

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

INITIAL STATEMENT OF THE UNITED STATES POSTAL SERVICE
ON RECONSIDERATION
(March 28, 2007)

On February 26, 2007, the Commission issued its first Opinion and Recommended Decision in this proceeding. On March 19, 2007, the Governors of the Postal Service issued their Decision in response, allowing the recommended decision to take effect under protest, and returning three matters to the Commission for reconsideration.¹ The Postal Service hereby provides its initial statement regarding the reconsideration process in general, and specifically with respect to the three matters returned by the Governors.

Reconsideration Process

In the view of the Postal Service, reconsideration in this instance can be conducted without the need to reopen the record. The Postal Service in this pleading explains the alterations to the Commission's recommendations that it believes would be both beneficial, and responsive to the concerns raised by the Governors. Because all of these changes would be consistent with the evidentiary record as it currently exists,

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) ("Decision").

their adoption by the Commission would not require any additions to that record. Of course, the Postal Service recognizes the need to allow other parties also to express their views on the matters returned for reconsideration. (In fact, with respect to the Standard Mail flat rates, creating the opportunity for mailers to respond directly to the rate levels recommended by the Commission was one of the reasons stated by the Governors to explain their determination to pursue reconsideration.) Allowing interested parties to file comments addressing both the specifics of the Commission's recommendations, and the Postal Service's suggested alterations to those recommendations as set forth in this pleading, would seem to be a logical next step in the reconsideration process. If any party perceived potential benefits from reopening the record, such a view could be stated and supported in its initial comments. Thereafter, a subsequent opportunity would appear to be warranted for the Postal Service and the parties to reply to the initial comments filed by other parties. Barring the identification of any compelling need to reopen the record, the Commission would thereafter appear to be poised to proceed to its own reconsideration and subsequent issuance of its further recommended decision.

Nonmachinable Surcharge for First-Class Mail Letters

Across many subclasses, the rates recommended in the Commission's Docket No. R2006-1 opinion are the product of its considerable emphasis on promoting efficiency in pricing. One conspicuous omission was for First-Class Mail letters weighing over one ounce, where there is no price differential based on machinability.

The Postal Service's requested Docket No. R2006-1 rate design would appear to

have accommodated this emphasis of efficient pricing. The Postal Service proposed that the initial-ounce rate for First-Class Mail flats be applied to nonmachinable one-ounce First-Class Mail letters, and that the respective surcharges otherwise then applicable to nonmachinable single-piece (13 cents) and presorted one-ounce letters (5.8 cents) be eliminated.

However, under the rate design recommended by the Commission, which includes a 41-cent rate for one-ounce letters, and a significantly higher initial-ounce rate for flats (80 cents) than was requested by the Postal Service (62 cents), application of the Postal Service's rate design approach would have resulted in an extraordinarily high rate differential (39 cents) associated with letter nonmachinability. Rather than impose what, in effect, would have been a 39-cent surcharge, the Commission preserved the long-standing nonmachinable surcharge classification that has applied to one-ounce letters, and recommended that the current 13-cent and 5.8-cent surcharges applicable to nonmachinable one-ounce single-piece and presorted letters, respectively, each be increased to 17 cents.

The Postal Service's requested rate design applied a letter/flat initial-ounce rate differential to account for the cost of nonmachinability at all letter weight increments. The Commission's recommended rate design only addresses the impact of nonmachinability for one-ounce letters. The logic applied by the Commission at the one-ounce tier seems applicable to the other tiers also, especially given the very large reduction in the additional ounce rate, which has historically been viewed as a proxy for such variables as nonmachinability. The new shape-based pricing structure, and the

significant lowering of the additional-ounce rate, have reduced this "proxy" effect. As expressed in the Decision, it is the view of the Postal Service that it would seem logical to close this gap in rate design and pricing of heavier letters by expanding the application of the nonmachinable surcharge to single-piece and presorted letters at the 2-ounce and higher letter mail weight increments.

By operation of the Governors' Decision, effective May 14, 2007, the following DMCS provision is scheduled to take effect:

221.26 Nonmachinable Surcharge. Single-piece and presort letter-shaped mail as defined in 221.211 or 221.221 weighing one ounce or less is subject to a surcharge if:

. . .

Further consideration of the evidence could lead to the conclusion that the goal of efficiently pricing nonmachinability at all weight increments can be accomplished by eliminating the phrase "weighing one ounce or less" from DMCS 221.26.

