

**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**

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March 19, 2007

On February 26, 2007, the Postal Regulatory Commission issued its Opinion and Recommended Decision in Docket No. R2006-1. The Postal Service initiated this proceeding on May 3, 2006, to request recommendations on general changes in postal rates and fees. The Commission's Recommended Decision comes slightly less than ten months after the Postal Service's Request. We commend the Commission for its efficient conduct of the proceedings, its thorough review of the record, its consideration of commentary from various parties, and its timely recommendations. We have reviewed the Commission's Opinion thoroughly, and in light of our consideration of the evidentiary record we have analyzed each of the Commission's recommendations.

In keeping with the Postal Service's filing, the Commission recommends rates which recognize the impact on costs of different shapes and which attempt to maximize economic efficiency within the mailing industry. In some cases, however, recommended rates give rise to concern, both within the industry and on the part of the Governors, about "rate shock." For example, postage for a small, but significant, minority of catalogs would increase by as much as 41 percent.

In evaluating the Commission's recommendations, the Governors begin with the proposition that, while cost is the foundation of any rate design, other considerations must also weigh heavily, at least during a transition. The Governors believe that rates should foster the financial viability of the Postal Service by aligning its interests in operating efficiently with its interests in retaining its customers, promoting growth and maintaining profitability. In achieving this alignment, the Governors are mindful that any business must consider the impact on its customers of the timing and magnitude of any price increase. In simple terms, avoiding surprises and encouraging the customer base to grow is "good business." Thus, for example,

the Governors are concerned about the short-term effect that some increases in the prices of Standard Regular flats might have on catalog mailers.

Additionally, the Governors believe that in a few other areas the Commission fails to provide appropriate cost-based incentives where they would be eminently appropriate. For example, the Governors note that the Commission's recommended decision would apply a nonmachinable surcharge only to letters weighing one ounce or less, and not to heavier-weight pieces where such a surcharge is equally warranted.

The Governors have 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. In order to allow the Postal Service to seek reconsideration of the three matters which merit such treatment, as provided under the former provisions of 39 U.S.C. § 3625(c)(2), we approve the Recommended Decision and return those three matters to the Commission. The technical term for our decision is "allow under protest." We ask the Commission to move as expeditiously as possible to give mailers a practical opportunity to plan effectively for future mailings. By resolution, the Board of Governors has today set May 14, 2007, as the effective date of the changes in rates and fees for all classes except for Periodicals. As explained below, unique circumstances have caused the Board to delay implementation of the Periodicals changes until July 15, 2007.

## **STATEMENT OF EXPLANATION AND JUSTIFICATION**

### **REVENUE REQUIREMENT**

The Commission recommends rates and fees based on a test-year revenue requirement of \$77,566 million. The Commission estimates that the rates and fees it recommends, together with other revenue sources, would provide total revenues of \$77,568 million. The Commission estimates that its recommended rates and fees would result in a test-year surplus of \$2.3 million, after recovery of \$9.374 million for prior years' losses, and including a provision for contingencies of \$768 million, or 1 percent of total accrued costs, as requested by the Postal Service. The changes made by the Commission to the revenue requirement were based on updates provided by the Postal Service concerning known changes in employee health benefits

and Cost-of-Living Allowances (COLA) which had occurred since the case was filed. The Commission appropriately resisted arguments to make changes in the revenue requirement that were not supported on the record: a reduction in supervisory costs due to cost reduction programs that were already accounted for elsewhere; a reduction of the provision for contingencies to zero percent; and changes due to the enactment of the Postal Accountability and Enhancement Act (PAEA), which took place after the record in this docket closed.

## **RATES AND FEES**

As discussed below, we elect to put the Commission's Recommended Decision into effect but return three matters for reconsideration.

### ***First-Class Mail***

The Commission's recommended rates for First-Class Mail would lead to a cost coverage of 212 percent (of attributable cost) for the Letters and Sealed Parcels subclass and a 7.0 percent average rate increase. For the Cards subclass, the corresponding figures are a 155 percent cost coverage and a 6.1 percent average increase.

With the reservations expressed below, we adopt the Commission's First-Class Mail rate and classification recommendations and seek reconsideration of only one matter regarding First-Class Mail. We also encourage postal management to monitor mailer behavior carefully to determine whether, in the future, the Postal Service should consider refining the rates or rate structure based on an assessment of the operational and business effects of implementing the rates the Commission has recommended.<sup>1</sup> In particular, we are concerned that our inability to predict precisely how mailers might respond to increases based on the new shape-based structure might lead to unexpected consequences that might require a rebalancing in the future,

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<sup>1</sup> In reaching its recommendations, the Commission placed great reliance on Efficient Component Pricing (ECP). ECP is an approach for pricing discrete work activities (such as presorting or transporting mail) that can be performed either by the Postal Service or by mailers. Under strict ECP, discounts are set at the estimated level of the costs avoided by the Postal Service if the mailer performs the activity (presuming such costs can be measured with sufficient specificity). ECP has the goal of minimizing total costs to society by allowing the more efficient entity, the Postal Service or the mailer, to do the work.

including appropriate incentives to mailers to reduce costs. In this regard, while we believe that the Commission's explanations are clear and supported on the record, it may be necessary to reevaluate the rates in the future to ensure that revenues remain adequate and that efficiencies are realized from both the Postal Service's and the mailers' perspectives.

