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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

Before:

Chairman Blair,
Vice Chairman Tisdale,
Commissioners Acton, Goldway, and Hammond

Postal Rate and Fee Changes — Docket No. R2006-1

SECOND OPINION
AND
RECOMMENDED DECISION
ON RECONSIDERATION

Washington, DC 20268-0001
May 25, 2007

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SUMMARY

The Governors of the Postal Service have asked the Commission to reconsider the level of rates applicable to lightweight Standard Mail catalogs that pay the minimum per-piece flat rates. The Governors ask the Commission to focus on the potential impact on mailers that may result from the substantial rate increases this mail faces.

Extensive responsive comments have been submitted by mailers of lightweight catalogs, other types of Standard Mail, and the Postal Service. In general, these comments can be summarized as follows:

- catalog mailers want rate relief during a transition period to allow them to adjust to the cost-based rates recommended by the Commission and approved by the Governors;
- most other Standard Mail users support such relief so long as they are not burdened with higher rates as a result; and
- the Postal Service supports relief so long as it continues to receive sufficient revenues to break even, including the one percent contingency found appropriate in this case.

The Commission finds that each of these positions is well-taken. However, none of the suggestions in the comprehensive comments of the parties offered a solution that satisfies each of these requirements.

The Commission offers for the consideration of the Governors a recommendation that meets each of these three criteria, although it has other aspects that may be viewed negatively by the Postal Service. The Commission recommends a temporary rate reduction of three cents for all Standard Mail Regular flats, and two cents for all Standard

Mail Nonprofit Regular flats. No other rate changes are recommended. These transition rates would expire on or before September 29, 2007, the Sunday before the test year of fiscal 2008 begins.

These transition rates would provide relief for users of Standard Mail flats, giving them approximately three months of lower rates during which they could adjust their mailing practices and business plans. Other mailers would not be unfairly burdened with a further rate increase.

On the other hand, reducing these rates will have a negative impact on overall Postal Service financial forecasts. Although recommended rates will allow the Postal Service to break even in the test year, including full funding of the requested contingency, the Postal Service will face some reduction in interim year revenues.

The Commission recognizes that it is the Governors who are charged with establishing implementation dates for new rates, and for preserving the overall financial health of the Postal Service. In light of that latter responsibility the Governors may determine that it is necessary to reject this recommendation. The Commission and the Postal Service are working closely together to implement the Postal Accountability and Enhancement Act, and in particular, to promptly fashion a modern system of rate regulation that will allow the Postal Service to implement rate increases without going through the lengthy and expensive “omnibus rate case” process.

The Commission realizes that ultimately the financial situation and prospects of the Postal Service will be the determining factors in any future Board of Governors’ decision on whether to file for rate changes under either system. The Commission emphasizes that a brief period of transition relief for a small segment of the mailing industry should not be reason for subjecting the Postal Service and mailers of all classes to the huge expenses in time and money inherent in a “final” omnibus rate case. All mailers, including the users of lightweight Standard Mail flats, would be worse off under that scenario.

This is the third recommended decision issued by the Commission in Docket No. R2006-1. The Commission views this history as an affirmation of the cooperative and complementary functions of the Commission and the Governors. The first decision (February 26, 2007) dealt with a myriad of issues and was largely accepted. The Governors had concerns in three areas and properly sought reconsideration. The Commission has responded quickly. The second decision (April 27, 2007) recommended that changes should be made in two areas, and those changes have already been implemented.

Today's decision offers a solution not directly proposed by the Governors in their request for reconsideration of Standard Mail flats. The Commission carefully considered the Governors' suggestion that the rates for letters and flats be rebalanced; however, it finds that such a result is neither justified by the evidentiary record, nor consistent with the policies of the law under which this case must be decided.

The Commission recognizes that some users of Standard Mail flats face large rate increases, and that the Governors would like to soften the impact of their increases. As a partner in this process, the Commission finds it is justified in recommending a temporary rate reduction. If the Governors find that the Postal Service can financially afford to soften the impact of increases on these mailers, this recommendation provides a means for them to do so.

I. PROCEDURAL HISTORY

[1001] In their Decision of March 19, 2007, the Governors of the United States Postal Service "concluded that three issues — Standard Mail flats, the Nonmachinable Surcharge for First-Class Mail letters, and the Priority Mail Flat Rate Box — would benefit from further consideration."[1] Accordingly, the Governors approved the Commission's Recommended Decision and returned these three matters for reconsideration under the "allow under protest" option provided in former 39 U.S.C. § 3625(c)(2). The Commission made further recommendations regarding the nonmachinable surcharge and the rate for the Priority Mail Flat Rate Box in our Opinion and Recommended Decision on Reconsideration of April 27, 2007. The Governors approved those recommendations in their Decision of May 1, 2007.[2]

[1002] As the Governors note in their May 1 Decision, reconsideration with regard to Standard Mail flats rates has required resolution of intervening procedural issues. On April 3, 2007, a new organization, the Coalition of Catalog Mailers, (CCM), filed a Notice of Intervention,[3] a motion for late acceptance of the former,[4] and a motion to extend the

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[1] Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Regulatory Commission on Changes in Postal Rates and Fees, Docket No. R2006-1, March 19, 2007, at 2 (Governors' Decision).

[2] Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision on Reconsideration of the Postal Regulatory Commission on Changes in Postal Rates and Fees, Docket No. R2006-1, May 1, 2007.

[3] Notice of Intervention by the Coalition of Catalog Mailers, April 3, 2007. The Coalition filed a Supplemental Notice of Intervention identifying additional members on April 5, 2007.

[4] Motion for Acceptance of Late Notice of Intervention by the Coalition of Catalog Mailers, April 3, 2007.

deadline for motions to reopen and supplement the record.[5] In Ruling No. 130,[6] the Presiding Officer noted the pleadings filed by CCM, and found its justification for extending the deadline for submitting its motion to reopen the record to be persuasive. That ruling set a deadline of April 12, 2007 for the filing of CCM's motion to reopen the record, and suspended the previously established deadlines for comments and reply comments regarding Standard Mail flats rates.

[1003] CCM filed its Motion to Reopen and Supplement the Record on April 12, 2007 (Motion to Reopen). The Presiding Officer certified this issue to the full Commission in P.O. Ruling R2006-1/132. The Commission dealt with that motion, and the larger issue of how to proceed in reconsidering Standard Mail flats rates, in Order No. 13.[7]

[1004] That Order granted CCM's motion to intervene at this stage of the proceeding. *Id*. at 4-6. CCM's motion to reopen the record was denied because the considerations it cited in favor of doing so were outweighed by material prejudicial effects towards other participants and the needs of the Governors; however, CCM was granted a full opportunity to present the arguments of its members, based on the existing record. *Id*. at 9-12. To accommodate receipt of the arguments of CCM and all other interested participants on what adjustments, if any, should be made in the initially recommended rates for Standard Mail, May 4, 2007 was established as the deadline for filing

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[5] Motion of the Coalition of Catalog Mailers for an Extension of Time in Which to File a Motion to Reopen and Supplement the Record for Reconsideration, April 3, 2007.

[6] P.O. Ruling R2006-1/130, April 5, 2006.

[7] Order (1) Granting Coalition of Catalog Mailers' Motion for Late Intervention, (2) Denying Coalition of Catalog Mailers' Motion to Reopen the Record, and (3) Establishing Procedural Schedule, April 27, 2007.

comments, and May 11, 2007 for reply comments. Fourteen participants filed comments on the issues presented for decision.[8] Thirteen participants filed reply comments.[9]

[8] Comments of American Business Media on Reconsideration of Standard Rates for Flats, May 2, 2007 (ABM Comments); Initial Comment of American Bankers Association on the Reconsideration of Standard Mail Flats Rates (ABA Comments); Initial Comments on Reconsideration of Coalition of Catalog Mailers (CCM Comments); Direct Marketing Association, Inc. Initial Comments Pursuant to PRC Order No. 8 (DMA Comments); Comments of Discover Financial Services LLC (DFS Comments); Comments of Financial Services Roundtable, Major Mailers Association, National Association of Presort Mailers and National Postal Policy Council (Letter Mailers Group Comments); Initial Comments of Mail Order Association of America on Reconsideration of the Rates for Standard Mail Regular Flats (MOAA Comments); Initial Comments of PostCom on the Board of Governors Request for Reconsideration of Standard Mail Flat Rates (PostCom Comments); Initial Comments of the United States Postal Service on Reconsideration of Rates for Standard Mail (USPS Comments); and Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the Reconsideration of Standard Mail Flats (Valpak Comments), all filed May 4, 2007.

[9] Reply Comments of Mail Order Association of America, May 9, 2007 (MOAA Reply Comments); Reply Comments of American Bankers Association on the Reconsideration of Standard Mail Flats Rates (ABA Reply Comments); Reply Comments on Reconsideration of Coalition of Catalog Mailers (CCM Reply Comments); Direct Marketing Association, Inc. Reply Comments Pursuant to PRC Order No. 8 (DMA Reply Comments); Reply Comments of Discover Financial Services LLC (DFS Reply Comments); Reply Comments of Financial Services Roundtable, Major Mailers Association, National Association of Presort Mailers and National Postal Policy Council (Letter Mailers Group Reply Comments); Reply Comments of PostCom on the Board of Governors Request for Reconsideration of Standard Mail Flat Rates (PostCom Reply Comments); Reply Comments of the United States Postal Service on Reconsideration of Rates for Standard Mail (USPS Reply Comments); and Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the Reconsideration of Standard Mail Flats (Valpak Reply Comments), all filed May 11, 2007. Financial Services Roundtable *et al.* filed a Notice of Errata and a corrected version of their Reply Comments on May 14, 2007.

