

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

Regulations Establishing System  
Of Ratemaking

Docket No. RM2007-1

**COMMENTS OF THE  
NEWSPAPER ASSOCIATION OF AMERICA**  
(March 30, 2007)

The Newspaper Association of America (“NAA”) hereby respectfully submits its comments in response to the Advance Notice of Proposed Rulemaking in this proceeding (“ANPRM”).<sup>1</sup>

NAA is gratified that Congress, in enacting the Postal Accountability and Enhancement Act (“PAEA”), reaffirmed the Postal Service’s status as a “basic and fundamental” public service (39 U.S.C. § 101(a) ), provided by the federal government. The Commission is now to implement a new regulatory regime to strengthen the Postal Service’s ability to fulfill its public service mission for years to come.

Congress has provided substantial direction to the Commission. First, Section 101(d) sets as a fundamental national policy that postal rates “shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.” Section 403(c) of the law prohibits any

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<sup>1</sup> NAA is a non-profit organization representing more than 2,000 newspapers in the United States and Canada. Most NAA members are daily newspapers, accounting for nearly 90 percent of the daily circulation in the United States. NAA’s membership also includes many nondaily newspapers published in the United States.

unreasonable discrimination in postal rates and services. And Section 404(b) authorizes the Governors to establish “reasonable and equitable classes of mail and reasonable and equitable rates of postage in accordance with the provisions of chapter 36.”

This proceeding is to create the ratesetting system required by chapter 36. In addition to satisfying the statutory policies mentioned in the preceding paragraph, Congress also directed that the ratesetting system for market-dominant mail services “shall be designed to achieve” nine objectives, that in designing the system the Commission also “take into account” 14 factors, and that the system satisfy statutory requirements applicable to revenue caps and worksharing discounts.<sup>2</sup> The outcome is to be a ratesetting system that allows the Postal Service to offer “reasonable and equitable” and nondiscriminatory “rates of postage” that achieve the objectives of the PAEA.

In these comments, NAA offers specific recommendations for the Commission to implement in the ratesetting system. Each is fundamental to meeting statutory requirements and properly balancing the interests of the Postal Service, mailers, and the American public that owns the system:

- First, the Commission should create a ratemaking system that:
  1. promotes transparency by allowing public comment on Postal Service notices of rate changes;
  2. assures that postal rates are predictable, stable, just and reasonable, and not unreasonably discriminatory, while conferring the Postal Service with pricing flexibility; and

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<sup>2</sup> See Section 3622(b) - (e).

3. assures the Postal Service's ability to obtain revenues adequate to sustain financial stability by producing rates that recover all costs, and that fairly, equitably, and reasonably apportion the institutional costs of the Service in light of the changing composition of the mailstream.
- Second, the ratesetting system, while important, is only one component of the comprehensive structure envisioned by Congress and should not be developed in isolation. This means that the system for setting rates for market-dominant products should be established in coordination with the consideration and adoption of rules, in separate proceedings, for:
    1. costing methodologies (to govern the required annual compliance reports and complaints); and
    2. complaint proceedings, consistent with their greater significance under the amended statute.

## **I. NEWSPAPERS' INTEREST IN THE POSTAL SYSTEM**

NAA member newspapers rely extensively on the United States Postal Service in their daily business operations. Indeed, newspapers' interest in the postal system dates to the very beginning of the nation, when a newspaper publisher, Benjamin Franklin, served as Postmaster General under the Continental Congress. The nation's postal system was largely created to deliver newspapers so that citizens settling the American frontier could stay connected and informed. Throughout our history newspapers have served as partners with the Postal Service in helping fulfill the mission, established in the Postal Reorganization Act, of "binding the nation together through the personal, educational, literary, and business correspondence of the people."

Newspapers today are active and growing postal customers. Within the market-dominant mail services at issue in the *ANPRM*, newspapers use First-Class, Periodicals, and Standard mail. Newspapers rely on First-Class Mail for

the delivery of invoices and for the receipt of subscription and advertising payments. Even as electronic payment becomes more common, newspapers today continue to receive the vast majority of their subscription revenues, and a majority of their total revenues, through First-Class Mail. Also, newspapers, particularly weekly newspapers, use Periodicals Within-County and Outside County mail to distribute at least a portion of their print publications.

Newspapers use Standard Mail for newspaper circulation marketing, particularly solicitations for new subscriptions, renewals, and customer appreciation programs. The growth of the national do-not-call registry has increased newspapers' use of the mail for their marketing efforts.