*Single-Piece Letters and Sealed Parcels.* In all material respects, the Commission adopts the Postal Service's approach to setting different rates based on shape for First-Class Mail letters and sealed parcels. The Commission recommends initial-ounce rate increases for First-Class Mail single-piece flats that are significantly higher than the increases requested by the Postal Service. Conversely, the Commission recommends a lower increase in the initial-ounce rate for single-piece letters than was requested – from 39 cents to 41 cents rather than to 42 cents.

The Postal Service's request for recognition of the impact of shape in First-Class Mail rate design was accompanied by a set of proposed rates that was sensitive to the potential adverse impact of replacing one average rate with three separate rates. In other words, the proposed change could be especially burdensome for mailers of flats and parcels, particularly those mailers who cannot convert their pieces to less costly shapes. The Commission's recommended rate design accommodates a 41-cent initial-ounce single-piece letter rate. However, that rate design seeks considerably more revenue from the mailers of single-piece flats and parcels than was requested by the Postal Service.

It may well be that within First-Class Mail the Commission's rate design would have the effect of encouraging a quicker conversion of parcels to flats and of flats to letters. The Postal Service benefits when mail pieces convert to shapes that it can process and deliver at lower costs. But, the magnitude of any such conversion and the test year revenue consequences are difficult to project, especially at the very outset of a significant change in rate design. With no historical track record upon which to predict whether First-Class flat mailers faced with significantly higher rates established distinctly for flats would be inclined to convert to letters, or instead simply leave the mailstream, a substantial amount of judgment is required. The risk of incorrectly anticipating mailer response increases dramatically with the size and speed of the rate swing. By that token, the much larger increase for flat mailers recommended by the Commission substantially increases the risk that a substantial portion of flat mail would disappear entirely rather than being converted to letters, with potentially serious adverse financial consequences

on Postal revenue. Based upon information available when the Docket No. R2006-1 Request was filed, the rate design the Postal Service recommends appears reasonably capable of achieving the Postal Service's test year revenue target. We hope that the Commission's alternative single-piece rate design linked to a 41-cent letter rate constitutes a different course to achieve the same objective. In the absence of a compelling basis for doing otherwise, we adopt the Commission's single-piece initial-ounce First-Class Mail letter, flat, and parcel rate recommendations.

We are concerned about one additional element of the Commission's recommended rates for First-Class Mail. In lieu of the surcharge historically applied to nonmachinable one-ounce First-Class Mail letters, the Postal Service proposed that such nonmachinable one-ounce letters be charged the proposed rate applicable to one-ounce flats. The Commission's recommendation of a considerably higher initial-ounce rate for flats (80 cents) than was proposed by the Postal Service (62 cents) justifies the Commission's conclusion that application of the 80-cent rate for one-ounce flats to nonmachinable one-ounce letters would be "excessive." PRC Op. R2006-1 at 163, ¶5211. Accordingly, the Commission has recommended retention of a separate surcharge for nonmachinable one-ounce letters and fixes it at 17 cents, which is equivalent to the additional-ounce rate recommended for First-Class Mail. We agree that the 39-cent initial-ounce letter/flat rate differential recommended by the Commission would be an excessive surcharge for nonmachinable one-ounce letters. In view of the initial-ounce First-Class Mail flat and parcel rates recommended by the Commission, we agree that the Commission's recommended 17-cent surcharge for nonmachinable one-ounce letters as part of the new shape-based classification schedule is reasonable.

We observe, however, that the recommended rate schedule reflects the same total postage being applied to two-ounce and three-ounce letters -- 58 cents and 75 cents, respectively -- regardless of whether those letters are machinable. The issue of whether the nonmachinable surcharge also should apply to letters weighing more than one ounce seems to warrant further analysis. In particular, in order to reflect more accurately differences in costs and to provide appropriate incentives to mailers, we believe that the provision in the recommended Domestic Mail Classification Schedule (DMCS) language (section 221.26) limiting the applicability of the surcharge to letter pieces "weighing one ounce or less" should be removed. Accordingly, we

return the matter for reconsideration by the Commission. In the meantime, the surcharge will take effect as recommended.

The Commission recommends a slight decrease in the current rate differential applicable to Qualified Business Reply Mail letters. We concur in the Commission's recommendation.

*Bulk Presorted And Barcoded Rate Categories.* In the area of discounts for the presorted and/or barcoded First-Class Mail letter rate categories, we observe that the Commission elected to rely on the traditional reference point, or benchmark ("bulk metered mail"), for designing rates that incorporate the discounts. The Postal Service had proposed an innovative approach to rate design based on calculating separate reference points using data from the Cost & Revenue Analysis system. The Commission, however, disagreed. While we would have preferred to see the Commission use the Postal Service's "de-linked" rate design approach, we concur that the bulk metered benchmark is superior to alternatives proposed by intervenors, and we elect not to disturb the Commission's rate design.