II. RATES FOR STANDARD MAIL FLATS

A. Issues Raised by the Governors and Participants

[2001] The Governors request that the Commission review its recommendations relating to Standard Mail flats rates. The Governors express concern about the effect the rate increases recommended for Standard Regular flats may have on the vitality of the catalog industry and on the economy as a whole. Governors' Decision at 9, 12. They "urge the Commission to use the opportunity [provided for by reconsideration] to mitigate the recommended increases for catalogs and other flat mailers[,]" and consider whether "rebalancing" might be appropriate. *Id.* at 12.[10] The Governors believe that a "more gradual transition to cost-based pricing … better serve[s] to balance the considerations of both efficiency and the long-term health of the catalog industry." *Id.* at 9. With respect to this issue, the Governors have asked "the Commission to move as expeditiously as possible to give mailers a practical opportunity to plan effectively for future mailings." *Id.* at 2.

[2002] In its Initial Statement, the Postal Service requests that on reconsideration of Standard Mail flats rates, the Commission (1) ensure that the Regular 5-digit automation letter rates remain below the Basic ECR letter rates, and (2) retain the dropship discounts for letters and flats rates as initially recommended. Initial Statement at 10-11.

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[10] The Commission notes, and both the Postal Service and Valpak agree, that the Governors appear to request reconsideration of only Standard Regular and Standard Nonprofit Regular and do not request reconsideration for ECR/NECR flats. *See* PRC Order No. 8 at 4, n.6; *accord* Initial Statement of the United States Postal Service on Reconsideration, March 28, 2007, at 9-12 (Initial Statement); USPS Comments at 6-9; USPS Reply Comments at 2; Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Opposition to Late Intervention by Coalition of Catalog Mailers, April 13, 2007, at 1, n.1; Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Opposition to Motion to Reopen and Supplement the Record by Coalition of Catalog Mailers, April 19, 2007, at 1, n.1; Valpak Comments at 1-4. Accordingly, this discussion is limited to the Standard Regular subclasses.

The Postal Service believes that a “reasonable objective would be to provide some rate relief, particularly for those catalog and other flat mailers ….” *Id.* at 11.

[2003] In its comments, the Postal Service elaborates on this proposal. Its suggested approach maintains the automation, presort and dropship discounts and flats pound rate originally recommended by the Commission, but makes the following “revenue neutral” adjustments to the Commission’s recommended rates:[11]

(1) Reduce the minimum per-piece rate and the piece rate for piece-pound rated flats by $0.03 per piece; and

(2) Increase the price for automation and nonautomation machinable letters by $0.007 per piece.

USPS Comments at 5-7.[12] The proposal specifically excludes an adjustment to nonmachinable letters. The Postal Service does not believe that “nonmachinable letters should receive even further increases, if a reasonable rebalancing granting rate relief for flats can be otherwise achieved,” since in some circumstances, nonmachinable letters will already receive large increases. *Id.* at 8. The Postal Service argues that its approach is practical for the following reasons: (1) it is simple; (2) it would provide “reasonable rate relief” to catalog mailers without excessive increases for others; (3) it would be approximately revenue neutral; and (4) it would maintain “reasonable” rate relationships and discounts as well as the unity of the pound rate. *Id.* at 8-9. The Postal Service believes that it is a “less viable, and unacceptable alternative” to rebalance only among flats rate categories. *Id.* at 9. Flats-only rebalancing would force

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[11] The Postal Service responds to the Letter Mailers Group’s apparent claims that the *Ass’n. of Oil Pipe Lines v. FERC*, 281 F.3d 239 (D.C. Cir. 2002) stands for the proposition that “the Commission lacks the legal authority upon reconsideration to recommend different rates on the basis of the same evidentiary record.” USPS Reply Comments at 4-5. It believes such an interpretation would render the statutory option to seek reconsideration meaningless. *Id.* at 7. It interprets the *Oil Pipe Lines* case as remanding because the agency fails to provide an adequate explanation for changing its methodology; not by reason of changing its methodology in and of itself. *Id.* at 6. For the reasons stated by the Postal Service, the Commission agrees that *Oil Pipe Lines* does not bind the Commission’s hands on the substantive aspects of reconsideration, and it strives here, as in all of its decisions, to provide well-reasoned justifications for its actions.

[12] It notes that similar changes for Standard Mail Nonprofit Regular rates may be necessary. *Id.* at 7.

heavier-weighted flats pieces (including heavier catalogs) to offset decreases in lighter-weighted flats pieces. The Postal Service also points out that flats-only rebalancing would lead to an inconsistency with the Commission's recommendations regarding the pound rates in the Standard Mail subclasses or force the Commission to change the presort and automation rate relationships originally recommended. *Id.* at 9-10.[13]

[2004] The Postal Service also takes issue with the arguments that the Commission should reduce the rates for flats, but not make any compensating adjustments in other rates. It believes that such a position is contrary to the breakeven requirements of the Postal Reorganization Act and that there is no record evidence supporting an adjustment to the volume forecasting methodology at this stage of the case. USPS Reply Comments at 8-10. It also contends that such an argument is essentially a "back-door" attempt to change the revenue requirement; a matter well outside the scope of the issues returned for reconsideration by the Governors. *Id.* at 10-11.[14]

[2005] CCM discusses the inability of catalog companies to respond quickly to "significant and abrupt" rate increases. CCM Comments at 3-4. It highlights the fact that it is not only the size of the increases that "threatens the catalog industry[,]" but also the suddenness since catalogers "have had only a few weeks to address the much higher rates actually recommended by the Commission." *Id.* at 4. CCM notes that "[w]ithout a transition period to revamp catalog operations, catalogers are faced with the immediate choice of (a) maintaining volumes and incurring increased expenses … or (b) reducing volume and foregoing future revenue streams …." *Id.* at 6.

[2006] CCM believes that such an impact could be substantially mitigated if the rate increases "are phased in over a reasonable period." *Id.* Accordingly, CCM repeatedly asks for a "reasonable transition period" to "allow catalog companies time to change their businesses in the most efficient manner possible to adjust to the new shape-based rate

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[13] PostCom concurs that a flats-only rebalancing would be unworkable and negatively affect not only revenues, but also Postal Service costs. PostCom Reply Comments at 4-5.

[14] Valpak and the Letter Mailers Group make similar arguments. Valpak Reply Comments at 3; *see also* Letter Mailers Group Reply Comments at 22.

structure." *See, e.g.*, CCM Comments at 1. To support its position, CCM points to certain statements in the record made by Valpak witness Mitchell and Postal Service rebuttal witness Kiefer. Witness Mitchell stated that he believed that "[*m*]*any flats could not in any reasonable way be converted into a letter*." (Emphasis in original.) *Id.* at 8 (quoting Tr. 25/8836). Witness Kiefer testified on rebuttal that he strongly believed that changes in the rates for flats should be adjusted gradually, instead of "jump[ing] instantly to [his] preferred rate relationships …." *Id.* at 9 (citing USPS-RT-11 at 20-21).[15]

[2007] CCM agrees with the Postal Service that rebalancing within Standard Regular flats is inappropriate for the following reasons. First, since a large number of catalogers send both heavy and light catalogs, any relief to lightweight flats would be offsetting. Second, granting relief in this manner would distort the economic incentives created by existing rate relationships and fail to promote economic efficiency. Finally, the volume of heavy flats may not be large enough to give meaningful rate relief to lightweight flats.

[2008] CCM does not set forth a specific remedy for rebalancing letters and flats, but it "acknowledges the difficulty of fashioning specific rate relief to mitigate the effect of moving to the new shape-based rate structure." *Id.* at 10. It stresses, however, that its goal is for the Commission to "allow a reasonable transition to shape-based rates." *Id.* at 11.[16] It believes that the Postal Service's proposed rebalancing is a "reasonable

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[15] Mail Order Association of America (MOAA) also points to this and similar statements by witness Kiefer and witness Mitchell in support of lowering Standard Mail flats rates. Mail Order Association of America Answer to Motion of Coalition of Catalog Mailers to Reopen and Supplement the Record, April 19, 2007, at 3-5 (MOAA Response to CCM Motion to Reopen). MOAA also submits that the Commission can take "official notice" of the fact that catalogers have production difficulties that differ from those that would affect other types of mail. *Id.* at 2.

[16] It also attaches to its comments six letters from catalog companies to demonstrate potential impact. Valpak and the Letter Mailers Group correctly point out that these letters "are most certainly not record evidence[.]" *See* Valpak Reply Comments at 7. The Letter Mailers Group also cite statements in CCM's pleading which it argues are "less a guide to the existing record … than a wish list of additional points that CCM hoped to establish through its belated and untimely proffer of additional testimony" and "can be given no evidentiary weight[.]" Letter Mailers Group Reply Comments at 13-14. The Commission agrees that statements made on brief without an evidentiary basis do not establish facts that can be relied upon by the Commission in making its recommendations.

approach" to providing some rate relief and "thus supports the Postal Service's proposal with respect to Standard Mail Regular flats." CCM Reply Comments at 3.

[2009] MOAA supports the rebalancing proposal set forth in the Postal Service's comments.[17] MOAA points out that the Commission has already recognized the need to moderate rate increases as the result of rate shock concerns in Periodicals, and it should apply that same analysis to reduce rates for Standard Mail flats.[18] MOAA also urges the Commission to consider "suggesting to the Governors that the increased rates for flats be delayed" since it would allow mailers to adjust more readily to the Commission's recommended rates and give an appropriate "transition period." MOAA Response to CCM Motion to Reopen at 6.[19]

[2010] PostCom argues that the Commission should mitigate the rates it recommended for the Standard Regular flats rate categories. PostCom Comments at 1. It believes that such mitigation should be accomplished by an across-the-board reduction of each rate cell. *Id.* at 1, 3. PostCom contends that it is "of critical importance" that a reduction be done in this manner to avoid disrupting rate relationships, particularly the incentives for presortation and dropship entry. *Id.* at 3.

