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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

REGULATIONS ESTABLISHING SYSTEM OF RATEMAKING	))	Docket No. RM2007-1

ASSOCIATION OF PRIORITY MAIL USERS, INC.
COMMENTS ON REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING IN RESPONSE TO COMMISSION ORDER NO. 2
(April 6, 2007)

On January 30, 2007, the Postal Regulatory Commission issued Order No. 2, Advanced Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking ("ANPRM"), which, *inter alia*, stated:

> The PAEA … directs that the Commission shall promulgate regulations to bound Postal Service discretion in setting rates for **competitive** postal products … by June 19, 2008. [Order No. 2, p. 1, (emphasis added).]

The Association of Priority Mail Users, Inc. ("APMU") submits these comments in response to this request for comments on ratemaking for competitive products.

The Postal Accountability and Enhancement Act ("PAEA"), Pub. L. 109-435, amended 39 U.S.C. section 3631 to classify Priority Mail as a competitive product. The Postal Service Board of Governors are given broad latitude to set rates for competitive products under 39 U.S.C. section 3632. Rate changes of general applicability require only a 30-day notice published in the *Federal Register* before their effective date. 39 U.S.C. section 3632(b)(2). Further, the Commission's authority to fashion regulations for competitive products appears limited to: "(1) prohibit the subsidization of competitive products by market-dominant products; (2) ensure that each competitive product covers its costs attributable; and (3) ensure that all competitive products cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service." 39 U.S.C. section 3633(a)(1)-(3).

With respect to the first issue, it must be recognized that the problem of subsidization can run both ways. The draft Cost and Revenue Analysis ("CRA) for FY 2006 shows that one market-dominant product, Periodicals, lost the Postal Service $355.1 million in FY 2006 — certainly not the first time that Periodicals rates have been set so low that they create a deficit that must be made up by other mailers. Certainly it is vital that steps be taken to ensure that products like Periodicals do not continue to be priced so low that actual revenues and costs demonstrate a loss, causing a hemorrhage in Postal Service revenues which would need to be made up by remaining products, including competitive products.

With respect to the second issue, PAEA defines "costs attributable" as "the direct and indirect postal costs attributable to such product through reliably identified causal relationships." APMU believes that it will continue to be of the greatest importance that "attributable" costs be defined in an economically meaningful manner, so as to require identification of the type of causal relationship which PAEA requires, and as has been determined by the Commission in the past. Accordingly, it would appear that any changes in the definition of "attributable costs" should be made only by the Commission, and not by the Postal Service alone.[1]

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[1] It is understood that PAEA Title IV (39 U.S.C. section 2011(h)) contains provisions for input from the Secretary of the Treasury to the Commission and the convening of proceedings to obtain a full review on the record to consider "accounting practices and principles." It does not appear clear that this review was to deal with economic principles of cost allocation.

With respect to the third issue, PAEA provides no clear standard as to what the term "appropriate share" of the institutional costs of the Postal Service means. The Commission will need to define those criteria it will use to compare "shares" of institutional costs. For example, criteria could be developed based on aggregates, such as share of total volume, share of total attributable costs, share of total weight, etc. But "appropriate share" criteria should include unit contribution. The FY 2006 unit contribution from Priority Mail was $1.095 — over a dollar per piece. That compares to $0.171 for First-Class Single-Piece letters, and $0.069 for Standard Regular Mail. Clearly, Priority Mail's unit contributions are high by any standard.

However, whatever "appropriate share" test is developed is to be applied to all competitive products collectively (1. Priority Mail, 2. Express Mail (presumably, termed "expedited mail"), 3. bulk parcel post, 4. bulk international mail, and 5. mailgrams). Of these five products, Priority Mail makes the dominant contribution to institutional costs. Once those criteria are developed, it may be necessary to either reduce or increase the contribution to institutional costs from competitive products, and at that point that benefit or burden must be allocated among the various competitive products. The following chart sets out the relative contributions from competitive products based on the FY 2006 Draft CRA:

Classes of Mail	FY 2006 Contribution (in millions)
Priority Mail	$1,012.1
Express Mail	$ 335.7
Parcel Post	$ 75.7 (a separate breakout for bulk parcel post is not provided)
International Mail	$ 318.5 (a separate breakout for bulk international mail is not provided)
Mailgrams	($ 1.8)

Source: Cost and Revenue Analysis, PRC Version, Draft, Fiscal Year 2006, as filed with the Commission, March 15, 2007, pp. 1-2.

In determining the criteria for the "appropriate share" of institutional costs test, it should be recognized that the resulting rate changes could have real consequences in a highly competitive marketplace. Historically, the Commission has experienced great difficulty in learning the details of how this marketplace operates, as competitors of the Postal Service state seemingly high stated rates, although it appears that these rates are not actually paid by commercial mailers entering even relatively small volumes. Moreover, the rates actually charged are protected by confidentiality agreements insisted upon by these competitors. These impediments to information about the marketplace imposed by competitors make the pricing of these competitive products quite difficult.

Priority Mail was once a successful product, with respectable market share and significant numbers of commercial users. However, increasingly, the Postal Service has proven to be a high cost provider in this market, due at least in part to wage rates paid by the Postal Service. With high costs, it is impossible to impose a high markup and survive in a competitive marketplace. "Appropriate share" must not be defined in a way that would artificially increase Priority Mail rates so as to further damage the already weak market share of Priority Mail. The over $1 billion in contribution earned in FY 2006 is already down substantially over several years ago[2] and could plummet further, to the detriment of market-dominant products.

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[2] For example, the CRA for FY 1998 (revised June 11, 1999) showed that Priority Mail made a contribution of $1.507 billion.

CONCLUSION

The $1 billion-plus net contribution to institutional costs from Priority Mail, as well as the several hundred millions of dollars earned from other competitive products, need to be nurtured over the long term, not milked in the short term. Any other policy will have the long-term effect of losing volume in these competitive classes, losing important contribution, and, paradoxically, making it necessary that rates for market-dominant products need to increase even further.

Respectfully submitted,

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