

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

Repositionable Notes Market Test

Docket No. MC2004-5

**REPLY TO
RESPONSE OF UNITED STATES POSTAL SERVICE TO
MAILER COALITION'S JOINT MOTION TO DISMISS**

The Postal Service answered the Mailer Coalition's joint motion to dismiss this proceeding arguing that the motion is both procedurally improper and substantively unsound. The Postal Service is wrong on both points. We deal with the substantive arguments first.

- I. The Postal Service's Unbounded Classification And Reinterpretation of the Term Value of Service Cannot Be Reconciled With The Act**
- A. The Pricing Factor of the Act Is Relevant To The Legality of the Proposal, And the Proposal's Lack of Attributable Cost is Determinative**

The Postal Service's first substantive argument (*USPS Response* at 3-4) suggests that this is not a rate matter under Section 3622 of the Postal Reorganization Act of 1970 ("Act") but should be exclusively governed by Section 3623. Invoking *National Retired Teachers Association, et al. v. United States Postal Service*, 430 F.Supp. 141, *affirmed*, 593 F. 2d 1360 (D.C. Cir. 1979) (hereinafter "*NRTA*"), it argues that attributable cost is not a factor in determining what constitutes a classification. But Commission rules and decisions, court precedent, and even the Postal Service's own filing, belie the implication

that the only relevant statutory criteria are those set forth in 3623, and demonstrate that attributable cost is a key factor in classification.

There is an inevitable interrelationship between classification and pricing. The purpose of a classification is to group mail to enable the Postal Service to charge a "fair and equitable" rate.¹ As this Commission has previously stated, "the Postal Service's formalistic argument that it submitted its Request as a proposed classification change pursuant to [39 U.S.C. § 3623](#) does not obviate the patent rate effects that would accompany implementation of its proposal."² Thus, it is beyond dispute that the pricing factors of the Act are relevant to a classification proceeding. Indeed, despite the Postal Service argument (*USPS Response* at 3) that Section 3622 does not govern the creation of classifications, the Postal Service's own Witness Kaneer attempts to address each of the factors contained in the section. (*Direct Testimony of Kirk Kaneer at 7 et seq.*)

In short, the RPN rate proposal is not a mere classification change; it is no more or less than a rate or surcharge. In either case – whether this is a classification with rate consequences or purely a rate – the statute and case law simply do not permit this Commission to approve it. The Commission has long recognized mail classification as a process "for identifying groupings of mail for the purpose of setting rates, based on differences *in costs and values of service*...."³ This definition received judicial approval in *NRTA*, where the court said: "a classification is a 'grouping' of mailing matter for the

¹ *National Easter Seal Society v. U.S. Postal Service*, 656 F. 2d 754, 762-3 (D.C. Cir. 1981)

² *United Parcel Service, Inc. v. United States Postal Service*, 615 F.2d 102, citing, *inter alia*, MC78-1, Order No. 280 at 19 & n.1 (May 18, 1979).

³ *MC95-1 Opinion and Recommended Decision* at II-20 (Emphasis added); see 39 USC § 3622(b)(3).

purpose of assigning it a specific rate or method of handling. Relevant factors include size, weight, content, ease of handling, and identity of both posting party and recipient."

The Commission will readily observe that the factors of size, weight, and ease of handling are relevant to a definition of a classification for purposes of assigning a specific rate precisely because they influence attributable costs. These factors obviously offer no grounds for a classification distinction here. Likewise, obviously, no grounds exist for a classification distinction based on the identity of both the posting party and recipient: these would be the same for a particular mailpiece with or without a RPN (and no one claims otherwise).

The remaining classification criteria, content, is concededly not a cost-based factor. Rather, it is a criterion which reflects social values. However, content has always referred to the text of the piece. For example, an eligible Periodical must contain a specified percentage of "non-advertising" matter. The text on an RPN can be anything: an advertisement or offer, a teaser for editorial content, an advertising or editorial correction, or simply contact information. This proposal does not restrict the content of the RPN; the content (and social value thereof) is presumed to be consonant with the mailpiece to which it is adhered. Thus, this proposal is not a classification based on content (and the Postal Service is careful not to argue that it is). Rather, the RPN proposal is a categorization based on physical characteristics of the piece (a repositionable note is on the outside). Precisely because this physical attribute has no attributable cost consequence, it is impossible to distinguish RPNs from other physical characteristics—such as the cover layout, or the placement or content of the address block, which like RPNs, are without cost effect but are perceived by mailers to influence

response rates. Physical characteristics that have no attributable cost effects cannot serve as the basis for a classification with rate consequences: the statute and the cases make clear that physical characteristics (such as size and weight) are relevant only because they affect attributable costs.

The courts and this Commission have insisted that classifications be based on cost or some other characteristic of the mailpiece for a compelling reason. If classifications are permitted to be based on some event or occurrence that is external to, or arguably a consequence of the mailpiece (such as response rates), there is a very real danger of precisely the sort of price discrimination that Section 403(c) of the Act forbids. Without attributable costs or other cognizable bases for classification, there are no lawful grounds for the proposed classification, even assuming there is grounds for calling this proposal a classification at all.