In calculating cost avoidances for First-Class Mail discounts, the Commission did not adopt the Postal Service's proposed methodology for the treatment of delivery cost savings resulting from mailer worksharing activities.<sup>2</sup> The Postal Service will continue to evaluate whether the methodology for the calculation of mail processing and delivery costs savings could be improved.

The Commission has recommended rates that have the effect of increasing the incentives for mailers to presort their letter mail, but to reduce their incentives to make their mail compatible with the Postal Service's automated mail processing environment and to use the Postal Service's new Intelligent Mail barcode. This seems inconsistent with past recommendations by the Commission that acknowledged the substantial value of prebarcoding and may even impede future efforts to use enhanced barcodes as a foundation for a data-rich mailstream. The Commission's recommended workshare mail rate design also results in significantly higher initial-ounce rates for flats in almost all rate categories, as well as significantly higher initial-

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<sup>2</sup> In particular, the Commission decided to retain the use of average acceptance rates to calculate Delivery Point Sequencing percentages by rate level. While the Postal Service maintains that the use of average acceptance rates could overstate the delivery savings, the record supports the methodology the Commission retained.

ounce rates for bulk presorted parcels, than were proposed by the Postal Service. Accordingly, we express the same reservations discussed above in relation to the recommended single-piece flat and parcel rates. We do not take issue with the Commission's recommended additional-ounce rates applicable to bulk workshare letters, flats and parcels, the establishment of the Business Parcels rate categories, or the surcharge for nonmachinable Business Parcels. Nor do we disagree with the Commission's recommended elimination of the Automation Carrier Route rate category or the heavy piece deduction.

Overall, we acknowledge that reasonable minds may prefer different results after viewing the same record evidence. In the absence of a sufficiently compelling basis for disturbing the Commission's recommended First-Class Mail workshare rate designs, however, we adopt them going forward.

*Forever Stamp Classification.* We approve the Commission's recommendation that the Forever Stamp classification be adopted. This innovative classification change will add an unprecedented level of convenience for United States Postal Service customers whose predominant use of the mail is for sending one-ounce, single-piece First-Class Mail letters. In the long run, the use of Forever Stamps should permit these customers, primarily household mailers, to reduce their usual rate-change-related postal window service transactions, and to minimize other inconveniences associated with rate changes. The Commission's recommended classification language appropriately recognizes the intended purpose of the Postal Service's proposal, and the Commission's recommended decision reflects careful consideration of all relevant considerations.

The Forever Stamp will apply to any transition from the new 41-cent basic First-Class Mail letter rate to a higher rate. It does not apply to the transition from the current 39-cent rate to the 41-cent rate. This feature of the Forever Stamp led the Commission to conclude that its implementation would not significantly affect the estimate of Postal Service finances in the test year. See PRC Op. R2006-1 at 180, ¶5276. Postal management should publicize the availability and applicability of the Forever Stamp so as to maximize customer goodwill. The Forever Stamp proposal owes a lot to the energetic work of a task force, which included representatives from the Postal Service, the Commission's Office of the Consumer Advocate (OCA) and the Greeting Card Association, and which began work shortly after the conclusion of

Docket No. R2005-1. We encourage the Postal Service to continue to work collaboratively with the OCA and other interested parties to develop additional rate and classification proposals of practical and widespread benefit to the general mailing public.

*Additional Ounces.* With the exception of the automation letter rate categories, for which it requested that the additional-ounce rate be reduced to 15.5 cents, the Postal Service requested reductions in all other First-Class Mail additional ounce rates to 20 cents. The Commission recommends an additional-ounce rate of 12.5 cents for automation letter rate categories and 17 cents for all other rate categories, respectively. In the context of the Commission's overall First-Class Mail rate design, we find no basis for doing anything other than accepting the recommended additional-ounce rates.

*First-Class Mail Cards.* The Commission recommends that the basic rate for single-piece post cards be increased from 24 cents to 26 cents, in line with its recommended increase for letters. The Commission recommends relatively minor changes in the rates for the bulk presorted and/or barcoded cards categories that were proposed by the Postal Service and agrees with the proposed elimination of the Automation Carrier Route rate category. We find there to be no basis to take exception to the Commission's rate and classification recommendations in this area. The Commission also recommends a slight decrease in the current rate differential applicable to Qualified Business Reply Mail cards. We concur in this result.

### ***Standard Mail***

*Standard Regular and Nonprofit Regular Subclasses.* As with First-Class Mail, in all material respects the Commission recommends the shape-based classification structure for Standard Regular and Nonprofit Regular subclasses requested by the Postal Service, with one significant exception. Specifically, it splits the former "nonletter" rate category into three categories: flats, Not Flat-Machinables (NFMs), and parcels. These new categories better reflect how these pieces are processed. However, the Commission does not create additional categories by also splitting the destination entry discounts by shape. Under its approach, the Commission recommends increases for Standard Regular flats that are significantly higher than the increases requested by the Postal Service.