[2011] At the same time, PostCom also believes that the Postal Service's proposal to offset the reductions in Standard Mail flats by raising rates for Standard Mail letters is unsupported by the record and is "utterly irrational and unnecessary." *Id.* at 1. Specifically, PostCom submits that the Postal Service's demand models are imperfect,

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[17] MOAA Reply Comments at 1. MOAA also notes in passing that it "supports a reduction in the pound rate" although it provides no rationale for doing so other than a statement that "[t]here is no remaining justification for a pound rate at the level recommended by the Commission." MOAA Comments at 1. MOAA's use of the term "no remaining justification" is confusing and inopposite. On reconsideration, the Governors do not ask the Commission to revisit its rationale for its recommended pound rate and the Commission's analysis for its pound rate recommendations remains sound in light of the reconsideration request. Accordingly, the Commission does not find any basis to reduce the pound rate more than it initially recommended.

[18] MOAA Response to CCM Motion to Reopen at 4; *see also* CCM Comments at 7-8.

[19] In its comments, MOAA incorporates by reference its Response to CCM's Motion to Reopen and Supplement the Record. MOAA Comments at 1.

especially below the subclass or rate category level (such as flats) that represent smaller percentages of the subclass. As a consequence, it asserts that the elasticity assumptions that underlie the volume and revenue forecasts are subject to a degree of uncertainty, which is accounted for in the contingency reserve.[20] It believes that it would be "unconscionable" for the Postal Service to have both a contingency reserve and an offset in the anticipated reduction in flats revenues by a corresponding increase in Standard Regular letter mail revenues. PostCom Comments at 6-7; PostCom Reply Comments at 1-2, 4.[21]

[2012] Direct Marketing Association, Inc. (DMA) "strongly supports" the Governors' request for the Commission to reconsider the rates for Standard Regular flats and revise its recommendations. DMA Comments at 2, 8-9. However, DMA believes that rate relief for Standard Regular flats can and should be accomplished without raising rates for any other rate categories. It points to isolated statements from the Commission's opinion that it asserts support its contention that the Commission did not give adequate evidentiary weight to the impact that its recommended rates would have on flats mailers. *Id.* at 4-8. It submits that there is no basis in the record for concluding that Standard Regular flat mail should make the same contribution per piece as Standard Regular letters and that such a contention is "fundamentally unfair." *Id.* at 8.

[2013] However, DMA strenuously objects to raising Standard Regular letter rates to offset any revisions to flats rates. *Id.* at 2. It believes that such an offset is not justified because the Commission has overstated the Postal Service's revenues due to unrealistically high volume projections for Standard Regular flats. Additionally, DMA seeks to revisit the Commission's recommended contingency reserve of one percent or,

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[20] MOAA makes a similar point regarding volume projections. MOAA Response to CCM Motion to Reopen at 5-6.

[21] DFS and DMA make a similar argument regarding the use of the contingency reserve. DFS Comments, Attachment at 2; DMA Comments at 4. ABA agrees that "the contingency fund should be looked to as a source for any 'rebalancing' of the Standard flat rates before raising letter rates." ABA Reply Comments at 4. It believes that using the contingency reserve as a funding source for mitigation would still result in "subsidizing flat mailers," but would at least not be doing harm to Standard letter mailers or anyone else. *Id.* at 5.

alternatively, "'spend' the contingency that the Commission awarded the Postal Service … and implement the USPS-proposed rates for Standard Regular flats, without increasing the rates for any other mail." *Id.* at 11-12. It calculates that the Postal Service's proposed 3-cents decrease in Standard Regular flats rates will reduce revenues by approximately $350 million which will "still leave … the Postal Service with a substantial revenue cushion in the Test Year." DMA Reply Comments at 2.[22]

[2014] American Bankers Association (ABA) does not take a position on whether Standard Mail flats rates should be reduced, but "sympathizes with the concerns of flats mailers regarding the size of the rate increases for their mail." ABA Reply Comments at 5. However, if the Commission does grant rate relief to flats mailers, ABA urges that it "should not come at the expense of letter mailers." ABA Comments at 1. Rather, it should be the result of rebalancing among flats rate cells. *Id.*; ABA Reply Comments at 3. ABA notes that under the Commission's recommended rates, some heavier catalogs will experience a decrease in rates which suggests that rebalancing should start within the catalog industry. ABA Comments at 3. Any attempt to rebalance at the expense of letters would "reintroduce the subsidy of flat rates" and would be a step backwards especially given the passage of the PAEA. *Id.* at 2. It believes that Congress intended the PAEA to force the postal system to become more efficient by ensuring that rates charged actually track costs and rates are representative of a modern business environment. *Id.* Additionally, ABA contends that it is "too late" to implement any rebalancing since by the time this reconsideration decision is acted upon, rebalancing will entail multiple rate changes over a short period of time.[23]

[2015] The Letter Mailers Group argue that the Commission should not change the recommended rates since changes would result in a "zero sum game at the expense of

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[22] Other participants calculate the burden to be around $400 million. *See, e.g.*, Valpak Reply Comments at 3.

[23] ABA believes that this option is unattractive because of its substantial costs. Those costs include those based on the manufacturing of new rate schedules, reprogramming of computers, customer education, disruption of marketing plans, and lost faith in the stability and reliability of rates. *Id.* at 3; ABA Reply Comments at 4-5.

letter mailers."[24] Fashioning relief in this manner would restore prior inefficiencies due to incomplete passthroughs of shape-related cost differentials that were unfair and long overdue for reform. Letter Mailers Group Comments at 4-6; Letter Mailers Group Reply Comments at 25-26. Accordingly, it believes the burden should be on the proponents of reducing Standard Regular flat rates to show that the benefit of such action outweighs the harms of an offsetting rate increase for letter-shaped mail. *Id.* at 20-25. In any event, the Letter Mailers Group contends that there is no support in the record to make such a finding on behalf of flats mailers. It asserts that the following harms would result to the detriment of letter mailers: (1) economic injury in the form of higher rates; (2) dead weight loss to society from a rate structure that does not follow the principles of Efficient Component Pricing (ECP); and (3) transaction costs to mailers and vendors due to multiple changes in the rate schedules within a very short period of time. Letter Mailers Group Comments at 3-4, 6.

[2016] The Letter Mailers Group notes that rather than challenging the new rate structure on economic grounds, the flat-shaped mailers instead argue that the "existing rate preference" must be extended for some "indefinite further period to avoid rate shock." *Id.* at 7. However, the Letter Mailers Group does not believe this is an adequate justification given that flats mailers have been repeatedly warned for many years that their rates were too low and needed to be raised.[25] Additionally, it disputes CCM's arguments that witness Kiefer's rebuttal testimony supports a reversal of the Commission's original rate recommendations. It contends that the oft cited witness Kiefer testimony merely rebuts witness Mitchell's rate proposals as too rigid and does not

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[24] Letter Mailers Group Comments at 1. However, the Letters Mailers Group points out that if the Postal Service would agree to a reduction in its overall revenue, the Commission could recommend lower rates for flats without increasing the rates for letters. *Id.* at 1, 3. It does not believe that rate reductions could be considered self-financing since such reductions would require unrealistic demand elasticities in the range of -1.6 or -1.7 when taking into account increased costs. Letter Mailers Group Reply Comments at 21. The Postal Service makes a similar point. USPS Reply Comments at 9.

[25] Letter Mailers Group Reply Comments at 3-5. In support of its proposition that flats mailers' claims of rate shock are unjustified due to the length of the delay in fashioning cost-based rates for flats mailers, it cites several court cases dealing with businesses in other regulated industries. *Id.* at 10.

support CCM's claims or otherwise provide sufficient record evidence to support rebalancing. *Id.* at 10-13; Letters Mailers Group Reply Comments at 11-12. The Letter Mailers Group further argues that flats mailers have failed to point to any record evidence showing that they will suffer any "transitional" injury from the recommended rates sufficient to require rebalancing.[26]

[2017] Discover Financial Services (DFS) submits that it is sympathetic to the catalog industry's situation, but argues that it is inappropriate to provide relief by raising rates a second time for letter mailers. This "would be very disruptive to the financial services industry and would not be fair." DFS Comments, Attachment at 1. It notes that computers have already been programmed with the new letter rates and long-term marketing plans have been made based on those rates. It argues that "[a] second rate increase in one year would significantly disrupt all these projects and be very costly to the industry." *Id.*

[2018] Valpak asserts that no mailer should be required to pay "artificially higher rates to allow mailers of certain Standard Regular flats to pay artificially reduced rates." Valpak Reply Comments at 13. It points out that the criterion "effect on mailers" in § 3622(b)(4) is only one of nine statutory criteria that has already been considered by the Commission. It views § 3622(b)(4) as a short-term consideration that should not dominate long-term rate design; otherwise, it would lead to years of rates that do not recognize the higher costs of flats. Valpak Comments at 3.

[2019] Valpak further addresses the arguments made by the parties seeking to use the contingency to lower Standard Mail flats rates. It notes that such an argument implicitly urges the Commission to have not just letter mailers, but "**all** mailers foot the bill for tempering Standard Regular flats rates" by advancing the date when the next general rate increase will be needed. Valpak Reply Comments at 2. (Emphasis in original.) It further takes issue with what are essentially arguments seeking a social policy favoring

[26] It also points to several recent Postal Service and vendor press releases encouraging flats mailers to convert to letters and notes that half of all commercial Standard Mail flats weigh less than the maximum letter weight and would be eligible for conversion at least on the basis of weight. *Id.* at 8.

flats. It contends that there is nothing in the record to support such a proposition, and if anything, the record supports "policy reasons which could be said to favor letters." *Id.* at 5-6 (citing Tr. 25/8824-35, VP-T-1 at 67, 115-16).

