agents without any reasonable justification in violation of 39 U.S.C. § 403(b). Platinum Coalition Comments at 8-12. Second, it argues that the proposed price is contrary to both the “reasonable and equitable” rate requirement of 39 U.S.C. § 404(b) and the “just and reasonable” rate and classification objective of 39 U.S.C. § 3622(b)(8). *Id.* at 12. Third, the coalition asserts that the proposed increase violates the following specific objectives and factors contained in 39 U.S.C. §§ 3622(b) and (c): the objective of rate predictability and stability in § 3622(b)(2); the obligation to take into account the requirement in § 3622(c)(2) that rates bear only a reasonable share of institutional

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[47] Such information would also be useful to the Commission in the annual compliance report filed by the Postal Service next year.

[48] Comments of the Platinum Coalition, March 2, 2009 (Platinum Coalition Comments).

[49] Declaration of Cameron Bellamy Concerning the Price Adjustment for Confirm Service (Bellamy Declaration); Declaration of Charles M. Howard on the Price Adjustment for Platinum Confirm Service (Howard Declaration); Declaration of Mark Mandell (Mandell Declaration); Declaration of Janyce S. Pritchard of the Flute Network on the Price Adjustment for Confirm Service (Pritchard Declaration); and Declaration of Wanda Senne Concerning the Price Adjustment for Platinum Confirm Service (Senne Declaration), all filed on March 2, 2009.

costs; and the obligation in § 3622(c)(3) to take into account the effect of rate increases on the general public and business mail users. *Id.* at 12-17. Finally, the Platinum Coalition suggests that the Postal Service's definition of "mailing agent" could require mailers and mailing agents to buy duplicate subscriptions in order to gain access to a single set of Confirm data. *Id.* at 17-18. NPPC makes many of the same arguments. NPPC Comments at 10-11.

The five individuals who filed comments on behalf of members of the Platinum Coalition identify potential adverse effects of the proposed price increase on mailing agents who use Platinum tier service and their customers. Those adverse effects include a predicted drop in Confirm usage;[50] the possible discontinuation of value-added Confirm-related services;[51] the possible withdrawal of mailing agents from the Confirm market;[52] reduced investment in the development of value-added services;[53] greater market concentration and less competition among Confirm resellers;[54] and further downward pressure on First-Class Mail and Standard Mail volumes that use Confirm service.[55] The Platinum Coalition relies on the comments of these individuals to assert that the Postal Service will not replace the lost value-added services provided by mailing agents, and that the victims will be "the businesses, nonprofit organizations and state and local bodies that lack the mail volume, financial resources or expertise to use Confirm [services] directly." Platinum Coalition Comments at 16.

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[50] Bellamy Declaration at 4; and Senne Declaration at 4.

[51] Howard Declaration at 3.

[52] Bellamy Declaration at 4; and Howard Declaration at 3.

[53] Bellamy Declaration at 4; and Senne Declaration at 4.

[54] Bellamy Declaration at 4.

[55] Pritchard Declaration at 5. *See also* NPPC Comments at 11.

4. Commission Analysis

The rate increase that is the subject of this proceeding was filed under part 3010 of the Commission's regulations. In adopting those regulations, the Commission acknowledged the "tension in the PAEA between its goals of facilitating rapid and flexible adjustments to rates and classifications, and increasing the transparency and accountability of those processes." (Footnote omitted.) Order No, 43, ¶ 2006.

Nowhere is the tension between rate-setting flexibility and accountability more apparent than in the context of the Commission's pre-implementation review of a rate adjustment like the one for Confirm in this docket. On the one hand, the Postal Service has presented a proposed adjustment in the prices for Special Services which complies with the applicable price cap, as adjusted for previously unused and banked rate authority. On the other hand, various commenters have protested the price increase applicable to mailing agents who purchase the Platinum tier of Confirm service on the grounds that the increase is unduly discriminatory and does not comply with fundamental policies of the PAEA. Given the magnitude and selectivity of the proposed increase, it is not surprising that mailing agents and their customers have questioned the lawfulness of the Platinum tier price increase for mailing agents. Their allegations raise troubling issues of discrimination and compliance with the objectives and factors of 39 U.S.C. § 3622.