However, newspapers' most substantial and fastest growing use of the mail has occurred in Standard Enhanced Carrier Route ("ECR") mail. NAA member newspapers rely on the Postal Service for the delivery of their Total Market Coverage ("TMC") products.<sup>3</sup> Indeed, newspapers make such substantial use of Standard Mail for the TMC programs that NAA believes that three of its member newspapers are among the largest Standard ECR mailers. Collectively, NAA believes that newspapers pay in excess of \$650 million annually in Standard Mail postage, and nearly \$1 billion overall.

Newspaper TMC mailing programs deliver print advertising in targeted geographic areas through a combination of advertising preprint inserts in subscriber copies of the newspaper and mailing of the same inserts to residents

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<sup>3</sup> Nearly 90 percent of daily newspapers have a TMC product for non-subscribers.

who do not subscribe to the newspaper.<sup>4</sup> A TMC program thereby enables a newspaper to satisfy advertisers' requirements for coverage of a complete audience. TMC program mailings to nonsubscribers typically qualify for the high-density rate category, and, in some instances, saturation rates, depending on circulation penetration.<sup>5</sup> Regardless of the rate category, newspapers mailing programs today are characterized by sophisticated mail preparation and dropshipping efforts second to none among ECR mailers.

Newspapers, whether large or small, daily or weekly, serve as vehicles for news and advertising. Newspapers rely on the revenue from advertising to support the operations of the newspaper, and in particular the editorial function. The amount of editorial content in the nation's newspapers is a function of the advertising revenue stream. The more advertising revenue, the more the newspaper can afford to publish editorial content.

Advertising, of course, is a highly competitive market. Newspapers compete with other advertising vehicles, including direct mail, for advertising dollars. And, in particular, newspaper TMC programs compete vigorously with other Standard ECR mailers – particularly saturation mailers – to distribute local advertising, primarily preprint advertising. The competition in the advertising

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<sup>4</sup> Generally, there are two kinds of newspaper advertising. One commonly called "ROP" ("Run of Press") is printed on the pages of the newspaper. The other, called "preprints," consists of free-standing inserts, which are placed inside subscriber copies of the newspaper and, when advertisers so desire, are also distributed to nonsubscribers via the TMC program.

<sup>5</sup> Under postal regulations, to be eligible for saturation rates a mailing must, in addition to other preparation requirements, be delivered to the lesser of (1) 90 percent of active residential addresses; or (2) 75 percent of all addresses, on a given carrier route. The greater a newspaper's subscriber penetration, the lower the percentage of nonsubscribers and the less likely the TMC mailing will be able to qualify for the saturation rate.

market between newspapers and saturation mailers is widely recognized.<sup>6</sup> In response to changing market conditions, including a gradual shift from run-of-press to preprinted insert advertising, newspapers in recent years have improved and expanded their mailing operations.

What newspapers want from the U.S. Postal Service is quite simple. First, like other postal customers, newspapers want efficient and reliable mail delivery. Second, in the rates, classes, and new services that it offers, newspapers want the Postal Service to be competitively neutral between newspapers and their direct mail competitors. Special treatment for newspapers' competitors (or, indeed, special treatment for newspapers' advertising mail products) would likely lead only to a shifting of advertising between the two products with no net benefit to the Postal Service. Competitive neutrality is far more appropriate and consistent with the Postal Service's public service mission recently reaffirmed by Congress.

## **II. THE RATESETTING SYSTEM FOR MARKET-DOMINANT MAIL SERVICES MUST BE TRANSPARENT AND RESULT IN JUST AND REASONABLE RATES THAT SOUNDLY AND EQUITABLY FUND THE POSTAL SERVICE IN THE FUTURE**

The *ANPRM* requests comment on how to design the new ratesetting regime. NAA will confine these comments to the system for market-dominant postal services. As the great majority of today's postal volume resides in the market-dominant classes of mail, the rates governing those services will have the

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<sup>6</sup> See, e.g., Docket No. R2006-1, Tr. 28/9532-33 (Gorman) (acknowledging that newspapers that have TMC programs are part of the saturation mail industry); SMC-RT-1 at 6-7 (Crowder); *accord* Tr. 17/5084 (O'Hara);

greatest effect on the ability of the Postal Service to sustain financial soundness for years to come.

NAA will first comment on the procedures that should apply when the Postal Service files notice of rate changes. Thereafter, NAA will address substantive issues for the Commission to consider in developing a specific set of proposed regulations.

**A. The Ratesetting System Should Include the Opportunity For Public Comment During the Notice Period For Rate Changes**

Under the PAEA, the system for market-dominant mail services must require the Postal Service to provide public notice of proposed rate adjustments “not later than 45 days before the implementation in rates under this section.” Section 3622(d)(1)(C). The statute thus provides for public notice and an opportunity for review by the Commission.