The revenue impact of this change would be *de minimis*. With the removal of flat- and parcel-shaped pieces to their own rate categories, the volume of letter-shaped pieces that are less than one ounce and that would be required to pay the recommended nonmachinable surcharge is very small. Approximately 114 million pieces (or 0.34 percent of total letter-shaped pieces within single-piece) and just 14 million pieces in the nonautomation presort rate category (or 1.34 percent of letter shaped pieces in nonauto presort) would be subject in the test year to the surcharge as recommended by the Commission. See PRC Library Reference LR-12, Spreadsheet FCM Appx G and Rate Design, Worksheet Appx G. Using these ratios and the data on

pieces by ounce increments and shape (see PRC Library Reference LR-12, Spreadsheet FCM Appx G and Rate Design, Worksheet Shape and Wgt), one can approximate the total number of nonmachinable pieces for both single-piece and nonautomation presort that would be covered by an expanded surcharge if the one-ounce limitation were removed. For single-piece, the volume of pieces within the one-to-three ounce range that would be subjected to a nonmachinable surcharge is approximately 3.8 million pieces, with a revenue impact of \$643,000. Within nonautomation presort, the volume is 27,000 pieces within the one-to-three ounce range, and the revenue impact is \$5,000. Some more pieces would also be covered in the range between 3.0 ounces and the upper limit for letters of 3.5 ounces, but that volume (and associated revenue) would be even more minute.

Priority Mail Flat Rate Box

In their Decision, the Governors asked the Commission to reconsider its recommended rate for the Priority Mail Flat-Rate Box, and further directed the Postal Service to file, with the Commission, a preferred calculation of the rate using the Commission's cost estimates. Governors Decision at 14. For the reasons set forth below, the Postal Service submits that the rate for the Priority Mail Flat-Rate Box, when calculated using the Commission's cost estimates with the Postal Service's pricing model, should be \$8.95.

There are two reasons why this rate differs from the \$9.15 recommended by the Commission. First, under the Postal Service's pricing model, the implicit cost coverage

for the Priority Mail flat-rate box should equal, as nearly as possible, the implicit cost coverage for the Priority Mail flat-rate envelope. As detailed below, application of this principle yields a rate of \$8.95, not \$9.00 as initially calculated by the Commission. Second, the Commission increased the price of the Priority Mail Flat-Rate Box by an additional 15 cents, from \$9.00 to \$9.15, in order for Priority Mail, as a whole, to achieve its target subclass cost coverage. The Commission, however, used the Postal Service's cost estimates in one portion of its analysis, instead of its own cost estimates, apparently by inadvertence. Had it used its own cost estimates throughout, this 15-cent adjustment would not have been necessary to achieve the target subclass cost coverage.

As to the first point, the Commission attempted to employ the methodology established on the record by the pricing model outlined in the Postal Service's testimony, USPS-T-33, Attachment F. In following this approach, however, the Commission erred when it initially calculated a rate of \$8.98 (which rounds to \$9.00) for the flat-rate box. See PRC-LR-13, Attachments.xls, Attachment F, Table 13. Adherence to the record methodology (while still using the PRC's attributable costs) would yield a price for the Priority Mail flat-rate box of \$8.95. This compares to a price of \$8.80 proposed in USPS-T-33 (using USPS cost estimates).

The Priority Mail rate design in USPS-T-33, Attachment F, stipulates "equating the flat-rate box's implicit cost coverage with implicit cost coverage for the Priority Mail flat-rate envelope." USPS-T-33 at 57-58. An examination of cells FX10 and FX82 in USPS-T-33, Attachment F (Table 19) reveals that this was accomplished in the Postal

Service's testimony at the flat-rate box's proposed price of \$8.80, resulting in an implicit cost coverage of 179.3 percent for the flat-rate envelope and 179.4 percent for the flat-rate box. Neither a lower price at \$8.75 nor a higher price at \$8.85 would have achieved a closer convergence of the two implicit cost coverages.²

