

**BEFORE THE
POSTAL RATE COMMISSION**

Docket No. MC2004-5

REPOSITIONABLE NOTES MARKET TEST

INITIAL BRIEF

OF

**DIRECT MARKETING ASSOCIATION, INC.
ASSOCIATION FOR POSTAL COMMERCE
MAGAZINE PUBLISHERS OF AMERICA, INC.
MAILING & FULFILLMENT SERVICE ASSOCIATION**

Dana T. Ackerly II
Counsel to
Direct Marketing Association, Inc.

Ian D. Volner
Rita L. Brickman
Counsel to
Association for Postal Commerce
Mailing & Fulfillment Service Association

James Pierce Myers
Counsel to
Magazine Publishers of America, Inc.

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WASHINGTON, D.C. 20268-0001

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MAILING & FULFILLMENT SERVICE ASSOCIATION

The Direct Marketing Association, Inc., the Association for Postal Commerce, the Magazine Publishers of America, Inc., and the Mailing & Fulfillment Service Association (collectively, the “Mailers”) respectfully submit this brief in opposition to the proposal made by the Postal Service in this proceeding.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Postal Service is seeking the Commission’s approval to charge fees when mailers add “Repositionable Notes” (“RPN’s”) to qualifying pieces of mail. The Postal Service needs the Commission’s approval only to impose fees. It already has the authority, which it has been exercising, to allow mailers to add RPN’s without a fee.

Mailers do not oppose expanding the categories of mail to which RPN's may be attached. However, Mailers do oppose strongly the imposition of any fees or charges on RPN's based on the record of this case.

Properly viewed, this case is neither a "market test" case, nor a "provisional service change" case.¹ This is a mini-rate case, pure and simple, but the record does not contain the evidentiary support necessary to permit the Commission, consistent with the requirements of the Postal Reorganization Act of 1970 (the "Act"), to recommend the imposition of separate fees for RPN's.

The Postal Service claims that it has filed this case as a "market test," to "test mailer reaction" to the proposed fee structure. To the contrary, it appears that the primary goal of the Postal Service is to "garner revenue reflective of [the] value"² anticipated from the addition of RPN's, *i.e.*, a portion of the economic benefit produced by the USPS/maileer cooperation. As a threshold matter, Mailers emphasize that it is totally appropriate for the Postal Service to seek to increase its revenues; moreover, it is totally appropriate for the Postal Service and mailers to work together in the entrepreneurial spirit in search of more effective ways to utilize the services offered by, and the infrastructure maintained by, the Postal Service. It is also totally appropriate for the Postal Service to receive a portion of the economic benefits when these efforts produce successes – provided, however, that the Postal Service accept part of the financial risk when

¹ Mailers note that the distinction between a "market test" and a "provisional service change" is not clear. *See., e.g.*, PRC Order No. 1084, 60 FR 54981, 54983 (PRC Dkt. No. RM95-4, October 27, 1995) (discussion of "whether rules for provisional services would accomplish any purposes different from those addressed by the market test rules").

² USPS-T-2 at 2-3.

these efforts are not as successful as expected. If the Postal Service is to operate more like a business, it must share in the risks as well as the rewards.

Mailers oppose the instant proposal primarily because it is unsupported -- and certainly not supported well enough to meet the “substantial evidence” standard. In the first place, the Postal Service has assumed the answer to the central issue in this case: whether it is appropriate for the Postal Service to charge any fee for RPN’s in addition to the postage paid on the underlying mail piece.³ Second, the proposal does not meet the criteria for a provisional service change; nor, for that matter, does it meet the criteria for a market test, or an experimental classification change.⁴ Third, the RPN proposal is a mini-rate case, but the Postal Service has not provided the evidentiary support needed to justify the fees it seeks to impose.

Finally, even if the Commission were to determine that the imposition of fees here were appropriate, this proposal should still be rejected, because it is not designed to collect data on the matter to which it purportedly is addressed: pricing decisions. Contrary to the Postal Service claims, this “test” will not yield any data that could be used meaningfully to inform future pricing decisions.

Mailers respectfully suggest that, if the Commission thinks there is merit in the RPN concept, it approve the Postal Service proposal with the salient modification that the fees be set

³ The USPS proposal does not address the fundamental question of whether the Postal Service should simply permit RPN’s at no cost or whether it makes sense to treat RPN’s as a separate “service” for which additional fees are appropriate. *See, e.g.*, Testimony of NNA witness Tidwell, NNA-T-1.