[2020] American Business Media (ABM) seeks to remind the Commission that the Standard Regular flats rates will also affect mailers of Periodical publications. It accordingly expresses general support for some reduction in rates for Standard Mail flats. ABM Comments at 1-4.[27]

[27] Valpak points out that the record does not contain any evidence about the practice of using Standard Mail flats for sending magazines to subscribers or the volume of magazines that follow such practice. Valpak Reply Comments at 11-12.

B. Commission Analysis

1. Preliminary Issues

[2021] It is important to begin our analysis with the observation that in the comments received by the Commission on reconsideration, no participant has asked the Commission to revisit or change its originally recommended overall rate design structure for the Standard Regular subclasses.[28] In fact, the comments that did address the rate design details of rebalancing specifically ask that the Commission not disturb the rate relationships within or between the flats categories which could affect the "automation, presort, and drop-ship discounts" initially recommended by the Commission.[29] Instead, those participants that ask the Commission to reduce flats rates urge that such a reduction be done as suggested by the Postal Service. *See, e.g.*, MOAA Reply Comments at 1. Any other method of adjustment would lead to the creation of "disruptive rate relationships" and send "confusing and/or anomalous signals to mailers." *See* Initial Statement at 11. Adjusting rate relationships in this manner would also have the undesirable effect of moving away from Efficient Component Pricing (ECP) rates for automation, presort, and/or dropship discounts. ECP is a bedrock principle of the Commission's original opinion and recommended decision — an issue the Governors did not ask the Commission to revisit in this reconsideration. Moreover, none of the

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[28] ABA and DFS ask the Commission to rebalance among flats, but did not provide any particular details for such a proposal. The Commission finds the lack of a concrete proposal fatal to their argument especially given that rebalancing among only flats would disrupt those ECP (or nearly ECP) rate relationships that were central to the overall recommended decision. It would also create an anomalous result in that the pound rate for flats would be above the pound rate for parcels and not flat machinables. Such a result would also be contrary to the Commission's explicit finding in its initial recommended decision that there was no evidence in the record to support a different pound rate for Standard Regular parcels and the Commission's findings regarding lowering the ECR pound rate. Nothing has been presented on reconsideration to support a change in those findings.

[29] *See* USPS Comments at 6, 9-10; DMA Reply Comments at 1; PostCom Comments at 3; MOAA Comments at 1; CCM Comments at 11.

comments identifies any of the accepted costing methodologies or other costing analysis as issues ripe for reconsideration.[30]

[2022] The Commission agrees that the most rational way to adjust Standard Mail flats rates is in a manner similar to that suggested by the Postal Service so as not to undermine the economic principles discussed above. The Postal Service has proposed such a change and those participants that seek a reduction in flats rates have endorsed its proposal or at least the portion of its proposal that lowers all minimum per-piece rated pieces and the piece rate for piece-pound rated flats by 3 cents per piece. USPS Comments at 5-7. Accordingly, if flats rates are to be moderated, the Commission will recommend reducing all piece changes by a uniform amount.

2. Breakeven Requirement

[2023] A major point of contention is whether any reduction in Standard Regular flats rates can be accomplished without increasing rates for any other rate categories. Several participants seek to achieve this by "spending" part of the provision for contingencies on lowering flats rates. *See, e.g.*, DMA Comments at 12. As others point out, this would be akin to lowering the revenue requirement. The proper amount of the contingency (one percent of test year costs) has already been thoroughly litigated in this case and is not an issue ripe for reconsideration. Indeed, the Governors carefully noted in their Decision that both Postal Service's proposed Standard Mail rates and the Commission's recommended rates achieve the Postal Service's test year revenue target.

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[30] CCM asks that its silence on disputed cost issues not be considered a substantive concession, but rather "an attempt to stay focused on the limited issues on reconsideration relating to the effect on mailers of unexpectedly large rate increases." CCM Reply Comments at 2, n.2. The Commission takes this to imply that CCM believes that challenging costs are outside the scope of the matters returned for reconsideration or that it did not believe it was important enough to warrant revisiting those issues. In any event, costing has not been a contested issue in this reconsideration. *See also* Initial Statement at 11 (noting that rebalancing is a policy decision and is not based on cost or technical analysis).

[2024] The Commission agrees with participants' claims that it would be less disruptive in the short term to allocate a portion of the provision for contingencies to offset a Standard Mail flats rate reduction than to generate funds by increasing rates for Standard Mail letters. However, even if the contingency reserve were an issue currently before the Commission on reconsideration, such a finding would effectively have the Commission involved in Postal Service financial management by determining for the Postal Service how to use resources already allocated. The Commission will not tell the Postal Service where to spend funds allocated for test year contingencies, and the law does not authorize the Commission to do so. The Commission's role with respect to the provision for contingencies is to review the requested test year contingency amount for appropriateness and to determine if it is adequately justified, making adjustments where necessary.

[2025] In essence, "allocating" a portion of contingency funds to offset reduced Standard Mail flat revenue would amount to providing a smaller reserve for test year contingencies. This would mean that there would be fewer funds to cover potential test year revenue shortfalls from unpredictable or unexpected volatile expenses such as rising gas prices. Such a result would undermine the main purpose of a contingency reserve. It could also result in advancing the date that rates will have to be increased for all mailers — whether through a final rate case or under the rate cap regime. The Commission views such a result as undesirable from the point of view of the postal system as a whole.

[2026] Rather than recovering the potential revenue shortfall by raising rates for other mailers or using funds allocated to the contingency, several participants essentially argue that the elasticity assumptions accepted by the Commission are surrounded by a degree of uncertainty. *Id*. The effect of this uncertainty, they argue, results in an overstatement of volume for certain rate categories. It then follows that an overstatement in volume would translate into an overstatement of revenues. These rates are therefore subject to adjustment without a decrease in actual revenues. Put another way, they argue that the Commission's models have overstated revenues due to unrealistically high volume projections for Standard Mail flats given the recommended rates.

[2027] This Commission does not accept this argument. First, this argument has no factual foundation in the record. The elasticities accepted by the Commission on this record for Standard Regular do not distinguish between shapes.[31] There is nothing in the record — and the participants did not even proffer to reopen the record to supplement it with data — supporting this position. Additionally, uncertainty works both ways. The flats volumes could be understated just as easily as they could be overstated.

[2028] The record shows that the elasticity data are reasonably accurate in the aggregate, that is, when combining all the mail shapes within the subclass. *See* USPS-T-7 at 103, 365; PRC Op. R2006-1, App. I, ¶ 15; *see also* PostCom Comments at 5. If there is a good degree of confidence in the elasticities for the whole subclass, but an adjustment is made to a portion of that subclass elasticity, mathematically the remaining portions of that subclass would compensate for that difference with an adjustment in the other direction. In other words, the average elasticity is a weighted sum of its parts. If the elasticity of flats is higher (in absolute value) than previously believed, then the elasticity of letters must be lower (in absolute value) than initially anticipated. Therefore, if in response to a rate increase the after-rate volumes of Standard Regular flats are lower than expected, then it is probable that the after-rate volumes of Standard Regular letters would be greater than expected. So long as the average elasticity for the entire subclass is accurate, the subclass after-rate volume estimate should be reliable. Most important for this analysis, there is no record evidence supporting different elasticities for Standard Mail Nonprofit Regular flats and letters.

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[31] Indeed, the record shows that witness Angelides attempted to persuade the Commission to use a different elasticity for Standard parcels. In rejecting that argument, the Commission found that "Angelides elasticity claim is overbroad and its validity has not been shown on this record …. Angelides does not explore the consequences of adopting his claim or propose alternative volumes. If parcels have a higher elasticity than anticipated, this would require their rates to be priced even higher to achieve the same target contribution." PRC Op. R2006-1, ¶ 5473. (Footnote omitted.) A similar analysis applies here for the proposals seeking to adjust the elasticity for flats mail.

[2029] The Letter Mailers Group raises a further important point about changing the elasticity assumptions for Standard Regular flats. Using record evidence, it calculates that in order for a rate reduction for flats to be "self-financing," that is, not require a corresponding increase in letter rates, the demand elasticities for flat-shaped pieces would have to be in the range of -1.6 or -1.7 when taking into account increases in attributable costs. Letter Mailers Group Reply Comments at 21. Such elasticities are well beyond the realm of reasonableness for Standard Regular. Even the Standard ECR subclasses — which have many more alternatives than Standard Regular[32] — have a 95% confidence interval for its own-price elasticity from -0.725 to -1.433. *See id.*

[2030] Even if the proposition that as rate increases become larger, the accuracy of forecasting models can become more tenuous is accepted as true, the Commission uses econometric point estimate elasticities whenever it can do so and typically does not rely on qualitative judgments to estimate elasticities. The Postal Reorganization Act requires the Commission to recommend rates that allow the Postal Service to "as nearly as practicable" break even in the test year. 39 U.S.C. § 3621. As the Commission stated in its initial opinion when one of witness Thress' point estimates was challenged as subject to sufficient statistical uncertainty as to undermine the validity of the conclusion:

> While this observation may be technically correct, this does not help the Commission choose an appropriate elasticity to estimate changes in mail volumes or help measure value of service. A point estimate for elasticity is necessary to make such calculations, and a better estimate has not been presented on this record. In fact, witness Ingraham conceded that Thress's estimate is … 'the best guess' for ECR volume. Tr. 35/11870. Accordingly, the Commission uses Thress's elasticity estimate to measure volume and to help determine the value of service under 3622(b)(2).