The Postal Service's rate proposal reflected greater sensitivity to the sudden impact of restructuring by shape on the mailers of flats and parcels, particularly those mailers who cannot readily convert their pieces to less costly shapes. The Commission's approach incorporates the full cost differences based on shape between letters and flats. This has led to steep price increases for flats. For example, those catalogs which pay the piece rates for automation flats entered at Sectional Center Facilities (SCF) closest to the delivery destination (DSCF) face a 41.1 percent increase under the Commission's proposal, but would have experienced an 18.5 percent increase under the Postal Service's proposal. As suggested by our earlier discussion regarding rates for First-Class Mail flats, the risks of misjudging how mailers (and thus mail volume) would respond increase significantly with rate changes of this magnitude.

The Governors are concerned about the effect that the steep increases in the prices of Standard Regular flats would have on the vitality of the catalog industry. The long-term interests of the Postal Service and its customers are served by a healthy catalog industry that creates interest in the mail and contributes to the institutional costs of the Postal Service. The benefits of a robust catalog sector spill over not only into other types of mail (such as First-Class Mail and the parcel classes) and other parts of the delivery industry (private entities which likewise deliver parcels), but also into those portions of the economy that produce, distribute, and service the goods ordered from catalogs during the holidays and throughout the year. We believe the more gradual transition to cost-based pricing proposed by the Postal Service would have better served to balance the considerations of both efficiency and the long-term health of the catalog industry.

The Commission justifies the sharp increases for Standard Regular flats by applying ECP to shape-based differences as a way to promote more efficient mailer behavior. It states that "Mailers should be able to convert lightweight pieces to more efficient, less costly letters if they feel that these cost-based rates are no longer the most cost effective way to send their mailings." PRC Op. at 249. The Commission also relies on the Bookspan NSA as evidence that mailers can be induced to change their mail piece shape through economic incentives. Id. at 87.

In light of the magnitudes of the increases recommended for Standard Mail Regular flats and the differences represented by the industries in which those rates are used, we are not

confident that Bookspan provides a completely reliable guide for Standard Mail rates in current circumstances. Furthermore, the ability to convert from flat-shaped to letter-shape is not shared by all mailers of Standard flats equally. While the Commission concluded that the record regarding the capability of conversion did not preclude its recommendations, we are not so confident. For example, letter mail can be only up to 0.25 inches thick. The Commission did not explain how flat-size mail pieces that already exceed the maximum letter thickness could change from flat shape to letter shape. Moreover, the Commission's rate design significantly increases the price not only of light-weight flats but also most heavy-weight flats. The Commission did not address heavy-weight flats in its decision.

We therefore have significant reservations concerning the levels of the flat rate increases embodied in the Commission's recommendations. We therefore wish the Commission to reconsider whether some rebalancing between Standard Mail letter and flat rates might be appropriate.

The Commission appropriately recognizes the importance of creating new classifications for Standard Regular parcels and Not Flat-Machinables (NFMs)<sup>3</sup> and providing meaningful price distinctions between flats, parcels, and NFMs. For parcel shaped pieces, the recommended increases, even though large, were found necessary to cover costs. We too believe that these are appropriate bases for above-average increases; however, we are concerned that the Commission, mitigated above-average increases by recommending larger presort discounts. Larger dropship incentives might have been a preferable option for mitigation.

With regard to the change establishing an intermediate NFM rate for pieces no longer eligible as automation flats, we note that both the Postal Service's proposals and the Commission's recommendations are grounded in logic, operations, and record support. Pieces that are somewhat flat-shaped, but rigid, or that are between 0.75 inches and 1.25 inches in thickness, currently pay postage as automation flats. However, these pieces are not processed on flats sorting equipment and are seldom delivered as flats. Rather, they are processed either manually or in the parcel mail stream. Since pieces processed manually or in the parcel stream cost significantly more than pieces processed in the flats stream, they have not been adequately

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<sup>3</sup> The NFM category would apply to certain rigid pieces that would no longer qualify for flats automation rates.

covering their costs, and their cost burden has been shared disproportionately by other automation flats. Therefore, to better align rates for these pieces with the costs associated with their actual operational treatment and to encourage mailers to adopt more efficient practices, the Postal Service proposed the creation of a NFM category with separate rates specifically for these pieces. No party opposed the Postal Service's Not Flat-Machinable classification changes.

The Commission appreciates the need to collect accurate cost information for these pieces and recommends the creation of the Not Flat-Machinable category. PRC Op. R2006-1 at 230. The Commission also recognizes that accurate cost information cannot be collected without a meaningful flat/NFM rate differential, and therefore recommends appropriate rates. *Id.* at 265. Although the Commission mitigates the rate initially proposed by the Postal Service by recommending that more highly workshared NFM pieces receive smaller rate increases than less workshared NFM pieces, we approve and adopt its recommendations.

Although some mailers have contended that the proposal to create an NFM category with separate rates is abrupt and that they need more time to develop and implement business plans reacting to these changes, the Commission is convinced that mailers have been on notice for a considerable time. PRC Op. R2006-1 at 265. Immediate implementation would also make NFMs more visible in the cost and revenue data collection systems. The benefits of more accurate tracking of the number of pieces for cost and revenue purposes will begin to accrue immediately when the classification is implemented. Based on the Commission's findings, as well as the record, we believe that the operational and financial need to implement this new category with its associated rates is clear.