B. Commission Precedent Supports A Finding That The Proposal is Unlawful

There is a further fatal defect to the RPN proposal: it involves a classification that cuts across the subclasses, and it adjusts (and only adjusts) institutional cost burdens below the subclass level. The Postal Service argues (*USPS Response* at 4) that, in any event, Section 3622 (b) of the Act does not require that non-cost factors must be applied at the subclass level or on a comparative basis. The Mailer Coalition recognizes that it is not a statutory imperative that non-cost factors have to be applied at the subclass level, but it is undisputed that this Commission has consistently applied the statutory factors to assign institutional cost burdens at the subclass level. The Postal Service does not deny this: "It should be noted that these factors are traditionally applied to determine cost coverages at the subclass level." *USPS Response* at n. 3. What the Postal Service

chooses to ignore is that these Commission's decisions are obviously part of the "existing legal framework." *Joint Motion* at 3 and *USPS Response* at 5.

The Postal Service argues that if the cost coverages must always be set at the subclass level and on a comparative basis, then it cannot make institutional cost adjustments between omnibus rate cases. *USPS Response* at 4. That argument is invalid. This Commission has routinely favorably recommended modifications to existing classifications, and the introduction of new services that have had the potential to affect the institutional cost coverage of the subclass to which the proposal applied. Commission precedent does not forbid all such modifications, as the Commission's authorization of Customized Market Mail suggests. But it does forbid the proposal that the Postal Service has advanced here⁴ -- the imposition of a rate based on a distinction which has no purpose whatsoever except to directly increase the institutional cost burden of pieces with RPNs, and thereby indirectly raise the cost coverages for each of the subclasses affected and the comparative relationship of those cost coverages. The Commission's established method of applying the non-cost factors for the Act derives from statutory command. Institutional costs must be "reasonably assignable" to the subclass or type of mail upon which they are to be imposed. 39 U.S.C. § 3622(b)(3). An RPN may be attached to mail which cannot be distinguished from other mail within the subclass in terms of cost or any other cognizable classification criteria. There is simply no means to judge whether this institutional cost surcharge constitutes a "reasonable" assignment of costs that do not vary with a characteristic of mail.

⁴ See, e.g., *id.*, see also *R77-1, Opinion and Recommended Decision*, at 245-8 (where the Commission recognized that a classification should have unique characteristics that warrant an independent application of all of the § 3622(b) ratemaking criteria).

Attempting to illustrate the legality of its proposal, the Postal Service cites *Customized Market Mail* ("CMM"). *USPS Response* at 5 and 6. But *CMM* is readily distinguishable from this case. Customized mail had been previously treated as non-mailable matter because of the perceived difficulty of processing these pieces due to their odd shape. The Postal Service recognized that it could capture new Standard Mail volume if it could establish certain entry and processing rules, and set a rate to reasonably recover the costs of processing such pieces. CMM was a new service offering for which the Postal Service developed a new classification that fit into the existing Standard Mail rate design. The Postal Service averted the previously anticipated difficulties of processing these pieces by requiring that these pieces be boxed and sent to the destination delivery unit; they thus bypassed Postal Service automation. The Commission found the Postal Service's record in that case was (as here) devoid of traditional quantitative support, but (unlike here) it was not devoid of other indications that the Commission found sufficient to satisfy the statutory criteria.⁵ In CMM, shape was the factor that affected attributable costs (basically, the costs of DDU sorting and delivery) and thereby justified the new classification and rate. The test was to determine if the rate was sufficient to cover attributable cost. Here, by contrast, no cost affecting change is being made to the existing services, the surcharge applies to different classes, and the test will only demonstrate the extent of the Postal Service's power to exploit its monopoly.

⁵ *MC2003-1 Opinion and Recommended Decision* at 26. Here, since the statutory criteria have not been met, we need not reach the factual question of whether the Postal Service's claim that "the volume is not expected to be particularly large" is sufficiently reliable when it has "no basis at this time to estimate the volumes in this case." *Direct Testimony of Kirk Kaneer* at 5.

C. The Postal Service's Interpretation of Value of Service Cannot be Reconciled with the Statute, Case Law, or Ratemaking Principles

Nonetheless, and even if the Commission decides to abruptly depart from 34 years of consistent interpretation of the statute, it still must dismiss this RPN proposal as unlawful. This is because the Postal Service seeks to interpret the term "value of service" in a way which cannot be reconciled with the language of the Act, case law and the very purpose of rate regulation.

The sole justification advanced by the Postal Service for this peculiar proposal is that RPNs will increase the response rate, and that therefore, the Postal Service should be entitled to share in the "value" derived by the mailer through the imposition of this institutional cost surcharge. There is no legal basis for this theory of value. In *Association of American Publishers, Inc. et al., v. Governors of the United States Postal Service*, the Court of Appeals held that "value of service" as used in Section 3622(b)(2) is "the economic concept ... an approach which looks to demand factors". 485 F.2d 768, 775 (D.C. Cir. 1973).