⁴ In Mailers’ view the distinction between (1) “experimental classification changes” under Rules 67 through 67d, (2) “market tests” under Subpart I, and (3) “provisional service changes” under Subpart J, makes little difference in this case. The point is that the proposal to impose fees for RPN’s has not been justified and would have to be rejected no matter which set of rules were applied.

initially at \$0.00. In that way, the Postal Service and all mailers could gain experience with RPN's; mailer enthusiasm for RPN's could be judged on a broad basis; meaningful data could be collected, ; and a decision on fees could be made in the proper context, *i.e.*, in the forthcoming omnibus rate case.⁵

STATEMENT OF FACTS

The Postal Service filed its Request in this case on July 16, 2004, asking that it be considered under the Commission's "Market Test" rules.⁶ On July 21, 2004, the Commission issued its Order No. 1413, in which it ruled that the request could not appropriately be considered under the Market Test rules, in part because it was not "undertaken concurrently with, and in support of, a proposed permanent change in the mail classification schedule."⁷ However, the Commission agreed to consider the request under the Commission's "Provisional Service Change" rules.⁸

On August 11, 2004, a group of mailers filed a motion seeking dismissal of the case. The Commission denied this motion on August 30, 2004, ruling that:

"... whether RPN mail has 'value' or 'desirability' that should be reflected in classifications and rates is something that should be examined in a proceeding where there is an opportunity to make a record, rather than be determined in summary fashion at the outset."⁹

⁵ To the best of Mailers' knowledge, the Postal Service has not identified any aspect of its RPN proposal under Rule 172(a)(3) as not lending itself to modification "without significantly reducing the benefits of introducing the proposed service." Thus, any aspect of the proposal may be modified consistent with Rule 174.

⁶ 17 CFR Subpart I.

⁷ PRC Order No. 1413 at 3.

⁸ 17 CFR Subpart J.

⁹ PRC Order No. 1417 at 5.

Since August 30, the record has been amplified by, *inter alia*, the filing of testimony by NNA witness Tidwell and certain USPS responses to interrogatories asked by the DMA.

The record was closed on October 15, 2004.

ARGUMENT

I. The Postal Service Has Not Justified The Imposition Of Any Extra Charges For Repositionable Notes.

The USPS proposal relies on an unstated premise: that it is appropriate to charge mailers an extra fee for RPN's. This fundamental assumption is completely unsupported and unjustified. The Postal Service at no time explains why it is consistent with the principles of the Act to charge an extra fee solely because response rates may, perhaps, be higher when RPN's are used. The implications of such an approach to pricing RPN's are totally unexplored on this record.

A. Imposing Charges For RPN's Is A Fundamental Pricing Decision For Which There Is No Support On This Record.

The Postal Service states blithely that it is seeking information on "mailer reaction" to the RPN fees that it has proposed, *i.e.*, 0.5 cents for First Class and 1.5 cents for all other classes. Nowhere in its testimony, however, does the Postal Service discuss the threshold issue of whether it is appropriate to charge a fee for RPN's in the first place.

In his testimony, USPS witness Kaneer stated, "The RPN classifications and rates . . . provide an effective way to garner revenue . . ." ¹⁰ In response to a question from the DMA, witness Kaneer asserted further that, "The RPN proposal embodies a tiny adjustment in the way the Postal Service's institutional cost burden is shared among mailers." ¹¹

¹⁰ USPS-T2-2 at 2-3.

¹¹ DMA/USPS-T2-2.

Putting aside the question as to whether the proposed fees would be considered “tiny” by mailers forced to pay them, the Postal Service has conveniently avoided a critically important threshold question: whether it is appropriate to charge any fees for RPN’s and whether the resulting adjustment in the sharing of USPS institutional costs among mailers is consistent with the pricing principles of the Act.¹²

For example, the record is ambiguous at best concerning the “value” of the RPN service. The fact that companies that have pilot-tested RPNs have had “highly mixed experiences with them”¹³ suggests that the value of the RPN lies in the content, and not the form, of the message. Moreover, witness Holland candidly admitted that “there is no basis at this time for estimating the number of participants and the potential volumes . . .”¹⁴ Thus, the Commission has no evidence regarding value of service that is sufficiently reliable to justify the imposition of a separate fee or to determine the fairness of a fee of any particular size.