*Standard ECR and Nonprofit ECR.* The Commission agrees with the Postal Service's request to impose a charge for detached address labels. This is an appropriate incentive to reduce costs and to increase the quality of service.

As with the Standard Regular subclasses, the Commission's approach to incorporating cost differences results in a stiff increase in the letter/flat differential. The Commission justifies the increase by contending it provides incentives for flat-shaped pieces to convert to letter shape. See *Id.* at 284-5, 288. As stated above, not all mailers have the same ability to convert.

*Standard Mail Dropship Rates.* The Commission increases the dropship discounts for Standard Mail to reflect 100 percent of the cost differences, despite evidence that full recognition of the costs would affect prices for different pieces in different ways. While the record supports the Commission's dropship discount rate design approach, we believe the Commission could have also taken into account other intricacies of the Standard Mail price structure, such as the effect of full passthrough on lighter-weight pieces. For example, in reality, the Commission's approach leads to a much greater than 100 percent passthrough for letters, which on average weigh less than one-ounce; yet they receive a dropship incentive as if they weighed 3.3 ounces. It would be reasonable to recognize this effect in the rate design through a different passthrough. By rigidly adhering to the 100 percent passthrough and using it for all shapes, parcels might be "under-encouraged" to pursue dropshipping with the Commission's recommended rates. The Postal Service's proposed prices for parcels recognized that, all else being equal, savings are larger when parcels are dropshipped. In our view, the Commission's recommendations miss the benefit of this refinement.

*Summary.* The test year revenues expected to be generated under the Commission's Standard Mail rate design depend on a mail mix that, admittedly, is difficult to forecast. The rates requested by the Postal Service reflect a reasonable mix that would achieve the Postal Service's test year revenue target. Based upon the record evidence, the Commission's alternative rate design apparently would achieve that same objective. Nevertheless, based on the concerns we have expressed above, particularly regarding the vitality of the catalog industry to the economy as a whole, and the uncertainty inherent in rate increases of the magnitude recommended, we ask the Commission to reconsider whether some rebalancing between Standard Mail letter and flat rates might be appropriate, and we urge the Commission to use the opportunity to mitigate the recommended increases for catalogs and other flat mailers. Returning the matter for reconsideration might also allow individual mailers and their associations to address any unique problems created by the Commission's recommendations.

### ***Express Mail***

The Commission recommends without change the Postal Service's Express Mail rate proposal. It does so in light of the recent passage of the Postal Accountability and Enhancement Act (PAEA), the lack of any opposition to the rates proposed by the Postal Service, and the

uncertain impact of any alternate rate design. The Commission's recommendation includes disaggregating the current uniform rate for one-pound and two-pound pieces into separate rates, consistent with the practice of Postal Service competitors in the expedited delivery market and consistent with the rate schedules for Priority Mail and Parcel Post. Express Mail rates will experience a 12.5 percent increase, with a cost coverage of 170.4 percent. While we do not necessarily agree with every statement made by the Commission in recommending the Postal Service's proposed rates, we find that its recommended decision is supported by substantial evidence and is consistent with the criteria of the Postal Reorganization Act.

### ***Priority Mail***

The Commission recommends that Priority Mail rates be increased an average of 13.6 percent, as proposed by the Postal Service. The Commission also recommends three major classification changes proposed by the Postal Service: (1) Dimensional weight (dim-weight) pricing, which considers the density (weight in relation to cubic volume) for parcels in Zones 5-8 if the parcels exceed one cubic foot and meet a certain low-density threshold; (2) eliminating the 15-pound balloon rate for Zones 5-8,<sup>4</sup> and increasing the balloon rate's threshold in Local and Zones 1-4 from 15 pounds to 20 pounds; and (3) making the Priority Mail Flat-Rate Box, currently an experiment, into a permanent classification.

In its rate design, the Commission also adopts several Postal Service proposals. These include incorporating a per-cubic foot rate element, distributing a portion of distance-related ground transportation costs to Zones 5-8 in recognition that such costs are incurred in connection with air transportation, and establishing a separate rate for Zone 3 by de-averaging the Local Zone and Zones 1-3. Certain recommended rates differ from the Postal Service's proposals, because the Commission substituted its attributable cost estimates for those provided by the Postal Service.

As requested by the Postal Service, the Commission recommends that the fee for Pickup On-Demand service, applicable to Priority Mail and other classes, be increased to \$14.25.

We agree with the Commission that the evidence of record shows that the Flat-Rate Box

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<sup>4</sup> Dim-weighting renders the balloon rate largely redundant in those zones.

experiment has been a success and that this classification should become permanent. It is available in two shapes, but both have the same capacity of 0.34 cubic feet. In addition, the Postal Service has customized Flat Rate Boxes for several mailers, but has maintained the standard size (0.34 cubic feet) while altering the dimensions. The current rate is \$8.10 and, as the name suggests, does not vary by weight or zone.