In Order No. 43, the Commission concluded that "[t]he inference is strong that Congress contemplated that complicated or subjective compliance issues would be addressed during the annual compliance review, or through the complaint procedures of section 3662." *Id.*, ¶ 2026. The Commission nevertheless recognized that exceptional cases could be presented.[56] After careful review of the filing and the additional information presented by the Postal Service, the Commission has concluded that this case is an exceptional case in which it would be inappropriate to defer consideration of the issues raised by the commenters until the next annual compliance review or until the completion of a complaint proceeding.

With one important exception, it appears from the information presented, that the Platinum tier Confirm service purchased by mailing owners and mailing agents is the same service. That exception is price. Mailing owners will pay $25,000 for a 12-month subscription. Mailing agents will pay $250,000 for the same 12-month subscription. The Postal Service asserts that the 963.8 percent increase in the annual subscription price for mailing agents "is intended to better align the revenue source with the source of the costs of providing the service (Factor 1, Factor 6)." Notice at 24.

In an information request, the Postal Service was asked to explain "how the new mailing agent fees better align revenues and costs within the Gold and Platinum tiers.[57] In its March 2, 2009 response, the Postal Service represented that "major costs" for Confirm service "are tied to" capacity and development costs; that mailing agent subscribers to the Confirm service use more scans and are responsible for driving up capacity costs; that Confirm development costs "tend to be driven" by mailing agent subscriptions; and that "[m]ost of the Postal Service's programming enhancements" for the Confirm service are completed to meet mailing agent needs. Response to CHIR No. 3 at 6-7. In other words, more scans generate more costs, and those persons responsible for generating more costs should pay higher rates. To support its

[56] In Order No. 43, the Commission noted "that neither the PAEA nor its legislative history explicitly define the scope of public input or Commission review of proposed rates prior to their implementation … [and] … that Congress intended to leave room for Commission discretion in determining the degree of public input that would be afforded in the pre-implementation period, the form that it should take, and what priority the Commission would give to evaluating the public input that it decided to elicit." *Id.*, ¶ 2028.

[57] Chairman's Information Request No. 3, February 23, 2009, Question 5.c.

explanation, the Postal Service submitted a worksheet that purports to show that mailing agent subscribers account for 59 percent of scans. *Id*. at 1-14.

There is a serious problem with the Postal Service's attempted justification. First, the same worksheet relied upon by the Postal Service lists three Platinum tier mail owners with more scans than three of the six largest Platinum tier mailing agents. Under proposed rates, those high volume mail owners would pay substantially less for their Platinum tier service than those three mailing agents. This data contradicts the Postal Service's claim that it is the status of the customer (*i.e*., mailing agent vs. mail owner) that drives costs. A lower price for an equivalent service has been accepted as a form of unreasonable price discrimination.[58] Unless and until the Postal Service can present a credible connection between customer status and cost causation, the large differential between the prices paid by mailing owners and the prices paid by mailing agents appears to be discriminatory on its face. *See* 39 U.S.C. § 403(c).

A further problem with the Postal Service's proposal to drastically increase the prices paid by mailing agents for Confirm service is its own admission in its recent Annual Compliance Report that it does not have cost, revenue, or volume data for Confirm service. FY 2008 ACR at 8-9. Without cost, revenue, or volume data, the Commission has no reliable basis for concluding that a price increase of this magnitude targeted solely to mailing agents for Platinum tier Confirm service will "better" align costs with revenues.

The magnitude and selectivity of the proposed increase also raises serious questions regarding the adequacy of the technical information and justifications presented by the Postal Service in its filing in this docket. Section 3010.14(b)(7) of the Commission's rules provides that the notice of rate adjustment shall be accompanied by:

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[58] *See The Competitive Telecommunications Assn. v. FCC*, 998 F.2d 1058, 1062 (D.C. Cir. 1993).