For this reason alone, the USPS proposal must be rejected on grounds of lack of “substantial evidence.”

B. Response-Based Rates Must Be A Two-Way Street.

Mailers recognize that the Postal Service needs to innovate and to find ways of making its services as useful as possible to as broad a spectrum of mailers as possible. It is appropriate for the Postal Service to gain financially when these innovations are successful; that is the only way that the Postal Service will remain viable into the future. If the Postal Service is to reap the

¹² Witness Kaneer’s recital of the pricing and classification criteria of the Act at pages 5 - 11 of his testimony amounts to no more than window dressing. It does not constitute an analysis that would be useful to the Commission in reaching a decision on this critical issue.

¹³ USPS-LR-1, Repositionable Note (RPN) Concept Research (May 2004) at iii.

¹⁴ USPS-T-1 at 5.

rewards of successful innovations, however, it must also be willing to share in the risks when innovations fail.

The innovation referred to as “negotiated service agreements” provides an interesting example. NSA cases, at least those proposed to date, have involved trade-offs between, on the one hand, USPS costs saved and revenues gained and, on the other hand, rate concessions granted by the USPS to reduce the additional costs borne by the mailer when it increases its volume.

If framed as an NSA, the RPN proposal would make good sense without any additional fees. It could be summarized as follows: the Postal Service agrees to accept RPN’s, a concession that costs it nothing, and the mailer agrees to pay the cost of printing and applying the RPN’s and to mail additional pieces of mail bearing RPN’s. The Postal Service gains financially through increased volume. The mailer bears all the additional costs involved, and it bears all of the risk that the RPN’s may not produce additional responses. That balance between risks and rewards seems more than fair to the Postal Service.

Imposing an additional charge for the RPN’s, however, would shift the relative risks and rewards significantly against the mailer. It would be a “heads we both win; tails I win and you lose.” In other words, regardless of whether RPN’s produce higher response rates, the Postal Service would gain additional revenue. The mailer would share in the gain only to the extent that the RPN innovation were so successful that response rates would increase enough to offset the increased mailing costs. The mailers bear all of the costs and even pay the Postal Service an extra surcharge. The Postal Service would get a financial benefit regardless of whether any given RPN mailing were a success. In short, there is none of the appropriate reciprocity in the Postal Service’s RPN proposal.

A balanced sharing of the risks and rewards in this case would argue strongly for the Postal Service to permit RPN's on a broad basis without imposing any additional charges.

II. The Postal Service's Testimony Does Not Adequately Support Its RPN Proposal.

Even assuming that RPN fees at some level were deemed appropriate as a threshold matter, the Commission should not approve the rates proposed by the Postal Service (or any other RPN rates) based on the record of this proceeding.

A. The Postal Service Has Not Fulfilled The Criteria For A Provisional Service Change.

On August 30, 2004, the Commission denied a motion for summary dismissal of this proceeding made by a coalition of mailers.¹⁵ In its order, the Commission said that the Postal Service:

“must show that the RPN categories that it requests are consistent with the statutory factors for evaluating classifications in section 3623(c). It must also show that the RPN rates that it proposes are consistent with the statutory factors for evaluating rates articulated in section 3622(b), including the cost factor articulated in section 3622(b)(3).”¹⁶

The Commission went on to articulate the central issue in this case as follows: “whether RPN mail has ‘value’ or ‘desirability’ that should be reflected in classifications and rates . . .”¹⁷ It then stated that this issue “should be examined in a proceeding where there is an opportunity to make a record . . .”¹⁸

¹⁵ PRC Order No. 1417 (August 30, 2004).

¹⁶ *Id.*, at 4.

¹⁷ *Id.*, at 5 (Emphasis supplied).

¹⁸ *Id.* Mailers note that the Commission has stated that “the same decisional considerations are mutually applicable to market tests and provisional service changes.” PRC Order No. 1110, 61 FR 24447, 24451 (PRC Dkt. RM95-4, May 16, 1996).

Mailers continue to believe strongly that this proposal should not be approved, because the Postal Service has not made its case on this central issue: whether the addition of RPN's to pieces of mail should be the basis of a separate "classification" for which higher rates should be charged.