We are troubled, however, by one aspect of the recommended rates for Priority Mail. The Commission recommends a rate of \$9.15 for the Flat-Rate Box, which is 35 cents higher than the Postal Service's proposal of \$8.80. While a portion of the higher increase can be explained by the Commission's estimate of higher attributable costs (in particular, its treatment of costs associated with the Federal Express network), it appears that the Commission may have relied on inconsistent cost estimates in applying the Priority Mail pricing model.<sup>5</sup> As a consequence, in order to achieve the cost coverage for the Priority Mail subclass that it was recommending (149.8 percent), the Commission imposed a higher rate for the Flat-Rate Box than would be warranted had the correct costs been used. Correcting this error should permit a rate closer to that proposed by the Postal Service.

For that reason, we are asking the Commission to reconsider its recommended rate for the Priority Mail Flat-Rate Box. We direct postal management to file, with the Commission, its calculation of the rate using the Commission's cost estimates.

### ***Periodicals***

*Outside County Publications.* For the Outside County subclass, the Commission recommends rates resulting in an average increase of 11.7 percent and a cost coverage of 100.2 percent. While the percentage increase is the same as the Postal Service proposed, the recommended rate structure differs quite substantially from what the Postal Service proposed. The Postal Service proposed rates based on pieces, pounds, and containers. The Commission instead recommends a rate structure proposed by Time Warner, Inc, under which rates apply to pieces

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<sup>5</sup> While the Commission apparently intended to use its estimated attributable costs throughout, it seems to have used the Postal Service's estimate of costs when it calculated the savings that would accrue when parcels that become more costly as a consequence of dim-weighting migrate away from Priority Mail. Because the Postal Service's costs are lower, this resulted in a lower estimate of savings.

and pounds, as today, but also to bundles, sacks, and pallets. The piece rates would vary based on machinability; and the bundle, sack, and pallet rates would vary based on the type of entry facility. As a result, the recommended rate structure is much more complex than the one proposed by the Postal Service.

As the Commission notes in its Opinion in this proceeding, the Postal Service and MPA/ANM did not support Time Warner's proposed rate structure, and American Business Media and McGraw-Hill sponsored witnesses opposing the proposal. PRC Op. at 323. Time Warner first proposed this rate structure in Docket No. C2004-1, a complaint proceeding in which Time Warner and other Periodicals mailers challenged the existing rate structure. At the conclusion of that proceeding, the Commission issued Order No. 1446, which maintained the status quo and specifically did not find the Time Warner proposal to be superior to the current rate structure. See Order No. 1446, Appendix B at 7. The Commission, however, did encourage some movement toward a more cost-based rate structure, suggesting three options.

The first option would implement Time Warner's proposed rate structure, but with only partial recognition of cost differences and/or costs. The Commission did not seem to favor that option, stating:

While this [option] might moderate the initial impact, if many mailers are unable to adjust mailing practices to avoid the resulting devastating rate increases, this approach seems unlikely to garner widespread support in the Periodicals community.

Order No. 1446 at 47.

The second option, endorsed by the Postal Service, was to "gradually mak[e] changes over time;" with "one or more changes per rate or classification case."<sup>6</sup> In Order No. 1446, the Commission commented favorably on this option, stating:

Gradual introduction of changes would allow focused evaluation of the benefit of specific changes as against their impact on Periodicals mailers.

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<sup>6</sup> Tr. 39/13534.

The third option, which was not pursued by any party, would be to provide mailers a choice between two rate schedules, one retaining the current rate structure, with another incorporating the full Time Warner approach or something similar.

We are concerned that the Commission recommended such major changes to the Periodicals Outside County classification in a manner that leaves the Postal Service and Periodicals mailers unable to implement within the reasonable time period the Board is establishing for all other subclasses. We note that the Commission directed Postal Service witness Tang to respond to a Commission inquiry about implementation of the single container rate that she proposed, but did not ask any questions about implementation issues related to the Time Warner proposal, with its 77 separate bundle and container rates. The Commission claims that the issues raised by the Postal Service's proposals go away because the container rate is not recommended. PRC Op. at 354, n. 46. But this ignores related issues that arise from the multitude of container rates in the recommended rate schedule. For example, the Postal Service needs to consider how mail prepared in tubs or similar containers fits into the recommended rate structure. In implementing the recommendations, the Postal Service also needs to specify Bulk Mail Center (BMC) facilities where mail is entered closest to destination (DBMC), and closest to origin (OBMC), to the extent that such facilities are ever appropriate for Periodicals entry. Furthermore, the Postal Service needs to specify machinability, addressing, and barcoding requirements to define what mail will qualify for both automation and nonautomation machinability rates. These are complex changes that must be formulated and communicated to accomplish an orderly transition to the new, complicated rate design. We find that it would be imprudent and impractical to rush implementation of these complex changes.

To achieve effective implementation, revised regulations communicating the new rate structure to mailers need to be developed. Software incorporating the new rate structure into the Postal Service's administrative systems also needs to be developed. For example, modifications to the Postal Service's automated mail acceptance system (*PostalOne!*) will have to be made. These tasks, and others equally necessary, are formidable. Orderly transition to the new rate structure will also benefit from more time to allow development of appropriate Periodicals mail preparation software used by customers. Accordingly, a separate implementation date is specified for Periodicals –...July 15, 2007.