PRC Op. R2006-1, ¶ 5356, n.121. The commenters have presented nothing that causes the Commission to change its analysis in that regard. Further, none of the commenters

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[32] These alternatives include private delivery firms and newspaper inserts — alternatives that are not typically available for Standard Regular mailpieces. USPS-T-31 at 29-31.

identifies a different "best guess" point estimate to use to estimate volumes and revenues for Standard Regular flats. Without such evidence, the Commission does not have sufficient information to justifiably conclude that lower test year rates will produce, as nearly as practicable, revenues that will allow the Postal Service to break even in test year 2008. *See* USPS-RT-2 at 12-15.

[2031] Finally, the most appropriate point estimate elasticity to use is an empirical issue that needs to be resolved by gathering quantitative evidence and applying the appropriate econometric techniques and statistical tests. The Commission uses econometric elasticity estimates whenever it can and typically does not adjust own-price elasticities from speculations about the importance of mailpiece characteristics. *See* USPS-RT-2 at 12-15.

[2032] For the reasons discussed above, the Commission finds that it can not adjust Standard Regular flats test year rates without a corresponding offsetting adjustment to other rate cells. Therefore, to determine on reconsideration that it should reduce the test year rates for Standard Regular flats, the Commission must find that record evidence provides a persuasive justification for increasing the Standard Regular letter rates. As discussed below, the Commission does not find that there is enough support in the record to adjust flats rates at the expense of letter rates. However, as also addressed below, the Commission does find that if the Governors find that a temporary rate reduction for flats is in the best interests of the Postal Service and the mailing community as a whole, there is sufficient evidence in the record to support a temporary, transitional rate reduction for Standard Regular flats.

3. Adequacy of Justifications for Moderating Flats Rates

[2033] The participants set forth several proposed justifications for adjusting the Standard Regular flats rates. CCM repeatedly states that it seeks "transitional rate relief" or a "reasonable transition period" and even concludes one of its pleadings by stating that "CCM respectfully requests that the Commission revise its recommended rates for

Standard Mail flats to allow a reasonable transition period to shape-based rates." *See, e.g.*, CCM Comments at 1, 11. There is a limited amount of evidence in the record to support flats mailers' contentions that Standard Regular flats rates should be permanently lowered. Flats mailers point mainly to witness Kiefer's rebuttal testimony as record support for lowering rates. *See, e.g.*, CCM Comments at 9. In relevant part, witness Kiefer stated:

> I understand that most Standard Mail flats are making significant positive contributions, and I am sensitive to the impacts that rapid changes in relative prices might have on the businesses of those customers who mail Standard Mail flats. Therefore, I *strongly believe that changes in relative letter-flat prices should be evolutionary, not revolutionary*. Witness Mitchell's approach would jump instantly to his preferred rate relationships, *heedless of the consequences his proposed pricing would have on mailers' businesses.* I believe that relative letter-flat prices should adjust gradually, even after considering that the 'evolution' has been delayed because of a number of unrelated factors.

USPS-RT-11 at 20-21. (Emphasis added.) Witness Kiefer also stated that he felt that witness Mitchell's proposed rates represented a lack of "adequate concern for impacts on mailers." *Id.* at 21. Upon reconsideration, the Commission finds that the rate impact concerns expressed by witness Kiefer and the commenters are important. Indeed, the Commission is sympathetic to the large rate increases that all flats mailers — not just catalogers — will have to endure. Nonetheless, as Valpak correctly points out, "rate shock" is only one out of nine criteria that the Commission must appropriately balance in reconsidering its recommended rates. The other factors of the Postal Reorganization Act, most significantly §§ 3622(b)(1), (3), (6), (7) and (9) are better met by moving closer to cost-based rates and the principles of ECP (discussed at length in the initial Opinion in this case, *see* PRC Op. R2006-1 at ¶¶ 4004-38). These factors weigh much more heavily in favor of the rates initially recommended by the Commission.

[2034] It is important to recognize that in its initial recommended decision, the Commission effectively tempered the letter/flat passthrough due to the factors of the

Postal Reorganization Act (including in particular impact on mailers). Furthermore, the significant increases for flats mailers are not only due to further recognition of the letter/flat differential, but also to the de-averaging of presort and destination entry cost differences. These additional presorting and destination entry discounts offer further opportunities for flats mailers to save on their postage. Even without changing mailpiece design, flats mailers can mitigate the rate impact through presorting and entering their mail deeper into the system — either on their own or through co-mailing and co-palletization.

[2035] While rate shock is an important factor to consider, it should not be elevated to a level where it is viewed as grounds to significantly downplay or ignore the other factors of the Postal Reorganization Act. It should not dominate rate design for many years to the detriment of mailers who have been effectively paying artificially higher rates so that other mailers (often their competitors) can continue to pay lower rates than they otherwise should pay. Cases cited by the Letter Mailers Group reinforce this proposition especially when, as here, the full recognition of cost has taken at least several years due in large part to rate shock concerns. Letter Mailers Group Comments at 9-10; *see, e.g.*, *Nat'l Ass'n of Reg. Utility Comm'rs v. FCC*, (D.C. Cir. 1984) 737 F.2d 1095, 1146 ("Exclamations of 'rate shock' are similarly undermined when the period since first notice has itself become a protracted delay".) As witness Mitchell pointed out with respect to flats mailers, "It does not seem reasonable for mailers receiving a preference at variance with appropriate principles to say: 'It is unfair to take away the preferential treatment that has been bestowed upon me.'" Tr. 5/8917-19.

[2036] Accordingly, the Commission does not find that the evidence would support a permanent rate reduction for Standard Regular flats during the test year. The Commission notes that the catalogers seem to recognize this fact in that they appear to be only asking for a short-term, temporary "transitional" adjustment in rates.

4. Adequacy of Justifications for Increasing Letter Rates

[2037] The analysis of whether to change Standard Regular letter rates can not be conducted in a vacuum. The Postal Reorganization Act requires the Commission to consider the rate structure of the entire system and examine how those newly increased rates interact with other rate categories, subclasses, and classes, such as First-Class Mail. *See* 39 U.S.C. § 3622(b)(7). With that in mind, the Commission turns to the Standard Regular letter rates initially recommended to consider whether changes are appropriate in light of the comments received and the evidence in the record.

[2038] Even though this is a reconsideration of a record that closed on December 19, 2006, the Commission can not ignore relevant circumstances relating to implementation of this case's recommended rates. Specifically, the Commission must recognize that the new rates for Standard Mail based on its recommended decision became effective on May 14, 2007, despite participants' efforts to delay that implementation date. *See* P.O. Ruling R2006-1/127; Governors' Decision at 22; MOAA Answer to CCM Motion to Reopen at 6.

[2039] There are two things that can be inferred from these facts that bear on this reconsideration. First, if the Commission were now to recommend higher letter rates, letter mailers would be subject to a second rate increase within a very short period of time. Second, higher letter rates at this time would cause additional significant indirect costs on mailers. Standard Regular letter mailers would be forced to undergo a second round of substantial transaction costs within a very short period. Marketing plans could be disrupted again. This would place a very high additional burden on Standard Regular letter mailers. These direct and indirect costs would result in a greater overall loss to mailers and the postal system than would have occurred had the Commission's initial decision balanced the rates of Standard Regular letter mailers to Standard Regular flats mailers differently. Additionally, it is noteworthy to point out that no participant identifies evidence or gives a reason for raising letter rates other than to counterbalance the effects of lowering flats rates.

[2040] As several participants point out, the Commission began attempting to recognize the inherent cost differences between letters and flats approximately 18 years ago in Docket No. R90-1 and has reaffirmed that policy many times. Letter mailers have also reminded the Commission of statements in this case supporting arguments that this practice should be brought to an end. VP-T-1 at 11, 114-23, 156-61, 178-86, 192-97; Letter Mailers Group Comments at 7-10; Valpak Reply Comments at 8. The Commission accepted rate shock arguments in favor of Standard flats mailers to the detriment of letter mailers over an extended period of time. Both economic efficiency and fairness support recognizing those cost differences; otherwise, the Commission's statements that postal rates should reflect costs incurred would ring hollow. Applying the principle of ECP to shape (which was litigated at length in this docket) is both economically sound and fair. At the rates recommended by the Commission, Standard Regular letters continue to make a significantly greater contribution to institutional costs than Standard Regular flats. Standard Regular letters make a 12-cents per-piece contribution to institutional costs while Standard Regular flats make a 9-cents per-piece contribution. There is no persuasive justification for expanding this difference in contribution. It is simply unfair and inequitable for letters to pay a higher per-piece contribution to institutional costs than other mailers within the same subclass.

[2041] Given all these considerations, it is clear that an increase in letter rates would result in significant harm to letter mailers and the factors of the Postal Reorganization Act as applied to the existing evidentiary record do not support raising letter mailers' rates in this matter.

[2042] Accordingly, no change in rates for Standard Regular letters during the test year is justified.

C. Temporary Transitional Rate Relief

[2043] On reconsideration the Commission does not find that the factors of the Postal Reorganization Act weigh in favor of a permanent rate reduction for Standard Regular flats mailers. Nor does the Commission find that the factors of the Postal Reorganization Act justify an increase in rates for Standard Regular letter mailers. However, the Commission does not read the Governors request for reconsideration so narrowly as to close the door on any sort of relief for catalogers. The Governors asked the Commission to consider the need for "a more gradual transition" to cost-based rates. *See* Governors Decision at 9.