> [a]discussion that demonstrates how the planned rate adjustments are designed to help achieve the objectives listed in 39 U.S.C. 3622(b) and properly take into account the factors listed in 39 U.S.C. 3622(c)…[.]

The Postal Service's failure to address in a meaningful fashion the two most obvious statutory objectives and factors set forth in 39 U.S.C. §§ 3622(b) and (c), namely price predictability and stability in § 3622(b)(2) and the effect on the general public and business mail users in § 3622(c)(3) also undermines the proposed price increase applicable to mailing agents who purchase Platinum tier Confirm service.[59] These same considerations apply to the Gold tier Confirm mailing agent rate.

The trade-off for the Postal Service's increased price adjustment flexibility is increased transparency. The limited arguments provided are insufficient to adequately justify rate differentials between mail owners and mailing agents for either the Gold or Platinum tier.

For these reasons, the Commission hereby finds, pursuant to 39 CFR § 3010.13(e), as follows: (1) that the overall adjustment for Special Services complies with the statutory cap; (2) that the mailing agent rate for both the Gold and Platinum tier Confirm service is inconsistent with applicable law; (3) until the Postal Service can provide an adequate justification for separate mailing agent rates for Gold and Platinum tier Confirm service, those rates must be removed from Confirm, and both mail owners and mailing agents must be charged the same rates; and (4) in the event the Postal Service chooses not to attempt to justify separate mailing agent rates, it must recalculate the overall adjustment for Special Services and the banked residual cap amount.

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[59] In Part II of its Notice, the Postal Service states that the objective of price predictability and stability in § 3622(b)(2) is fulfilled "by the Postal Service's publicly stated intention to increase prices on an annual, predictable basis, by keeping price changes at appropriate levels." Notice at 9. Such a general statement is hardly predictive of a 963 percent increase of over $225,000 per year in the subscription fee for Platinum tier mailing agents. Nor does this statement suggest how such a precipitous increase can be considered consistent with the concept of rate stability.

V. ORDERING PARAGRAPHS

A full review of the United States Postal Service Notice of Market-Dominant Price Adjustment, filed February 11, 2009, 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 CFR § 3010.11 and § 3010.28.

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). The proposed Confirm annual fees for mailing agents are inconsistent with applicable law.

4. Except to the extent granted or otherwise disposed of herein, all outstanding requests in Docket No. R2009-2 hereby are denied.

By the Commission.

Steven W. Williams
Secretary

ADDITIONAL VIEWS OF COMMISSIONER LANGLEY

Although I concur generally with the result of this Order, I am compelled to express my serious concern over two aspects of it. The first is the Postal Service's departure from established methodologies when designing workshare discounts for both First-Class and Standard Mail. The second is the lack of evidence presented by the Postal Service in its justification of First-Class automation discounts under 39 U.S.C. § 3622(e)(2)(D).

My support for the majority opinion is heavily influenced by the deep and on-going recession, which is severely impacting the Postal Service, its employees, and its customers. Ensuring the short- and long-term viability of the Postal Service is critical as the Commission exercises its discretion and takes into consideration extenuating circumstances in determining responsible actions. I have also taken into account the public comments on this matter, which indicates a general consensus for evaluating those methodologies in the separate rulemaking the Commission initiates today.

The Postal Accountability and Enhancement Act of 2006 (PAEA) imposes an expedited and less-than comprehensive pre-implementation review of proposed rates, coupled with after-the-fact annual compliance review. The PAEA also provides for an enhanced complaint process to enable interested persons to obtain compliance with the Act.

This pre-implementation review seeks to ensure that Postal Service rate adjustments conform to the legal requirements intended to protect the mailing public and provide accountability and transparency of postal finances and operations. The two key requirements are that increases for each class of mail, on average, are not higher than the Consumer Price Index (§3622(d)), and the second is that workshare discounts do not exceed 100 percent of the avoided costs, with certain exceptions (§3622(e)).