As a separate matter, we express some reservation about the wide variations in rate changes (from large increases to decreases) that different publications face and that some publications

face substantial rate increases even though they have limited options to become more efficient or to mitigate the increase. Despite these concerns, we note that while the Commission adjusted Time Warner's proposal by adopting Time Warner's proposed rate structure, it modifies many of its rates. Therefore, we believe that the Commission has adequately moderated rate impact, compared to Time Warner's proposals, and that the recommended rate structure and rates provide cost efficiencies and flexibility for the future that offset the negative impact on some mailers.

Therefore, we put the new rate structure and rates into effect on a delayed basis.

*Within County.* For within-county publications, the Commission recommends a 100.1 percent cost coverage. The rate increase is somewhat lower than what the Postal Service proposed, based on the Commission's use of volume averaging over a four-year period. Additionally, the Commission determined the Within County markup by a method that, while different from the method used in the Postal Service's proposal, is not inconsistent with statutory requirements. We accept the recommended rates. Since many publications use both Outside County and Within County rates, we believe that the same rate implementation date is required for both subclasses.

*Classification changes.* The Commission recommends many classification changes in order to implement its recommended rate structure. We accept these classification changes, which allow Periodicals rates to reflect costs and operational considerations more closely.

We find that the Commission's recommendations of rates and classifications for Periodicals satisfy the applicable statutory criteria and are in the public interest. We approve those recommendations.

### ***Package Services***

*Parcel Post.* The Commission recommends rates which result in an average increase of 16.6 percent and a cost coverage of 113.9 percent for Parcel Post. The Postal Service had proposed an overall increase of 13.8 percent, with a cost coverage of 115.2 percent.

The Commission generally follows the Postal Service's rate design approach for Parcel Post and rejects various criticisms by UPS of the estimated cost savings for the Parcel Select

destination-entry categories. With respect to other Parcel Post discounts (and surcharges), the Commission generally set them at 100 percent of estimated cost savings (or costs). The Commission, however, declines the suggestion of the Parcel Shippers Association to pass through all the estimated cost savings for Parcel Return Service, in favor of continuing a gradual increase of the passthroughs for this relatively new service.

The Commission recommends the two Parcel Post classification changes that the Postal Service had requested: to require parcels entered at Bulk Mail Centers closest to destination (DBMCs) to be barcoded, and to increase the weight for balloon parcels from 15 to 20 pounds.<sup>7</sup> The Commission also recommends the Postal Service's proposed 3-cent barcode discount for Parcel Post as well as the other subclasses of Package Services.

We find that the Commission's recommendations of rates and classifications for Parcel Post satisfy the applicable statutory criteria, are supported by substantial record evidence, and are in the public interest. We approve those recommendations.

*Bound Printed Matter.* The Commission recommends rates for bound printed matter which result in an average increase of 11.7 percent and a cost coverage of 119.4 percent. The Postal Service had proposed the same overall increase, with a cost coverage of 124.9 percent, based on its estimates of costs.

The Commission generally follows the Postal Service's rate design approach, but recommends that in the future the Postal Service compile data allowing a more cost-based approach less reliant on judgment. The Commission rejects the Association for Postal Commerce's (PostCom) proposed new rate design. The Commission also rejects Amazon.com's proposal to allow media such as DVDs to be mailed as bulk Bound Printed Matter. The Commission finds that Amazon.com failed to demonstrate the cost and revenue consequences of its proposal.

The Commission rejects the Postal Service's proposal to change the designation in the Domestic Mail Classification Schedule's (DMCS) of the Single-Piece Bound Printed Matter rate

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<sup>7</sup> "Balloon" parcels are parcels whose weight, dimension, and density characteristics significantly distinguish their processing requirements. Balloon parcels have long warranted distinct rate treatment.

category. The Postal Service proposed to rename this category Nonpresort Bound Printed Matter. We do not agree with the Commission's characterization of this proposal as "illogical." In this regard, the Commission's Opinion fails to note that much of this rate category consists of bulk mailings of fewer than the 300 pieces required to meet the presort requirements. Bound Printed Matter, which derives from the old fourth-class catalog rate, is essentially a commercial subclass, with 95 percent of the volume generated by commercial mailers, as the Commission notes. Moreover, in the past, the Postal Service has re-branded certain products (e.g., Standard Mail, Parcel Select, and Media Mail) on its own authority, in advance of conforming DMCS changes. In the Commission's view, the proposal apparently was tainted by the Postal Service's indication of its intention to accept at the retail window only pre-stamped parcels as Bound Printed Matter. We do not agree with the Commission's view that this would constitute a classification change. We think it is within the Postal Service's authority to manage its sales channels. For instance, Bound Printed Matter is not offered through Automated Postal Centers or usps.com. The Postal Service's retail associates will continue to provide customers with information regarding Bound Printed Matter and will accept pre-stamped Bound Printed Matter. The Postal Service will consider whether further classification changes are appropriate in the future.

Overall, we find that the Commission's recommendations of rates for Bound Printed Matter satisfy the applicable statutory criteria and are in the public interest. Accordingly, we approve those recommendations.

*Media Mail and Library Mail.* The Commission's recommends rates for Media Mail and Library Mail which result in average rate increases of 17.9 and 17.4 percent respectively and a cost coverage of 103.7 percent. The Postal Service's proposed rates would have increased rates 17.9 and 18.2 percent on average, with a cost coverage of 109 percent.