1. Recommendation of Temporary Rates Is Consistent with the Postal Reorganization Act

[2044] It is beyond dispute that, under the law applicable to this rate proceeding, authority over the timing of rate requests and implementation of rates recommended by the Commission resides within the Postal Service. The Postal Service has sole authority to request a recommended decision on rate changes. The Board of Governors possesses the exclusive statutory right to determine the date on which changes in rates and mail classifications will occur. More generally, the Commission's functions do not extend to participation in the management decisions of the Service.[33]

[2045] Furthermore, omnibus rate proceedings characteristically focus on the construction of "permanent" rates appropriate for the selected test year, i. e., rates that will remain in effect until superseded by others resulting from a subsequent Postal Service request. Rates of limited duration are not customarily recommended in omnibus rate proceedings.

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[33] *See Governors of the U.S. Postal Service v. Postal Rate Commission*, 654 F.2d 108, 114-117 (D.C. Cir. 1981).

[2046] However, from the early days of the Postal Rate Commission, rates with specific time limitations have occasionally been included in the Commission's recommended decisions and the Governors' actions. In the first mail classification proceeding conducted before the Commission, Docket No. MC73-1, participants submitted a Stipulation and Agreement that featured three provisions affecting the timing of implementation by the Postal Service. One provision included a restriction, to which the Service had agreed, against implementing prohibitions against undersize mail for a period of at least two years. A similar provision stated that no surcharge would be applied to nonstandard mail in three classes for a period of two years from the date of the Commission's decision in the proceeding. Finally, a third provision required that the fees applicable to Business Reply Mail remain unchanged for a period not less than one year from the date of the Commission's decision. PRC Op. MC73-1, Domestic Mail Classification Schedule, Supplement: *Provisions to Be Applied in the Future*, at 40-42. The Governors explicitly approved these provisions in their Decision of June 2, 1976,[34] and committed the Postal Service to abiding by the temporal limitations they contained.

[2047] More recently, the Postal Service sought the Commission's recommendation of a temporary, fixed term rate change. In the joint Docket Nos. R2001-2 and MC2001-2, the Service proposed a special classification and temporary fee change for Manual Delivery Confirmation service in connection with use of Priority Mail.[35] Under the Service's proposal, Manual Delivery Confirmation would have been offered without charge to users of Priority Mail during the holiday mailing season in 2001, from

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[34] "The Commission has stated … that certain of the provisions that are recommended to us are recommended subject to a transition period. In particular, the Commission states that provisions setting forth certain changes in minimum size requirements should be recommended for our approval at this time, subject to a two-year grace period during which mailers are to bring their mail matter into compliance with the changed size standards. In approving the recommended schedule, we also approve these provisions and have included them in the recommended schedule, with the grace period noted." Decision of the Governors of the United States Postal Service on Establishing a Mail Classification Schedule, June 2, 1976, at 4-5.

[35] Request of the United States Postal Service for a Recommended Decision on Experimental Delivery Confirmation Special Service Category and Fee, September 20, 2001.

December 1 through 16. While the Commission was actively considering the request on an accelerated schedule, the Postal Service gave notice of the Governors' determination to withdraw it, and the Commission terminated the proceedings. *See* PRC Order No. 1330 (November 6, 2001).

[2048] These examples from institutional history demonstrate that the Governors and the Commission can exercise our shared authority over rate setting to introduce rates of limited duration, where appropriate.[36] The experience in Docket No. MC73-1 also indicates that such rate recommendations need not originate as part of a formal Request by the Governors.

[2049] At this stage of Docket No. R2006-1, the Governors are asking the Commission to address a particular problem. The Governors approved the Standard Mail rates we recommended in our Decision of February 26, 2007 in general outline, expressing misgivings primarily regarding the "rate shock" resulting from the magnitude of some of the increases. Governors' Decision at 1-2, 9-10. The Governors express a preference for rates that would provide a "more gradual transition to cost-based pricing." *Id.* at 9. Similarly, the Coalition of Catalog Mailers seeks relief from the Commission's initially recommended rates "to allow a reasonable transition to shape-based rates." CCM Comments at 11. The Commission concludes that circumstances warrant a resolution in the form of temporary, transitional rate relief for users of Standard Mail flats.

[2050] The Commission believes that transitional rate relief of temporary duration is responsive to the concerns expressed by the Governors and all of the numerous participants that have submitted comments on reconsideration regarding impact. We

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[36] Similarly, the Governors and the Commission have exercised our shared authority over mail classification to introduce experimental services, and their associated rates, for fixed terms. *See, e.g.,* Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission Approving Stipulation and Agreement on Experimental Premium Forwarding Service, Docket No. MC2005-1, May 10, 2005; Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission Approving Stipulation and Agreement on Experimental Priority Mail Flat Rate Box, Docket No. MC2004-2, October 27, 2004.

also believe it would provide the least costly and disruptive solution to the current controversy.

[2051] The Commission understands that the Governors may not share our opinion regarding the appropriateness of temporary rate relief under the current circumstances. Should this be the case, in exercising the options available under former § 3625, the Governors may choose to retain the existing rates.

2. Recommendation of Temporary Rates Is Consistent with the Evidence of Record

[2052] The Commission concludes that the record would support giving transitional rate relief for a limited period of time for Standard Regular flats. Witness Kiefer urged that there should be “sensitive[ity] to the impacts that *rapid changes* in relative prices might have on the businesses of those customers who mail Standard Mail flats.” USPS-RT-11 at 20-21. (Emphasis added.) The Commission interprets this testimony to mean that the more sudden a change is, the more harmful it would be to those mailers affected by the change. Several of the commenters support this understanding. CCM repeatedly states that it seeks “[*a*] *reasonable transition period* [to] allow catalog companies time to change their businesses ….” CCM Comments at 1. (Emphasis added.) It argues catalogers have an “inability … to respond quickly to significant and abrupt rate increases.” *Id.* at 2-3. Presumably, if the rate increases were not <u>both</u> “significant and abrupt,” they would not be “especially painful when they are imposed with such little notice!!” *Id.*; DMA Comments at 5. This testimony and argument persuade the Commission that the record supports a finding that to ease the burden on catalogers and other flats mailers, a temporary rate reduction could be granted, if the Governors also conclude that such a reduction is in the best interest of the Postal Service and the mailing community as a whole.

[2053] The only concrete proposal to decrease flats rates came from the Postal Service. Those commenters that did support a flats rate decrease agreed that the Postal

Service's proposed 3-cents reduction in the rate for every Standard Regular flat is appropriate.

[2054] The Commission notes that there is minimal administrative and transactional cost associated with an across-the-board 3-cents per-piece reduction in flats rates. Reprogramming computer hardware and software to accommodate this temporary rate change is not necessary. All that needs to be done is a simple mathematical calculation whereby 3 cents is multiplied by the number of flat mailpieces sent during any temporary rate reduction period. That calculated amount is the discount off of the already published mailing rates. This could be done as a rebate at the end of the transition period or at the time of mailing. Indeed, this would be similar to the way the Postal Service currently administers several of the declining block discounts in the negotiated service agreement program. A temporary extension of relief in this fashion should not be difficult or result in undue administrative costs for either the Postal Service or the mailing community.

[2055] If the Governors find that temporary, transitional rate relief is warranted, the Commission recommends that the transitional rate relief for Standard Regular flats mailers end on September 29, 2007. This is the last Sunday before the test year begins. As outlined below, even with this temporary transitional rate reduction for flats mailers, the technical and economic analysis shows that the Postal Service will break even in the test year. However, if the transitional rate reduction extends into the test year, breakeven in the test year will no longer be achieved. The Commission views breakeven as far more important than providing an extended transition for Standard Mail flats mailers.

[2056] The dates for implementation of all rate changes are determined by the Board of Governors. Should the Governors approve this temporary rate relief, the Board will choose a date for implementation to balance the needs of mailers and the Postal Service. In calculating the financial impact of this recommendation, the Commission first assumed the temporary rates would be effective for 92 days. Under this scenario, the Postal Service would have a test year net surplus of $1.8 million. Chapter III also provides an analysis to help the Postal Service evaluate the impact of different transition periods.

[2057] Accordingly, the Commission finds that the "transitional rate relief" discussed above could be supported by the record and recommends that these temporary changes be implemented.

D. Necessary Adjustments to Standard Mail Nonprofit Regular

[2058] Under 39 U.S.C. § 3626(a)(6), the average revenue per piece for nonprofit pieces must be 60 percent of the average revenue for commercial pieces. Since the Commission finds that a temporary rate reduction for commercial Standard Regular flats mailpieces could be justified on this record, it follows that to maintain the average revenue per-piece ratio required under the statute, the Commission would need to recommend a reduction in the piece portion of Standard Mail Nonprofit Regular flats rates of 2 cents for the same duration. A 2-cents reduction in rates for Standard Mail Nonprofit Regular flats will result in rates that produce, “as nearly as practicable,” 60 percent of the average revenue per piece for commercial pieces. This result is in line with the Postal Service’s observation that “[a] similar, but proportionately reduced set of adjustments could be made to Standard Mail Nonprofit Regular pricing.” USPS Comments at 7.

III. FINANCIAL ANALYSIS

[3001] A primary responsibility of the Commission under the Postal Reorganization Act of 1970 is to recommend rates that allow the Postal Service to break even. In omnibus rate cases, the Commission projects Postal Service costs and revenues in a future fiscal year, and then adds an appropriate contingency to estimate breakeven. In this case, fiscal 2008 is the test year.

[3002] The rates implemented on May 14, 2007 are expected to allow breakeven in the test year. In fact, the final projection from the April 27, 2007 Opinion and Recommended Decision on Reconsideration shows the Postal Service with revenues of $77,567.0 million, and expenses (including contingency) of $77,555.1 million, producing a net surplus of $11.9 million.