The rate design in PRC-LR-13, however, does not conform to this model. Under the Commission's cost methodology, implicit cost coverage for the flat-rate envelope is 165.5 percent (PRC-LR-13, Attachments.xls, Attachment F, Table 19, cell FX10). Using the Postal Service's model correctly, the closest possible convergence with this implicit cost coverage would be achieved with a price for the flat-rate box of \$8.95.³ The resulting implicit cost coverage for the flat-rate box in PRC-LR-13, Attachments.xls Attachment F, Table 19, cell FX82 is 165.3 percent, only 0.19 percentage points lower than the flat-rate envelope's implicit cost coverage in cell FX10. In contrast, a rate of \$9.00 (rounded from \$8.98) results in an implicit cost coverage for the flat-rate box of 166.3 percent, which deviates from the flat-rate envelope's 165.5 percent implicit cost coverage by 0.73 percentage points, considerably more than the 0.19 percentage points obtained at \$8.95.⁴

2 The convergence was effected by using a hardcoded factor of 180 percent in the formula in USPS-T-33, Attachment F, Table 5, cells AN82 to AT82 (By "hardcoding," a number is inserted into a specific cell, rather than basing that cell's value on an equation). The hardcoding, which was necessary to avoid circularity (simultaneity) in the model, was identified in a footnote to USPS-T-33, Attachment F, Table 5.

3 This can be seen by hardcoding PRC-LR-13, Attachments.xls, Attachment F, Table 15, cells ED82 to EJ82 with a rate of \$8.95 rather than the recommended rate of \$9.15.

4 The same result (i.e., an \$8.95 price for the flat-rate box) can be obtained in conformance with the USPS-T-33, Attachment F methodology (i.e., without hard-coding

Turning to the second point, the Commission unnecessarily increased its recommended rate an additional 15 cents, to \$9.15. The reason given for the deviation — in a footnote to PRC-LR-13, Attachments.xls, Attachment F, Table 15 — was “to achieve the desired cost coverage (149.8%) for the subclass.” The adjustment from \$9.00 to \$9.15 would produce \$3.7 million in additional revenue, but this revenue is not needed to hit the target cost coverage.

The additional revenue is not needed because the Commission’s Priority Mail Dim-Weight Pricing Model underestimates the cost savings from dim-weighting by approximately \$8.2 million. See PRC-LR-13, DWZ-5.xls, DWZ-6.xls, DWZ-7.xls, DWZ-8.xls and DWUSA.xls. Specifically, four of the Commission tables⁵ contain, apparently by inadvertent oversight, unit cost elements that incorrectly reflect the Postal Service’s cost estimates, rather than the PRC’s cost estimates. All other costs in PRC-LR-13 utilize the Commission’s methodology. Since Postal Service cost estimates are lower (particularly in Zones 5 - 8, where dim-weighting takes effect), the end result is to estimate cost savings from dim-weighting at \$55.9 million, instead of \$64.1 million,

PRC-LR-13, Attachments.xls, Attachment F, Table 15, cells ED82 to EJ82). Simply use a hard-coded factor of 165.975 percent rather than 166.0 percent in the formulas in PRC-LR-13, Attachments.xls, Attachment F, Table 5, cells AN82 to AT82. In addition, undo the hard-coding in cells ED82 to EJ82 of PRC-LR-13, Attachments.xls, Attachment F, Table 15. This approach produces one small change to the “Rounded and Final Rates” obtained in PRC-LR-13, Attachments.xls, Attachment F, Table 15. That change is to the 29-pound, Zone 5 rate, which increases from \$27.90 to \$27.95. However, this change is immaterial, and can be ignored. It implies only an additional \$917 in revenue.

⁵ See PRC-LR-13 — DWZ-5.xls, Table Z5-12; DWZ-6.xls, Table Z6-12; DWZ-7.xls, Table Z7-12; and DWZ-8.xls, Table Z8-12.

resulting in a shortfall of \$8.2 million in estimated cost savings.⁶

Lowering the price point for the Flat-Rate Box from \$9.15 to \$8.95 will reduce revenue by \$5.0 million. However, given the shortfall of \$8.2 million in cost savings, the \$5.0 million is not required to hit the "desired" cost coverage of 149.8 percent for Priority Mail as a subclass.

Accordingly, the Postal Service submits that the correct price for the Priority Mail flat-rate box, using the Postal Regulatory Commission's version of attributable costs, is \$8.95.

Standard Mail Flat Rates

In their Decision, the Governors expressed concern about the size of the rate increases recommended for certain Standard Mail Regular and Nonprofit Regular flats, and the potential effect on mailers of catalogs and other flats. The Governors chose to return the matter to the Commission for reconsideration:

We therefore wish the Commission to reconsider whether some rebalancing between Standard Mail letter and flat rates might be appropriate.