1. The Postal Service Does Not Need To Collect Data To Inform Future Classification Decisions.

In its Order 1413, when the Commission allowed this case to proceed under the "provisional service change" rules, it stated:

"These [provisional service change] rules . . . are meant to facilitate 'introduction of provisional services that enhance the range of postal services available to the public, without producing a material adverse effect overall on postal revenues or costs, and without causing unnecessary or unreasonable harm to competitors of the Postal Service.' The Commission's provisional service change rules are designed to allow provisional service enhancements with little potential to adversely impact stakeholders to be implemented quickly without the making of an unnecessarily elaborate factual record."¹⁹

It is clear from the record that the Postal Service does not need any additional information or data to enable it to determine the qualitative character of the "classification change" it proposes. The Postal Service already has a great deal of information about the operational characteristics of RPN's and is confident that RPN's will not increase USPS costs.²⁰ It has conducted a series of studies, and it has permitted mailers to test the RPN's in the real world.²¹ Information has been received from the field, and the "verdict" is clear: RPN's work well. They cause no additional costs.

¹⁹ PRC Order No. 1413 at 4-5.

²⁰ USPS-T-1 at 2.

²¹ *Id.* See generally USPS-LR-1.

Thus, the instant proposal is not needed to obtain additional information relevant to the qualitative characteristics of any permanent classification change.

2. The Postal Service's Proposal Will Fail To Collect Data Useful To Inform Future Pricing Decisions.

At the core of the Postal Service's case is the assertion that an affirmative recommended decision is needed in order to obtain important market-related data. Mailers would not oppose a market test that is designed to (1) determine whether demand for a new service justifies the imposition of separate charges, and (2) collect information that would inform decisions on specific prices. The Postal Service's proposal will do neither.

On the first point, the Postal Service has already concluded that there is significant demand for RPN's, and it is acting as if the fundamental decision to charge separately for RPN's has already been made. It does not need a further market test for this purpose.

On the second point, the Postal Service claims that the instant proposal is designed to "test mailer reaction" to the specific charges it is proposing. The data-gathering features of the proposal are so transparently inadequate that Mailers are led to suspect that the Postal Service's true motive is simply to secure additional revenue using the regulatory path of least resistance.²² In fact, the "market test" proposed by the Postal Service will yield no significant information that could be used to inform a future rate decision. The Postal Service's data collection plan is spelled out in witness Holland's testimony.²³ While it will collect various volume data, the plan will not collect any data that would inform marketing or pricing decisions.²⁴

²² *Cf.* PRC Order No. 1413 at 4 ("Its purpose is less to fill in unknowns that are needed to fashion a proposed permanent change, than to make a service enhancement quickly available . . .").

²³ USPS-T-1 at 6-7.

²⁴ *See* DMA/USPS-2, 5.

Apparently, the Postal Service seeks to refine its market research, but it has provided no plan to collect market-related data, nor any explanation as to how the volume data that it will collect will be utilized for any significant rate-making purpose.²⁵ The Postal Service asserts that it will be able to measure RPN volume at the proposed rates. Granted. But so what? The USPS will have no baseline, no before-rates data; it will not know how many pieces would have been mailed if no extra charges had been imposed. Therefore, it will not be able to estimate elasticity, or any other indication of mailer demand, after the extra charges are imposed. Moreover, it will have no way of determining whether smaller or larger charges would have similar, or substantially different, impacts on volume; it will have no way of measuring the relative demand as between the various classes; and it will have no way of associating the experience in First Class with the experience in the other classes, where the charge will be three times as large (and substantially larger than that when measured on a percentage basis).²⁶

There are a number of other problems with the Postal Service proposal. For example, the decision to impose a charge on First Class that is one-third of the charge proposed for the other classes is counter-intuitive. The explanation offered by USPS witness Kaneer, *i.e.*, that RPN's

²⁵ The Postal Service simply states, "The purpose of the proposed test is simply to measure volumes and revenues at the prices proposed in order to make informed judgments (not mathematical projections) concerning the next step(s), if any, in the product's evolution." DMA/USPS-5. The Postal Service provides no explanation as to why volume data at a \$0.00 charge would not be equally useful.

