

## SUMMARY

In this decision the Postal Regulatory Commission responds to a United States Postal Service Request for rate increases designed to generate almost \$4 billion of additional annual revenue. In addition to rate increases, the Service asks the Commission to approve rate design changes for most categories of mail, including First-Class Letters and Sealed Parcels.

The Commission finds the Postal Service will need to increase rates in order to break even next year. The Commission also concludes that the rate designs for many postal products can and should be improved.

The rates recommended in this decision fully fund every expense the Postal Service identifies in its Request, including \$768 million for contingencies. However, the Commission has identified calculation errors in the Service's supporting financial documentation, and conceptual errors in the Service's proposed rates, that allow the Commission to recommend smaller increases than the Postal Service requested. The Commission recommends rates that increase, on average, 7.6 percent. The rates requested by the Postal Service equate to an 8.1 percent increase.

The Commission recommends an increase of 2 cents instead of 3 cents in the rate for First-Class one-ounce letters. The rate will go from 39 to 41 cents. The Commission also recommends an increase of 2 cents instead of 3 cents in the rate for postcards. That rate will go from 24 to 26 cents. On average, First-Class Mail rates increase 6.9 percent.

The Postal Service sought authority to offer a new “Forever Stamp” to ease the transition to new rates. Forever Stamps will be sold in reasonably limited quantities for the price of a First-Class one-ounce letter, and continue to be worth the price of a First-Class one-ounce letter even if that price changes. The Commission recommends this innovative proposal which will be a convenience for individual consumers, and reduce the costs of transitions to new rates.

The Postal Service also requested new, separate shape-based rate schedules within First-Class. Large or odd-shaped pieces are more expensive to process than letters, and the Service wants to be able to charge compensatory rates for such pieces. The Commission finds this step justified and recommends separate rate schedules for flats (large envelopes) and parcels. This refinement also allows the Commission to reduce the First-Class additional ounce rate from 24 to 17 cents. The Postal Service is urged to carry out a broad public education program before it begins to charge separate rates for letters, flats, and parcels.

In this case the Commission obtained comments and testimony from a cross-section of interested participants on how best to develop rate discounts for mailers who perform worksharing to reduce Postal Service costs. Most business mailers now participate in worksharing activities in order to earn postage discounts. The consensus was to apply the economic principle of Efficient Component Pricing. This results in the most productive use of the Nation’s resources.

The Commission has used Efficient Component Pricing to develop rates wherever possible. Many rates proposed by the Postal Service were not consistent with Efficient Component Pricing as they failed to reflect cost differences fully. Rates that more accurately reflect costs send proper price signals. Rates that send proper price signals result in more efficient processing and transportation practices, which in turn reduce costs, thereby allowing smaller rate increases, and less volume losses.

In First-Class, the Postal Service proposed to “de-link” single-piece from worksharing rates. This practice would abandon the principle that worksharing discounts should be based on the costs avoided by worksharing activities. As applied by the Postal Service in this case, it would expand discounts beyond avoided costs, and unfairly shift the burden of this rate increase on to single-piece mailers. The Commission believes that mailers who workshare should be rewarded, and recommends discounts that fully reflect the costs avoided by worksharing. Because the de-linking approach does not equitably balance the interests of all mailers within a subclass, and does not follow established principles of rate design including Efficient Component Pricing, the Commission does not adopt it.

Standard Mail consists entirely of bulk mailings with rates intended to reflect cost distinctions. The Postal Service proposes that new, separate shape-based rate schedules be added to Standard Mail to better reflect costs. The Commission recommends this improvement. Recommended Standard rates vary from those suggested by the Postal Service in that smaller increases are recommended for the more efficient (lower cost) pieces, while some less efficient pieces face larger increases. On average, Standard Mail rates increase 9.3 percent.

Several participants, including the Postal Service, propose new rate designs for Periodicals. Here, too, the goal is to better reflect costs, and send price signals that will encourage more efficient mailing practices. Periodicals’ costs have risen disproportionately in recent years, in part because current rates send such poor signals. For example, Periodicals is the only class where no rate penalty is applied to nonmachinable pieces.

The Commission recommends a new design that draws from the separate proposals of the Postal Service and Time Warner Inc. The recommended rates recognize only a limited portion of the costs associated with identifiable cost drivers in order to moderate the impact on mailers. Nonetheless, Periodicals mailers are extremely cost conscious, and the Commission expects that these rates will foster more efficient, less costly Periodicals mail. On average, Periodicals rates increase 11.8 percent.

The Postal Accountability and Enhancement Act of 2006 has altered the way postal rates will be set in the future. In particular, the Postal Service will have wide flexibility to set the rates for competitive products, so long as those products generate revenues sufficiently above costs. In recognition of that fact, the Commission has not recommended new rate designs for the Postal Service's competitive products. Rates for Express, Priority and Parcel Post include adjustments to better reflect costs, but otherwise are largely as suggested by the Postal Service.

This completes the last omnibus rate request filed prior to enactment of the 2006 legislative reform. The rates recommended by the Commission provide a sound foundation on which the Postal Service and the Postal Regulatory Commission will begin to exercise their new, important responsibilities under this legislation.