In order for this nascent ratemaking system to work, it is essential that previously vetted rate-setting methodologies and analytical techniques are used when designing proposed rate adjustments. The lack of adherence to accepted methodologies reflects outright disregard for the goal of predictable increases and frustrates the goal of transparency. Such actions lead to uncertainty and confusion, substantial disruption to mailing practices, and potentially significant adverse financial impact on both the Postal Service and its customers.

In the present case, the Postal Service made significant and unexpected changes in the methodologies used to calculate worksharing adjustments. It did so in full knowledge of existing standards, the admonitions of the Commission in the FY 2008 Annual Compliance Determination, and ample opportunity to seek approval of its proposed changes prior to filing adjusted rates.

Timely and effective rate review under the PAEA does not preclude changes in rate-setting methodologies. Proposed changes should, however, be presented in an orderly fashion outside the context of an expedited rate proceeding. The Commission has shown itself willing and able to promptly review proposed changes to costing methodologies as demonstrated by its action on the 13 changes suggested by the Postal Service over the past year.

The public has a right to advance notice of proposed methodological changes and should be given an opportunity to review and comment on those changes prior to their appearance in a rate filing. In addition, the Commission has the responsibility to adequately review such proposals in order to give full consideration to the views of both the Postal Service and those who wish to comment, prior to their use in a rate case. This practice is essential for the PAEA to succeed.

I consider this Commission action to be a one-time accommodation of the extraordinary financial situation facing both the Postal Service and the mailing community.

Commissioner Nanci E. Langley

DISSENTING OPINION OF COMMISSIONER GOLDWAY

The First-Class Mail prices proposed by the Postal Service fail to comply with the statutorily imposed workshare requirements of 39 U.S.C. § 3622(e), when analyzed under the established analytical methodology. To circumvent this problem, the Postal Service employs a different analytical methodology, which effectively delinks single-piece First-Class Mail prices from presort First-Class Mail prices. This unilateral decision on the part of the Postal Service is far reaching in that it directly influences the design of economically efficient rates, the distribution of hundreds of millions of dollars in workshare discounts, and potentially could lead to Postal Service decisions that place an unequal, and potentially unfair, price burden on single-piece mailers. I believe that major methodological changes should not be made in a vacuum without thorough review, including the consideration of the view of those that use the mail.

My colleagues believe that the short-term disruption that rejecting these prices would cause outweighs this transgression. They find support in the general provisions of the PAEA, which promote pricing flexibility for the Postal Service. The only reference to pricing flexibility in the PAEA is in the objectives list of section 3622 (objective 4). Because the PAEA must be interpreted solely on the basis of its text, there is no way to elevate pricing flexibility above any of the other nine objectives, such as objective 1, which is to "maximize incentives to reduce costs and increase efficiency." It should be borne in mind that the 39 U.S.C. § 3622(e) requirement that workshare discounts equal costs avoided is not an "objective" or a "factor." It is a separately stated requirement. Section 3622(e) provides that the Commission "shall ensure that such discounts do not exceed the cost that the Postal Service avoids . . . ."

I believe that the most prudent approach is to require compliance with the specific requirements of the PAEA in this instance because it leads to the establishment of economically efficient prices which will help further the long-term viability of the Postal

Service. This approach outweighs the temporary inconvenience of immediately requiring the submission of new rates, when compared with the much more significant disruption caused if the Commission as a whole, or another reviewing authority, later finds the prices unlawful.

The Postal Service appears to be flouting the cost avoidance methodology affirmed by the Commission for several years. In Docket No. R2006-1 (the last omnibus rate case under the PRA), First-Class Mail workshare methodologies were litigated by the participants.[60] The Postal Service proposed but the Commission did not adopt a delinked workshare methodology similar to what the Postal Service introduces in this docket. In Docket No. R2008-1 (the first annual rate adjustment under the PAEA), the Postal Service attempted to introduce a similar methodology. However, the Commission used the established analytical methodology and noted that the Postal Service's methodology "has not been reviewed by the Commission, and is significantly different in approach than each of the other cost avoidances in the class." Docket No. R2008-1, Order No. 66 at 18 (footnote omitted). In the FY 2007 ACR, the Postal Service also initially presented First-Class workshare cost avoidances that do not use the established methodology. In the FY 2007 ACD Report, the Commission stated, "[a] decision to change the framework used for measuring worksharing cost avoidance should await a more complete airing of the pros and cons of the alternatives." FY 2007 ACD at 63.