Subsequent decisions of the Commission and the courts make clear that the "value" in subsection (b)(2) also includes the "what the customer gets" in terms of collection, priority delivery and mode of transportation—the so-called "intrinsic value" of mail.⁶

Thus, what the Postal Service's justification for RPN comes down to is that, in fact, there are three types of "value" embedded in (b)(2): (i) the "economic concept" of demand measured by relative elasticity; (ii) intrinsic value measured by quality of

⁶ *Direct Marketing Association, Inc. et al. v. United States Postal Service*, 778 F. 2d 96, 104 (2d Cir. 1985).

service⁷; and (iii) the value that the sender realizes in response rates. It is plain that the Postal Service seeks to give a new and different meaning to the term "value of service" as used in the Act. There is not one word in the Act, its legislative history, or the cases suggesting that (b)(2) values are to be measured by response rates. The Court in *AAP* pointed out that if a new meaning is to be added to subsection (b)(2), "the remedy is legislative." That conclusion obtains here.

The fact that some mailers may pay more than they now do for pieces with RPNs only compels the conclusion that the Postal Service has "misunderstood the meaning of factor (2)."⁸ As we pointed out in our Joint Petition, value of service pricing must be applied judiciously because the line between legitimate demand pricing and monopoly exploitation is very indistinct. Indeed, the general rule is that value of service is justifiable only when used to enable the utility to capture or retain volume that would otherwise be lost.⁹ That is certainly not the basis of the Postal Service's proposal here. On the contrary, the Postal Service seeks simply to exploit its monopoly position by extracting additional contribution to institutional costs.

In sum, the ultimate question is not, as the Postal Service poses (*USPS Response* at 6-7), "should the enhanced value be a factor to raise subclass rates for all mailers or be charged to those who benefit." Rather, the question is whether the Postal Service can lawfully charge a higher rate for a specific mailer innovation that neither causes an increase in cost, nor is distinguishable based on any other statutorily cognizable factor

⁷ There is no claim here that RPNs change the "intrinsic" value of a mailpiece. The quality of service is exactly the same as mail in the subclass without RPNs.

⁸ *AAP*, 485 F.2d at 775.

⁹ *Payne v. Washington Metropolitan Area Transit Commission*, 415 F.2d 901, 916-17 (D.C. Cir. 1968).

and is justified only by a newly-minted re-definition of the term "value of service." The answer is plainly, "no."

D. That the Proposal is Merely a "Test" Does Not Alter Results of the Necessary Legal Analysis

The Mailer Coalition recognizes that this proposal is only a test: however, a test is worthwhile only if it is likely to be given favorable consideration on a permanent basis. Even assuming that the test proves that mailers are willing to pay more for some pieces of mail which contain RPNs, there will be no way to ascertain whether that value is ascribable to the presence of the RPN or some other attribute of the mailpiece because the classification is unbounded. Nor would the test produce elasticities under the statutory definition of value of service at the necessary level to properly assign institutional costs below or at the subclass level. This test would only establish that the Postal Service has market power in each of the affected three subclasses. The Commission cannot lawfully authorize the exercise of such power, whether or not on a "provisional" basis.

II. The Postal Service's Procedural Arguments Are Without Merit

The first of the Postal Service's procedural arguments seems to be that the Mailers Coalition is estopped from raising the issue of legality because this Commission has not only accepted the proposal for filing, but has determined to consider it under the provisional rather than the market test rules. There is not one word in the Commission's Order instituting this docket which holds or implies the determination by the Commission that the proposal satisfies the statutory requirements; the decision merely determines which of two sets of rules will be applied in considering the proposal. Indeed, the

Commission could not possibly have reached a decision on the legality of the proposal because the issue was not raised until our Motion to Dismiss.

The Postal Service's second procedural argument seems to be that summary dismissal would deny it of its "opportunity" for hearing under 39 U.S.C. § 3624(a). This argument is equally without merit. It is true that this Commission has never granted a motion for dismissal, but that is only because this is the first case in which the Postal Service has advanced the proposal which is unlawful on its face. The summary disposition, including dismissal, is routinely employed by administrative agencies.

Authority for such disposition, including dismissal, is readily drawn from general principles of federal administrative and civil procedure. The legal standard for summary disposition is analogous to the familiar legal standard for summary judgment: if there are no genuine issues of fact material to the decision, the proceeding may be disposed of.¹⁰ It would be a waste of administrative resources, as well as the resources of the parties, if a hearing is held for purposes of addressing factual issues, when these factual issues are not material to the decision because the case can be disposed of as a matter of law. The conduct of a test simply cannot cure the legal defects of the proposal. It is both lawful and sensible for this Commission to adjudicate the Mailer Coalition's substantive arguments at this time.

¹⁰ See Fed. R. Civ. P. 56, 1 Richard J. Pierce, *Administrative Law* § 8.3 ("Even when an agency is required by statute or by the Constitution to provide an oral evidentiary hearing, it need do so only if there exists a dispute concerning a material fact.").

Respectfully submitted,

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