The Commission generally adopts the Postal Service's rate design approach and commends it for aligning rates more closely with costs. The Commission rejected PostCom's proposed rate design based on half-pound pricing increments for pieces weighing more than one pound but less than five pounds, while indicating some sympathy with the notion of making Media Mail a more attractive alternative.

We find that the Commission's recommendations of rates for Media Mail and Library Mail satisfy the applicable statutory criteria and are in the public interest. Thus, we approve those recommendations.

### ***Special Services***

The Commission recommends fees for the special services, as well as various annual permit and licensing fees. We approve the fees recommended by the Commission.

We still prefer the Confirm service fee structure proposed by the Postal Service, given the continued failure to cover costs of the subscription approach proposed for continuation by the Office of the Consumer Advocate (OCA). However, the improvements made by the Commission to the OCA proposal mitigate our reservations concerning the OCA's approach.

We also are concerned about the recommended fees for Registered Mail service, which would cover costs only because of a Commission adjustment to the Registered Mail costs the Postal Service presented. We ask management to review the Commission's application of an adjustment factor to the Postal Service's cost estimate, intended to separate out internal usage of Registered Mail by the Postal Service. We understand that the Postal Service's cost estimate already is limited to customer, rather than Postal Service, usage of Registered Mail. If an adjustment factor is to be applied, we urge management to provide the Commission with a cost estimate that reflects all usage of Registered Mail.

We are disappointed with the Commission's desire to specify all special service combinations in the DMCS, thereby requiring minor classification cases for changes in the allowable combinations as customer needs develop. During the case, the Postal Service suggested some more cooperative ways to involve the Commission in this process. Tr. 19/7031-32.

Unfortunately, the Commission's decision does not address those ideas. Instead, the Commission appears to favor an approach that would delay and otherwise constrain the Postal Service's ability to respond to changes in customer needs. As we said in Docket No. R2000-1, "Given the large number of possible special service interactions, omitting these lists would serve the Postal Service's need to respond more quickly and flexibly to customer interest in new

combinations.”<sup>8</sup>

We urge postal management and the Commission to explore more flexible ways to maintain and modify a list of special service combinations that does not require a series of minor classification cases. The Commission and the Governors should focus their attention on more important matters.

*Classification changes.* We approve the Commission's recommendation of several classification changes for special services, most of which were proposed by the Postal Service. These changes include updating the Address Correction Service classification to include a new automated option, location-based caller service fee categories, clarification of eligibility for Group E post office box service, the renaming of the "accounting" fees to "account maintenance" fees, renaming "license" to "permit" in the Business Reply Mail section, modifying the language for Merchandise Return service to clarify its availability for sending of most parcels, eliminating On-Site Meter service, requiring a delivery scan for all insured mail and a signature for items insured for more than \$200, revising the pricing structure for Express Mail insurance, modifying the language for Collect on Delivery service to indicate that the nondelivery service requires the payment of a fee, fixing the heading under Description in the COD Fee Schedule, modifying some of the mailer requirements for Confirm service, and adding Change of Address Service as a new classification.

We find that the Commission's recommendations of rates and classifications for Special Services satisfy the applicable statutory criteria and are in the public interest. We therefore approve those recommendations.

## **ESTIMATE OF ANTICIPATED REVENUE**

The provisions of former section 3625(e) of title 39 require that our Decision include an estimate of anticipated revenues. In accordance with our action on the Commission's Recommended Decision, we estimate that the rates and fees we are approving would result in test-year costs and revenues of approximately \$77.6 billion.

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<sup>8</sup> Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Postal Rate and Fee Changes, Docket No. R2000-1 (December 4, 2000).

**ORDER**

In accordance with the foregoing Decision of the Governors, the changes in rates and fees set forth in Attachment A hereto and incorporated herein, and the classification changes set forth in Attachment B hereto and incorporated herein, are hereby adopted, and we return three items for further consideration. (The technical language for this step is that we allow the rates to take effect under protest.) As identified in the text of the Decision, three matters are returned to the Commission for reconsideration. In accordance with Resolution 07-3 of the Board of Governors, dated March 19, 2007, the changes for all classes other than Periodicals will take effect at 12:01 a.m. on May 14, 2007. The changes for Periodicals will take effect on 12:01 a.m. on July 15, 2007.

By The Governors:

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James C. Miller III, Chairman

**RESOLUTION OF THE BOARD OF GOVERNORS  
OF THE  
UNITED STATES POSTAL SERVICE**

**Resolution No. 07-3**

Effective Dates of New Rates of Postage,  
Fees, and Changes in Mail Classification

RESOLVED:

Pursuant to former section 3625(f) of Title 39, United States Code, the Board of Governors determines that the rates of postage, fees, and changes in mail classification that were ordered to be placed into effect by the Decision of the Governors adopted on March 19, 2007, shall become effective at 12:01 a.m. on May 14, 2007, except that the rates and classification changes for Periodicals shall become effective on July 15, 2007 at 12:01 a.m.

The foregoing Resolution was adopted by the Board of Governors on March 19, 2007.

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Wendy A. Hocking, Secretary