[3003] To evaluate the financial impact of potential rate recommendations for Standard Mail flats on reconsideration, the Commission has relied on the record evidence and applied the same programs and analyses it has used in other phases of Docket No. R2006-1. The Commission has determined that it can not recommend lower test year rates for Standard Mail flats that will allow the Postal Service to break even. However, the Commission is very cognizant of the Governors' expressions of concern about the potential need for mailers of catalogs to transition to the higher rates approved in this case.

[3004] The recent passage of the Postal Accountability and Enhancement Act has focused attention on the potential benefits of providing the Postal Service with additional pricing flexibility. Consistent with that policy, and in an appropriate spirit of cooperation, the Commission has looked for a way to provide the Governors with pricing options that are consistent with the Postal Reorganization Act.

[3005] Currently, the Governors' options are limited by the prerequisite that they act on a Commission rate recommendation. As discussed above, the Commission has found it can not recommend lower rates for Standard Mail flats that would cause the Postal Service to fail to break even in the test year; and further, that it should not recommend higher rates for Standard Mail letters.

[3006] However, the Commission has identified a third option that allows the Governors to exercise their discretion to provide reduced transition rates to Standard Mail flats if they deem that to be in the best interests of the Postal Service and the mailing community as a whole.

[3007] Accepted practice in rate cases is to project Postal Service operational results for the interim period before the test year begins, and if the Postal Service will have a net deficit at the end of the interim period to include in the breakeven analysis a provision for the recovery of prior years' losses. The Docket No. R2006-1 revenue requirement already includes funds to allow the Postal Service to recover one-ninth of the deficit projected to exist at the close of the interim period. If a transitional rate reduction were to be put into effect during the interim year, this would impact the amount of projected net deficit for the interim year, and thus the amount allotted for recovery of prior years' losses.

[3008] The Commission is satisfied that over the past 18 years it has provided ample notice to mailers of Standard Mail flats that the rates for this mail were artificially low, and that disproportionate increases would have to take place. Notwithstanding getting repeated notice, certain catalog mailers apparently were surprised. These mailers now seek some temporary relief to enable them to adjust their business practices, and the Governors have indicated some predisposition to providing such relief.

[3009] Rate reductions will impact Postal Service revenues. A reduction in test year Standard Mail flats rates of 3 cents per piece (the reduction suggested by the Postal Service) would cost approximately $350 million. The Commission finds that it can not justify burdening letter mailers with a further $350 million rate increase in order to benefit flats mailers. Even a temporary three-month transition rate reduction would cost approximately $85 million and there is no evidence that justifies increasing letter rates by that amount. However, as detailed below, a temporary Standard Mail flats rate reduction that is effective entirely within the interim year would be consistent with breakeven in the test year.

[3010] Furthermore, such a transition rate reflects appropriate application of the ratemaking factors of the Postal Reorganization Act, as it would further the policies of §§ 3622(b)(1), (3), (4), (6) and (7). Additionally, as described above, it fosters other policies of the Postal Reorganization Act by encouraging a more efficient mailstream, and sending economically justified price signals to mailers.

[3011] The Commission provides the Governors with such a recommendation so that the Governors may evaluate the benefits of softening the rate shock claimed by catalog mailers against the cost of a larger interim year operating deficit.

[3012] In order to gauge the financial impact of the recommended transitional rates, the Commission has prepared analyses premised on two different assumptions regarding the period in which the rates will be in effect.

[3013] The first scenario assumes that the recommended rate reductions are in effect from May 6 through September 30, 2007, the end of fiscal year 2007. The financial consequences of this assumption are shown in Table III-1.

Table III-1
Reduced Rates Effective May 6, 2007

Summary of Interim FY 2007 Finances
(Millions)

	1st Reconsideration	2nd Reconsideration	Difference
Present Rates:			
Volume	212,903.4	212,903.4	0.0
Total Revenue Requirement	76,215.1	76,215.1	0.0
Less: Total Revenue	72,764.9	72,764.9	0.0
Revenue Surplus/(Deficiency)	(3,450.2)	(3,450.2)	0.0
Recommended Rates:			
Decrease in Volume	(1,249.3)	(1,148.1)	101.2
Increase in Revenue	1,719.3	1,607.2	(112.0)
Decrease in Costs	(388.3)	(362.9)	25.4
Change in Net Revenue	2,107.6	1,970.2	(137.4)
Revenue Surplus/(Deficiency)	(1,342.6)	(1,480.0)	(137.4)

Summary of Test Year FY 2008 Finances
(Millions)

	1st Reconsideration	2nd Reconsideration	Difference
Present Rates:			
Volume	216,269.3	216,269.3	0.0
Total Revenue Requirement	79,514.7	79,514.7	0.0
Less: Total Revenue	73,597.3	73,597.3	0.0
Revenue Surplus/(Deficiency)	(5,917.4)	(5,917.4)	0.0
Recommended Rates:			
Decrease in Volume	(4,784.6)	(4,755.1)	29.5
Increase in Revenue	3,969.7	3,974.8	5.1
Decrease in Costs	(1,959.6)	(1,936.5)	23.1
Change in Net Revenue	5,929.4	5,911.3	(18.1)
Revenue Surplus/(Deficiency)	11.9	(6.2)	(18.1)
Prior Years Loss Recovery			15.3

Source: PRC-LR-25, SCENARIO1

[3014] For the interim FY 2007, putting transitional rates into effect during this period would increase flats volume by 101.2 million pieces. Revenues would decrease by $112.0 million and costs would increase by $25.4 million, thereby producing a $137.4 million reduction in net income. This would increase the deficiency in the interim year FY 2007 to $1,480.0 million.

[3015] For test year FY 2008, at the Commission's initially recommended rates, flats volumes would increase by 29.5 million pieces due to the lagged effect of the rate changes on demand. The effects on revenues, including a reduction in investment income of $4.7 million, would result in a net increase of $5.1 million. Costs would increase by $23.2 million, including a $15.3 million provision for recovery of one-ninth of the reduction in net income in FY 2007. An increase in costs of $23.2 milion, offset by an increase in revenues of $5.1 million, produces a reduction in net income of $18.1 million that would expend the revenue surplus from recommended rates of $11.9 million, and produce a deficiency of $6.2 million.

[3016] The second scenario assumes that the reduced rates will be in effect only in the fourth quarter of FY 2007 — from July 1 through September 30, 2007. The results of this assumption are presented in Table III-2.

Table III-2
Reduced Rates Effective July 1, 2007

Summary of Interim FY 2007 Finances
(Millions)

	1st Reconsideration	2nd Reconsideration	Difference
Present Rates:			
Volume	212,903.4	212,903.4	0.0
Total Revenue Requirement	76,215.1	76,215.1	0.0
Less: Total Revenue	72,764.9	72,764.9	0.0
Revenue Surplus/(Deficiency)	(3,450.2)	(3,450.2)	0.0
Recommended Rates:			
Decrease in Volume	(1,249.3)	(1,194.3)	55.0
Increase in Revenue	1,719.3	1,648.9	(70.3)
Decrease in Costs	(388.3)	(374.5)	13.8
Change in Net Revenue	2,107.6	2,023.4	(84.1)
Revenue Surplus/(Deficiency)	(1,342.6)	(1,426.8)	(84.1)

Summary of Test Year FY 2008 Finances
(Millions)

	1st Reconsideration	2nd Reconsideration	Difference
Present Rates:			
Volume	216,269.3	216,269.3	0.0
Total Revenue Requirement	79,514.7	79,514.7	0.0
Less: Total Revenue	73,597.3	73,597.3	0.0
Revenue Surplus/(Deficiency)	(5,917.4)	(5,917.4)	0.0
Recommended Rates:			
Decrease in Volume	(4,784.6)	(4,759.3)	25.2
Increase in Revenue	3,969.7	3,975.6	5.9
Decrease in Costs	(1,959.6)	(1,943.6)	16.0
Change in Net Revenue	5,929.4	5,919.3	(10.1)
Revenue Surplus/(Deficiency)	11.9	1.8	(10.1)
Prior Years Loss Recovery			9.3