²⁶ The Postal Service's responses to questions posed by the DMA on this subject support the conclusion that the instant proposal will be virtually useless as a market test. Witness Kaneer asserts, for example that "An actual test in the market is superior to further market research." DMA/USPS-T2-5. That statement, while superficially accurate in some ways, misses the critical point. How will the Postal Service know, when it obtains volume data at particular price levels, whether it has priced the service at the optimal level, or anything close to it?

add relatively less value to this higher-value class,²⁷ does not withstand scrutiny. Because of the higher postage paid by First Class, a charge of 0.5 cents would represent a substantially smaller rate increase for First Class on a percentage basis. Nowhere in his testimony does witness Kaneer seek to explain the sizes of the different rate increases in quantitative terms, even in relative orders of magnitude.

Finally, even if the test were designed to collect informative pricing data, this proposal should still be rejected, because the timing is such that data will not be available when it might be useful. The “market test” being sought in this case will be overtaken by the next omnibus rate case. During this case, currently expected to be filed in early 2005, the Commission and all parties will have to consider the impact of RPN’s on the “value of service” being accorded to each respective mail category, and permanent rates for these categories will have to be determined. Given the lead time that the Postal Service needs to prepare omnibus rate cases, it is difficult to conceive that the Postal Service will have any data from this “test” in time to use it in its initial filing. By the same token, it is doubtful that meaningful data will be available in time to be added to the record in the next rate case, which will be closed approximately a year from now. Thus, having “provisional” RPN rates in effect for the next year will serve only to complicate, rather than inform, the Commission’s decisions in the next rate case, when decisions on permanent rates and classifications will have to be made.

Instead, the Postal Service could obtain RPN volume data simply by permitting RPN’s to be broadly available without charge, and it could obtain data on price sensitivity by interviewing mailers and gathering market-demand data in other ways. Such an approach would yield useful

²⁷ USPS-T-2 at 3-4.

information -- specifically, before-rates volume data -- and would avoid the imposition of a nationwide surcharge, with the ensuing adverse financial implications for affected mailers.²⁸

B. The Postal Service's RPN Proposal Is Simply A Rate Increase In Disguise.

A proceeding under either the Market Test or the Provisional Service Change rules is not the appropriate forum for resolving the appropriateness of a selective rate increase, as the Postal Service seeks to do here.

The Commission, when it proposed Market Test and Provisional Service Change rules, stated:

“The Commission agrees with the Postal Service and the Governors that it would be useful to explore new procedures explicitly designed for limited market tests that would enable the Service to gain "real world" experience with innovative services, and that would at the same time generate information needed to support recommendation of such services as permanent mail classifications.”²⁹

However, concerning proposals to conduct a market test of rate changes only, the Commission said:

“In the Commission's view, market testing of pure rate changes for existing services could raise difficult issues of consistency with the fairness and equity factor in 39 U.S.C. 3622(b)(1) and the prohibition of undue discrimination or preferences among mail users in 39 U.S.C. 403(c).”³⁰

The Commission repeated its concerns about fairness, equity and discrimination when it adopted the final Market Test and Provisional Service Change rules:

“As the Commission observed in the Notice of October 27, tests of pure rate changes in the usual selective form of market testing would necessarily raise questions of fairness and equity under 39 U.S.C. §3622(b)(1) and of undue discrimination or preference

²⁸ *E.g.*, Testimony of NNA witness Tidwell, NNA-T-1. The adverse impact on mailers is inconsistent with the concept that provisional service cases not impact stakeholders adversely. *See* PRC Order No. 1413 at 5.

²⁹ PRC Order No. 1084, 60 FR 54981 (October 27, 1995).

³⁰ *Id.*, 60 FR at 54982.

among mail users under §403(c). Comments provided in response to the October 27 Notice do not provide persuasive countervailing considerations that would justify inclusion of rate tests in the rule.”³¹

In a footnote, the Commission continued:

“The Postal Service is, of course, free to request expedited consideration under special rules of practice in connection with any rate change request it may wish to submit.”³²

In this case, the Postal Service is proposing to impose fees on a particular group of mailers under the guise of conducting a “market test.” The Postal Service has presented absolutely no analysis of the “equity,” “fairness,” and “discrimination” issues that properly concerned the Commission in RM95-4. Witness Kaneer’s responses to questions posed by the DMA clearly reveal how “thin” the USPS case is on this central point. For example, when asked about fairness and equity, witness Kaneer simply stated that “The proposed rates were analyzed in terms of the nine pricing criteria” and that “I do not accept the premise . . . that fairness can be measured quantitatively.”³³

Moreover, it is clear that, despite witness Kaneer’s assertions to the contrary,³⁴ the rates being proposed were chosen arbitrarily. The rates being proposed correspond closely to rates that were discussed during market research, but they were not chosen with any concern for fairness or equity or non-discrimination in mind. For example, there is an important question as to whether it is discriminatory to charge First-Class mailers at one-third the level of all other mailers. If the Postal Service had considered the matter and concluded that this is not an undue

³¹ PRC Order No. 1110, 61 FR at 24449.