NAA urges the Commission to adopt rules specifically allowing public review and comment during the notice period. The new statute already requires public comment when the Postal Service proposes an above-cap increase. Section 3633(d)(1)(E). Nothing in the PAEA, however, prohibits the Commission from inviting such comment also when the Postal Service purports to notice rate adjustments consistent with the CPI limitation. Public comment – which necessarily would have to be expedited and would be submitted in writing – would promote transparency and could provide information helpful to the Commission’s review.

Where the Postal Service’s notice is straightforward, there likely will be relatively few comments. However, in instances when the Postal Service notices

a more complicated set of rate changes, the Commission may benefit from the insights that the mailing community and broader public may be able to offer. The stakes of this review are important because the rates that will take effect from this process will be in effect for a substantial period of time before they are later reviewed by the Commission either in an annual review or in a complaint.

**B. The Rate System Should Achieve Just And Reasonable Rates That Satisfy the Objectives of Predictability, Stability, And Pricing Flexibility**

In Objective 2, Congress directed the Commission to design a rate regulatory system that would increase predictability and stability in postal rates. The task for the Commission is to reconcile that Objective with the fellow Objectives of allowing pricing flexibility (Objective 4) and achieving a just and reasonable rate schedule (Objective 8), as each of these objectives is to be applied “in conjunction with the others.”

As a preliminary matter, the Commission should recognize that rate predictability has two elements: (1) the *timing* of rate changes and (2) the *size* of rate changes. Section 3622(d)(1)(B) alludes to both elements in requiring the new system to provide for changes “at regular intervals by predictable amounts.” The quoted provision suggests that the time between rate changes should be “regular” and the amounts of change “predictable.”

**1. Timing of rate changes**

As to timing, the Commission should consider whether it may allow the Postal Service to announce, in its 45-day notification, not only the specific date that rate changes will take effect, but also the date for any seasonal or other

adjustments that it may choose to make at a future time over the course of the year.<sup>7</sup>

## **2. Size of rate changes**

As to the size of rate changes, the PAEA establishes an outer limit in the form of an annual limitation of revenue changes, applied at the class level, to CPI absent exigent circumstances. Section 3622(d)(1)(A). However, the phrase “predictable amounts” is not limited to the aggregate changes for a class, but on its face requires that the specific rate changes themselves within the class should be reasonably predictable. This interpretation is also supported by Objective 8, which requires that the rate schedule be “just and reasonable.” This interpretation is also consistent with Factor 3, which directs the Commission to consider the effect of rate changes on the “general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters.” Section 3622(e)(3).

NAA respectfully submits that the Commission should reconcile these provisions by providing in the ratesetting system for market-dominant products that a rate increase for a rate category within a class that exceeds CPI plus a small amount (for example, two percent) in a given year will not be considered either “predictable” or “just and reasonable” absent a special justification by the Postal Service. Such a range would satisfy the statutory objective of providing the Postal Service pricing flexibility while also honoring the provision in Objective

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<sup>7</sup> In such situations, it is reasonable to expect that the Postal Service’s showing that the announced rate changes comply with the rate cap and any other required showings would necessarily be more complex than if only a single, one-time change were announced.

8 that allows the Postal Service to make changes of unequal magnitude within, between, or among classes of mail.”

This could work in practice as follows. In its notice of annual rate changes, the Postal Service could certify that no rate would change by more than the permitted range, in the example CPI plus 2 percent.<sup>8</sup> In such case, there would be no issue of rate predictability.<sup>9</sup> But, if the Postal Service chose to raise a particular rate or set of rates by, say, CPI plus an additional 10 percent, it would need to bring those rates to the Commission’s attention and provide additional justification for that larger change. The Commission need not identify all of the possible justifications in its rules; however, examples of reasonable justifications might be exceptional cost changes,<sup>10</sup> an important need to recognize a significant cost difference, or similar grounds.

**C. The Ratesetting System Should Assure Revenues Adequate To Sustain The Financial Stability Of The Postal Service By Requiring That Rates Recover Institutional Costs Reasonably, Fairly And Equitably**

The fifth Objective directs that the rate system should “assure adequate revenues, including retained earnings, to maintain financial stability.” As a practical matter, this is the paramount objective of the new ratesetting system.

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<sup>8</sup> For example, if within Class A the Postal Service proposed to increase the rate for product 1 by CPI less 2 percent, and for product 2 by CPI, no special justification would be needed.