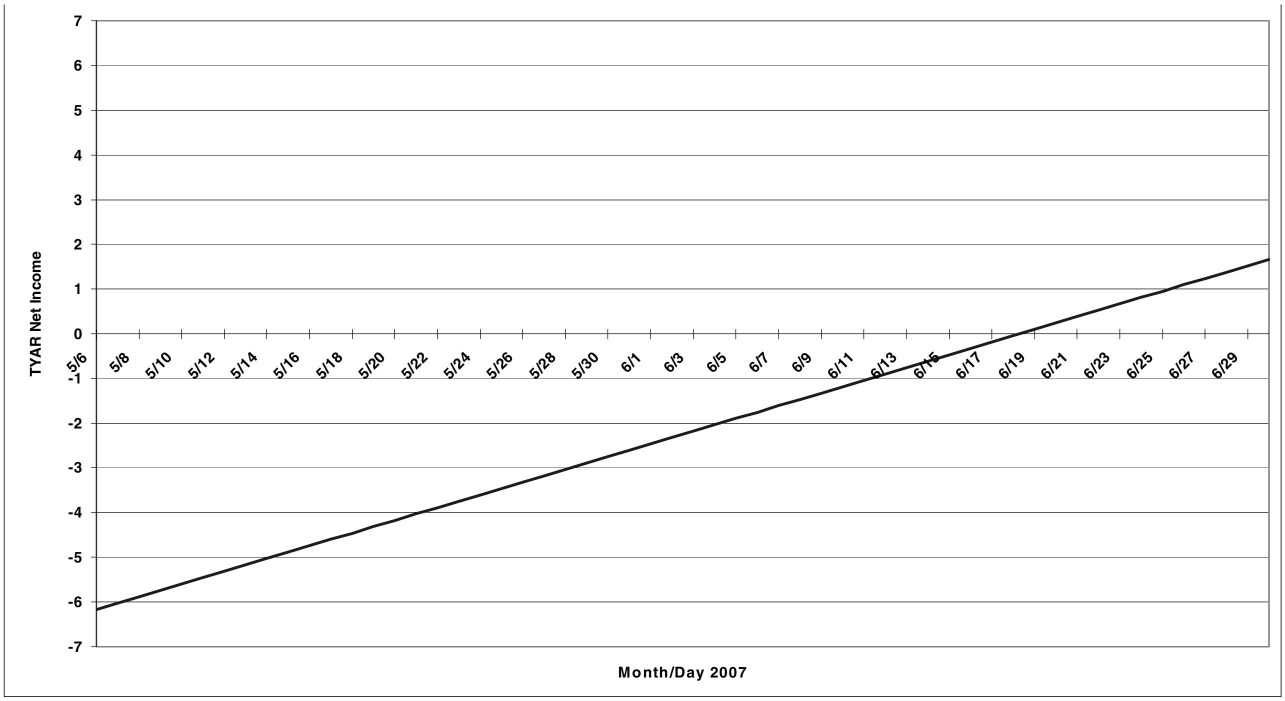
Source: PRC-LR-25, SCENARIO2

[3017] For the interim FY 2007, introducing the transitional rates during this period would increase flats volume by 55.0 million pieces. Revenues would decrease by $70.3 million and costs would increase by $13.8 million, thereby producing a reduction in net income of $84.1 million. This would increase the deficiency in the interim year FY 2007 to $1,426.8 million.

[3018] For test year FY 2008, at initially recommended rates, flats volumes would increase by 25.2 million pieces, again because of the lagged effect of the rate changes on demand. The effects on revenues, including a reduction in investment income of $2.8 million, would produce a net increase of $5.9 million. Costs would increase by $16.0 million, including a $9.3 million provision for recovery of one-ninth of the reduction in net income in FY 2007. An increase in costs of $16.0 million, offset by an increase in revenues of $5.9 million produces a reduction in net income of $10.1 million that would expend most of the revenue surplus of $11.9 million, but a surplus of $1.8 million would remain.

[3019] The first scenario can not occur, as Standard Mail flat rates increased to initially recommended levels on May 14, 2007. Nonetheless, it helps establish the potential impact of the recommended transition rates. Figure III-I provides a straight line extrapolation of the impact of recommended rate reductions. It shows that if the recommended reduction is implemented on June 18, 2007 or later, the Postal Service will break even in the test year.

Figure III-1
Linear Estimation of Net Income ($ Millions)
for Various Implementation Dates



UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

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

Postal Rate and Fee Changes — Docket No. R2006-1

SECOND RECOMMENDED DECISION ON RECONSIDERATION

(Issued May 25, 2007)

The Commission, having reconsidered the rates for Standard Mail raised in the Postal Service request for reconsideration, has issued its Opinion thereon. Based on that Opinion, which is attached hereto and made a part hereof,

IT IS ORDERED:

That the Commission's Opinion be transmitted to the Governors of the Postal Service and the Governors shall thereby be advised the Commission recommends:

a. The rates of postage set forth in Appendix One hereof are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.

b. The proposed amendments to the Domestic Mail Classification Schedule set forth in Appendix Two are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3623(c) thereof; and they are hereby recommended to the Governors for approval.

By the Commission.

Steven W. Williams
Secretary

RECOMMENDED CHANGES IN RATE SCHEDULES

The following changes represent the rate schedule recommendations by the Postal Regulatory Commission on reconsideration of Standard Mail rates in Docket No. R2006-1. The underlined text signifies that the text is new and shall appear in addition to all other Domestic Mail Classification Schedule text upon approval by the Board of Governors. The text in brackets is to be deleted.

STANDARD MAIL
RATE SCHEDULE 321A

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SCHEDULE 321A NOTES

1. A fee of $175.00 must be paid each 12-month period for each bulk mailing permit.
2. For non-barcoded parcels and NFM pieces, add $0.05 per piece. The surcharge does not apply to pieces sorted to 5-digit ZIP Codes.
3. For flats, parcels and NFMs, the mailer pays either the minimum piece rate or the pound rate, whichever is higher.
4. Letters forwarded as defined in DMCS section 353a are charged $0.35 per piece. Flats forwarded as defined in DMCS sect[uib]ion 353a are charged $1.05 per piece. Mailpieces forwarded as defined in DMCS section 353b are charged the appropriate First-Class Mail [R]rate for the piece plus the rate multiplied by a weighted factor of 2.472.
5. Pieces entered as Customized Market Mail, as defined in DMCS section 321.5, pay $0.460 per piece.
6. Add $0.015 per piece for pieces bearing a Repositionable Note as defined in DMCS section 321.8.
7. For flat-shaped mailpieces, the price for minimum per-piece rated pieces and the piece rate for piece-pound rated pieces are subject to a temporary discount of $0.03 per piece below the rates listed on this rate schedule in accordance with DMCS section 321.13.

STANDARD MAIL
RATE SCHEDULE 321B

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SCHEDULE 321B NOTES

1. A fee of $175.00 must be paid once each 12-month period for each bulk mailing permit.
2. Letters that weigh more than 3.3 ounces, but not more than 3.5 ounces pay the flats piece and pound rate, but receive a discount off the piece rate equal to the applicable flats minimum piece rate minus the applicable letter minimum piece rate corresponding to the correct presort tier.
3. For flats, the mailer pays either the minimum piece rate or the pound rate, whichever is higher.
4. Add $0.015 per piece for pieces bearing a Repositionable Note as defined in DMCS section 321.8.
5. Letters forwarded as defined in DMCS section 353a are charged $0.35 per piece. Flats forwarded as defined in DMCS section 353a are charged $1.05 per piece. Mailpieces forwarded as defined in DMCS section 353b are charged the appropriate First-Class Mail [R]r̲ate for the piece plus the rate multiplied by a weighted factor of 2.472.
6. <u>For flat-shaped mailpieces, the price for minimum per-piece rated pieces and the piece rate for piece-pound rated pieces are subject to a temporary discount of $0.03 per piece below the rates listed on this rate schedule in accordance with DMCS section 321.13.</u>

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STANDARD MAIL
RATE SCHEDULE 323A

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SCHEDULE 323A NOTES

1. A fee of $175.00 must be paid each 12-month period for each bulk mailing permit.
2. For non-barcoded parcels and NFM pieces, add $0.05 per piece. The surcharge does not apply to pieces sorted to 5-digit ZIP Codes.
3. For flats, parcels and NFMs, the mailer pays either the minimum piece rate or the pound rate, whichever is higher.
4. Letters forwarded as defined in DMCS section 353a are charged $0.35 per piece. Flats forwarded as defined in DMCS section 353a are charged $1.05 per piece. Mailpieces forwarded as defined in DMCS section 353b are charged the appropriate First-Class Mail [R]rate for the piece plus the rate multiplied by a weighted factor of 2.472.
5. Pieces entered as Customized Market Mail, as defined in DMCS section 321.5, pay $0.334 per piece.
6. Add $0.015 per piece for pieces bearing a Repositionable Note as defined in DMCS section 323.8.
7. For flat-shaped mailpieces, the price for minimum per-piece rated pieces and the piece rate for piece-pound rated pieces are subject to a temporary discount of $0.02 per piece below the rates listed on this rate schedule in accordance with DMCS section 323.13.

STANDARD MAIL
RATE SCHEDULE 323B

***

SCHEDULE 323B NOTES

1. A fee of $175.00 must be paid each 12-month period for each bulk mailing permit.
2. Letters that weigh more than 3.3 ounces, but not more than 3.5 ounces pay the flats piece and pound rate, but receive a discount off the piece rate equal to the applicable flats minimum piece rate minus the applicable letter minimum piece rate corresponding to the correct presort tier.
3. For flats, the mailer pays either the minimum piece rate or the pound rate, whichever is higher.
4. Add $0.015 per piece for pieces bearing a Repositionable Note as defined in DMCS section 323.8.
5. Letters forwarded as defined in DMCS section 353a are charged $0.35 per piece. Flats forwarded as defined in DMCS section 353a are charged $1.05 per piece. Mailpieces forwarded as defined in DMCS section 353b are charged the appropriate First-Class Mail [R]r̲ate for the piece plus the rate multiplied by a weighted factor of 2.472.
6. For flat-shaped mailpieces, the price for minimum per-piece rated pieces and the piece rate for piece-pound rated pieces are subject to a temporary discount of $0.02 per piece below the rates listed on this rate schedule in accordance with DMCS section 323.13.

RECOMMENDED CHANGES IN DOMESTIC MAIL CLASSIFICATION SCHEDULE

The following material represents changes to the Domestic Mail Classification Schedule recommended by the Postal Regulatory Commission on reconsideration of Standard Mail in Docket No. R2006-1. The underlined text signifies that the text is new and shall appear in addition to all other Domestic Mail Classification Schedule text upon approval by the Board of Governors.

STANDARD MAIL
CLASSIFICATION SCHEDULE

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321.13 **Expiration of Discount for Flat-shaped Mail.** Footnote 7 contained in Rate Schedule 321A, and footnote 6 contained in Rate Schedule 321B expire on or before September 29, 2007 at 12:01 a.m.

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323.13 **Expiration of Discount for Flat-shaped Mail.** Footnote 7 contained in Rate Schedule 323A, and footnote 6 contained in Rate Schedule 323B expire on or before September 29, 2007 at 12:01 a.m.

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