I am not averse to considering proposals to modify established methodologies should such analyses be brought forward in a timely manner. However, the Commission has continuously stressed that important methodological issues should be considered outside of the time constraints of annual price adjustments or compliance report proceedings. The Postal Service also appears to concur with this sentiment

[60] The history of considering these methodological issues can easily be traced back to Docket No. MC95-1.

when it suits them. After the filing of the Postal Service's 2007 Annual Compliance Report, the Postal Service requested consideration of 13 different methodological changes. Each issue was expeditiously considered, with public comment, and resolved in time for the filing of the 2008 Annual Compliance Report.

In this price adjustment docket, instead of allowing thorough consideration of an important methodological proposal using a tested, inclusive procedure, the Postal Service introduces its proposal during a proceeding under strict time constraints. This approach precludes meaningful public comment and effectively asks the Commission to accept the Postal Service's new methodology without analysis befitting the significance of this change, albeit subject to some future review.

The Postal Service justifies its change based on its legal interpretation of the relationship of the term "product" to the workshare requirements of 39 U.S.C. § 3622(e), not on any changed circumstance since the last price adjustment or on any new economic theory. I have not been convinced on this record that the Postal Service's legal interpretation is correct.[61] I am particularly concerned that the Postal Service's interpretation allows it to unilaterally determine what is or is not a workshare discount, thus effectively allowing it to write the protections intended by 39 U.S.C. § 3622(e) out of the statute when it is convenient.

In their opinion, my colleagues state that "the Postal Service has provided relatively little support for this contention" that First-Class automation discounts are justified by section 3622(e)(2)(D). The Postal Service has not met the requisite burden of proof to overcome the clear statutory prohibition against passthroughs exceeding 100 percent. Their opinion further maintains that "[T]his decision…is the most responsible

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[61] As noted, 39 U.S.C. § 3622(e) setting forth the 100 percent passthrough standard does not use the term "product." It does, however, use the term "workshare discount" which it defines as a discount provided for "presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a)."

way to respond to the Postal Service's failure to obtain advance review of its new workshare discount design methodologies."

I disagree. The most responsible way to address this failure is to reject the Postal Service's filing because it fails to satisfy the Commission's rules.

I believe that developing a new set of rates in compliance with the workshare requirements of 39 U.S.C. § 3622(e) and using established methodology can be accomplished more quickly and with less disruption than do my colleagues. This can be done while providing the Postal Service substantial flexibility in pricing its products and raising revenue equivalent to that proposed in the Notice. A number of workable options can be considered that satisfy the legal criteria, which could be implemented before May 11, 2009.

It strikes me that there are close parallels between what is happening to the Postal Service financially, and what has been happening to the banking industry. The banking industry was given wide discretion to lend how and on what terms it chose. The assumption was that this was safe because the managers' discretion would be bounded by certain basic principles (*e.g.,* that investors would have knowledge of the kind of securities marketed, and the risks would be publicly known either through an SEC filing or prospectus) and accountability would be provided by a diligent board of directors.

It is now clear that these basic principles and institutional safeguards were allowed to become mere window dressing. I fear this to be the direction in which postal regulation is headed. Congress intended that there be a certain economic "rhyme and reason" to both class prices and product discounts; hence, provisions such as section 3622(c)(2) (attributable cost floor) and section 3622(e) (discounts match avoided costs). Are these on the way to becoming window dressing? The uneconomic approach to rate setting can be a factor contributing to the Postal Service slide into financial distress. If the Postal Service is to be excused again for violating 39 U.S.C. § 3622(e), the reasons given must be carefully chosen so that the Postal Service, and the postal community, do not get the impression that there is not now, and never will be, any enforceable standard for workshare pricing.

Commissioner Ruth Y. Goldway