<sup>9</sup> However, rates within the zone of predictability might nonetheless violate other legal requirements, such as the prohibition against unreasonable discrimination in Section 403(c), or might not be just and reasonable for other reasons.

<sup>10</sup> The concept of “just and reasonable” is often interpreted by regulatory agencies to require that rates cover costs other than in exceptional circumstances. This is both to avoid cross-subsidy and to provide comparatively efficient price signals.

Put simply, if the Postal Service does not obtain adequate revenues to maintain its stability, it will be unable to fulfill its public service mission and the ratesetting system will have failed.

The recovery of attributable costs is fairly straightforward, assuming that they are properly measured. As explained in Section III(A), developing appropriate costing methodologies for such measurement should be the subject of a separate rulemaking proceeding. The Commission's task in this proceeding is to design a ratesetting regime that allows the Postal Service to recover all of its costs, including institutional as well as attributable costs, while preserving a revenue cap per class.

Congress has already enacted broad legal requirements applicable to recovering institutional costs. As noted above, Section 101(d) establishes a fundamental national policy that postal rates "shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." The "costs of all postal operations" clearly include both attributable and institutional costs. Those reasonable and equitable classes and rates established by the Postal Service by authority of Section 404(b) therefore by law must spread the costs of all postal operations fairly and equitably while achieving fiscal stability.

In the new ratesetting system, the Commission should give effect to this statutory policy and the Objective of "assuring adequate revenues . . . to maintain fiscal stability" by adopting a rule regarding institutional cost recovery. The rule should require that postal rates apportion the institutional costs of the Postal

Service fairly, equitably, and reasonably. The rule should provide further that in assuring that revenues are adequate to maintain the Service's financial stability and that institutional costs are apportioned fairly, equitably, and reasonably, an important factor is the composition of the mailstream during the period covered by the rates.

To enable the Postal Service to comply with this legal requirement, the Commission should make sure that the Service continues to have the flexibility to recover sufficient institutional costs from its growing services, rather than remaining dependent upon its declining ones. As is widely recognized, the composition of the mailstream has changed in recent years as First-Class Mail volume has declined while Standard Mail has become the majority of the mailstream.<sup>11</sup> Indeed, one impetus for postal reform legislation was a recognition that the Postal Service's former business model is broken, and that the Service can no longer rely, as it did historically, on growth in First-Class Mail volume to cover its ever-increasing institutional costs. Instead, the burden inevitably must shift to other, growing classes of mail.

Docket No. R2006-1 represented a step in the necessary direction, as the portion of the institutional cost burden recovered from First-Class Mail will decline to 55 percent under the recommended rates, while that from Standard Mail will rise to 30 percent. *Opinion and Recommended Decision*, Docket No. R2006-1, ¶ 4065. The Postal Service must have the ability to continue to shift the burden of institutional costs in this manner in order to stay financially viable. For this

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<sup>11</sup> This was the subject of the testimony of several witnesses in Docket No. R2006-1. See, e.g., Rebuttal Testimony of J. Gregory Sidak (NAA-RT-1).

reason, the Commission should take care to ensure that the Postal Service will have sufficient flexibility to continue to shift the institutional cost burden within the market-dominant classes in the years to come.

Finally, the Commission should be mindful that the cap applies to rates of a class, not to the institutional costs that are recovered by those rates, and that one way for the Postal Service to recover those costs is to retain the difference between revenues and costs as revenues rise and costs, ideally, decline or rise less rapidly than CPI. For example, there should be no requirement that the Postal Service adjust rates downward for a service if its attributable costs for that service decline, as there might have been under a cost-of-service regime.

### **III. THE RATESETTING SYSTEM FOR MARKET-DOMINANT SERVICES SHOULD NOT BE ESTABLISHED IN ISOLATION FROM IMPORTANT SEPARATE BUT RELATED PROCEEDINGS ADDRESSING COSTING METHODOLOGIES AND THE COMPLAINT PROCESS**

The PAEA directs this Commission to establish a new system for setting the rates for market-dominant postal services. This *ANPRM* is a first and necessary step in this process. However, the various requirements, objectives, and factors recited in the *ANPRM* that the new system must take into account are only part of the comprehensive new approach to ratemaking.

Also vitally important in the new statutory scheme are:

- (1) the annual report process, and in particular the costing methodologies that the Commission may prescribe for use therein, and
- (2) the complaint process.

Both of these are important components of the enforcement mechanism established by the PAEA.