³² *Id.*

³³ DMA/USPS-T1-6 (sic).

³⁴ *E.g.*, DMA/USPS-T2-4.

preference, it certainly did not see fit to share with the Commission and the parties the analysis underlying its judgment.

This proposal is more appropriately fashioned as a limited rate case. The Postal Service did not do that -- apparently because the rates could not be supported with the evidence available. Even masked as a provisional service case, the record in this case is legally insufficient to support any decision by the Commission favorable to the Postal Service's rate proposal.

III. Any Decisions Made By The Commission In This Case Will Be Provisional.

It is essential that the Commission recognize now that any decisions or conclusions it makes in this case about the RPN service will not be binding on its future considerations of RPN's. The decision that the Commission reaches about whether to conduct the provisional RPN program is simply that: provisional. Even if the Commission approves the Postal Service's request to conduct such a provisional program, it should make clear that it will consider the merits of the RPN program *de novo* if the Postal Service seeks to make the program permanent. As the Commission explained when it first proposed the provisional rules, "[t]he service would be approved initially for only a limited period, and subsequent review would be expected."³⁵

Even if the Commission were to view a subsequent request by the Postal Service as part of this proceeding, which it should not, the Commission would not be bound by any determination that it makes now because "the law of the case doctrine is of uncertain force in the context of administrative litigation."³⁶ Furthermore, the Commission is free to reverse prior determinations,

³⁵ 60 FR 22017, 22018 (1995)

³⁶ *Biltmore Forest Broadcasting FM, Inc. v. Federal Communications Comm'n*, 321 F.3d 155, 164 (D.C. Cir. 2003).

so long as it makes a reasoned decision. “Experience is often the best teacher, and agencies retain a substantial measure of freedom to refine, reformulate, and even reverse their precedents in the light of new insights and changed circumstances.”³⁷

The procedures for provisional approval are much like the procedures of a court deciding a preliminary injunction. There, as here, the procedures are truncated, the record small, and the time for a decision short. Thus, “[t]he decision of a trial or appellate court whether to grant or deny a preliminary injunction does not constitute the law of the case for the purposes of further proceedings and does not limit or preclude the parties from litigating the merits”³⁸

Therefore, if the Commission approves the request of the Postal Service, it should make clear in its order that it will not be bound by this decision and that it will require the Postal Service to submit adequate proof and sufficient legal justification to meet the standards for a permanent classification.

IV. Conclusion: The Fees Proposed By The Postal Service Are Unsupported By “Substantial Evidence” And Must Be Rejected.

As is envisioned in Order No. 1417, the Commission is now in a position to consider the USPS proposal based on an evidentiary record. For the reasons discussed above, this proposal must be rejected because it does not meet the applicable “substantial evidence” standard.

Mailers respectfully suggest that, if the Commission thinks there is merit in the RPN concept, it approve the Postal Service proposal with the salient modification that the fees be set initially at \$0.00. In that manner, the Postal Service and all mailers could gain experience with

³⁷ *Davila-Bardales v. INS*, 27 F.3d 1, 4 (1st Cir. 1994).

³⁸ *Berrigan v. Sigler*, 499 F.2d 514, 518 (D.C. Cir. 1974); *see also* 11A Wright & Miller, Fed. Practice and Procedure § 2950 (2d ed.) (“[T]he court’s findings of fact and conclusions of law with regard to the preliminary injunction are not binding at trial.”).

RPN's; mailer enthusiasm for RPN's could be judged on a broad basis; and a decision on fees could be made in the future in the proper context, *i.e.*, in the forthcoming omnibus rate case, and with the required evidentiary support.

Respectfully Submitted,

Dana T. Ackerly II
Counsel to
Direct Marketing Association, Inc.

Ian D. Volner
Rita L. Brickman
Counsel to
Association for Postal Commerce
Mailing & Fulfillment Service Association

James Pierce Myers
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