Governors' Decision at 10. As is implicit in the Governors' statement, in order to mitigate rates for flats, it would be necessary to make upward adjustments in other rates, namely, the rates for letters. Moreover, since neither the Governors in their

⁶ The cost savings estimate in PRC-LR-13, DWZUSA.xls, cell M76, is \$55.9 million. Substituting PRC-version unit cost elements — available at PRC-LR-13, Attachments.xls, Attachment F, Table 1 — into the four errant tables, a correct total for cost savings in PRC-LR-13, DWZUSA.xls, cell M76 of \$64.1 million is obtained. The estimation shortfall is therefore \$8.2 million. This amount is missing from the TYAR final cost adjustments in PRC-LR-3.

Decision nor the Postal Service in this pleading are intending to challenge the cost and cost difference estimates upon which the recommended Standard Mail rate design is based, it would likewise be necessary to depart to some extent from the specific passthrough levels initially chosen by the Commission.

To put this in context, however, with respect to Periodicals, the Commission noted that its recommended rates were intended to improve recognition of cost drivers, but acknowledged:

At the same time, significant steps are taken to temper rate impact. This tempering means that costs are not as fully recognized as they might otherwise be, but that negative rate impacts are not as significant as they might be.

Opinion at 350. In essence, the Governors are seeking further consideration by the Commission of the same type of moderation for Standard Mail Regular and Nonprofit Regular flats as was extended to Periodicals.

The Postal Service submits that opportunities exist to reduce letter-flat differentials in such a way to generate approximately the same net revenue, to provide rate relief to flat mailers, and to impose only a modest additional rate burden on letter mailers. In exploring such opportunities, however, the Postal Service requests that the Commission retain certain features of its recommended rates. Specifically, when contemplating any new set of Standard Mail Regular and Nonprofit Regular rates, the Commission hopefully will:

1. Ensure that the revised Regular/Nonprofit Regular 5-digit Automation Letters prices remain below the Basic ECR/NECR letters prices to continue our longstanding mutual efforts to support the letters automation program, and

2. Retain, for Regular and Nonprofit Regular letters and flats rates, drop-ship discounts as recommended. Differing drop-ship discounts for letters and flats in the Regular/Nonprofit Regular and ECR/NECR subclasses could potentially lead to disruptive rate relationships and send confusing and/or anomalous signals to mailers.

Within these guidelines, the Postal Service suggests that the Commission, in accordance with the Governors request for reconsideration, rebalance the Standard Mail Regular and Nonprofit Regular letter and flat rates. A reasonable objective would be to provide some rate relief, particularly for those catalog and other flat mailers who otherwise bear percentage rate increases substantially above the expectations they had based upon the Postal Service's proposed rates.

Moreover, because any such rebalancing would be based essentially on policy grounds, rather than on new cost or other technical analysis, it is especially important to hear the views of the Standard Mail mailers whose rates would be affected. Obviously, that would include letter mailers as well as flats mailers. Subsequent pleadings by mailers and their representatives should give the Commission an ample basis to consider the pros and cons of any further rate adjustments. Allowing those views to be expressed directly in response to the rate levels recommended by the Commission was certainly one of the motivations acknowledged by the Governors in favor of returning the matter for reconsideration. See Governors' Decision at 12. In particular, mailers may wish to discuss their perceptions of the relative trade-offs between possible benefits of further rate adjustments, and the potential costs of further disruptions associated with any additional rate changes (which, at this point, would be of uncertain magnitude and would be implemented at an unknown date). Thoughtful consideration by the

Commission of the comments of the parties and prompt issuance of a further recommended decision would appear to be in the best interests of all.

Conclusion

In accordance with the Governors' Decision, the Postal Service requests that the Commission reconsider the three aspects of its Recommended Decision returned for that purpose as expeditiously as possible. The Postal Service submits that such reconsideration should result in a recommendation to remove the DMCS language limiting the non-machinable surcharge to letter mail weighing one ounce or less, a recommendation of a Priority Mail Flat-Rate Box price of \$8.95, and some rebalancing of the letter-flat differential for the Standard Mail Regular and Standard Nonprofit Regular subclasses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

Daniel J. Foucheaux, Jr.
Chief Counsel

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989; Fax -5402
March 28, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Daniel J. Foucheaux, Jr.

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989; Fax -5402
March 28, 2007