Accordingly, NAA respectfully submits that the Commission should not craft a new ratesetting system without also adopting rules governing the appropriate costing methodologies and rules governing the complaint process, both of which will provide important tools for enforcing the new system. The Commission should commence separate rulemaking proceedings to address each issue.

**A. Costing Methodologies**

The PAEA requires the Postal Service to submit to the Commission annually a report, 90 days after completion of a rate year, that is sufficient to demonstrate whether rates charged in that preceding year met the requirements for lawfulness. 39 U.S.C. 3652(a). That report must “analyze costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe.” *Id.*

The costing methodologies that Congress directed the Commission to prescribe will be a cornerstone of the ratesetting system. They will play a central role in assessing the ultimate lawfulness of rates in the annual review process required by Section 3652 or in a Section 3662 complaint. Proper implementation of certain provisions of the new PAEA, such as the worksharing discount requirements and the sufficiency of institutional cost contributions from competitive classes of mail to name just two, will depend on accurate measurement of attributable costs. Given the importance of costing methodologies to the enforcement structure, the prevention of cross-subsidies, and their role in determining the ultimate lawfulness of rates, the Commission

should begin consideration of the costing methodologies simultaneously with its consideration of the ratesetting system.

In addition, establishing costing methodologies promptly would be fair to the Postal Service. Knowing what costing methodologies will serve as the basis for the ultimate judgment as to the lawfulness of the rates charged will enable the Postal Service to develop rates that are more likely to prove to be lawful in an annual review or complaint proceeding.

Establishing accurate and dependable costing methodologies is not a simple task. Many recent omnibus rate cases have featured extensive analysis of major cost segments such as mail processing and city carrier street time costs. Proper attribution of city carrier costs has become perhaps even more important as the composition of the mailstream has changed from a majority of First-Class Mail to Standard mail. This change may have significant implications on carrier cost causation.

Most recently, in Docket No. R2006-1, the consideration of alternatives to the city carrier cost attribution methodology now in use was deferred until a new proceeding to be commenced after the rate case was completed.<sup>12</sup> The Presiding Officer did so in order to address due process concerns by providing an opportunity for interested parties to consider more recent carrier data and alternative analyses to the current methodology.

The Commission may find it efficient to convert the intended rulemaking proceeding on city carrier cost attribution into a proceeding to prescribe the

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<sup>12</sup> See Postal Rate Commission Order No. 1482, Docket No. R2006-1 (issued November 8, 2006); Postal Regulatory Commission Order No. 1, Docket No. R2006-1 (issued Dec. 22, 2006).

costing methodologies, at least for carrier costing, for purposes of Section 3652(a)(1). Such a focused proceeding would be an appropriate forum in which to address and finally resolve city carrier cost attribution issues. The Commission may wish to consider whether to consider other difficult costing issues in the same or other proceedings. The resolution of those issues will provide a clear basis on which the Postal Service can plan its rate changes.

Finally, in considering costing methodologies, the Commission should recognize that combinations of mail may share costs that are not common to other mail. The Commission would more faithfully achieve Objectives 2 (predictable and stable rates), 6 (transparency), and 8 (just and reasonable), as well as Factor 2 (requirement that each class bear its direct and indirect costs), by making use of the “combinatorial cost test” for cross subsidization, which was introduced by economist Gerald Faulhaber in 1975. Under this methodology, the Postal Service first would calculate the costs attributable to each mail product by itself. Next, the costs incurred in common across each combination of two or more mail products would be calculated and attributed to that combination as an incremental cost floor. The revenue of each product must equal or exceed its incremental (attributable) cost, and the revenue of each possible combination of products must equal or exceed the incremental cost of that combination. This test protects all mailers against cross-subsidy.

Without costing methodologies in place, the new ratesetting system will be meaningless. NAA respectfully urges the Commission to launch a separate proceeding to establish costing methodologies without delay, and to coordinate

that proceeding with the adoption of the new ratesetting system so that the Postal Service will have clear guidance as to how cost attribution before setting rates under the new system.

## **B. Complaint Process**

NAA also requests that the Commission establish the rules that will govern complaints under amended Section 3662. NAA will separately be filing joint comments with other parties that address this issue in greater detail, but makes the following points here.

The Postal Reorganization Act, which governed rates for the past 36 years, provided for prior, on-the-record review of proposed rate changes. Whatever the merits of that superseded process, it indisputably allowed interested parties to challenge the lawfulness of the rates before the rates took effect. It is highly likely that the small number of complaints that were filed under former Section 3662 challenging the level of particular rates over the past 36 years can be attributed to the prior hearing-on-the-record process. Indeed, under the PRA, the complaint process was almost an afterthought.

Not so any more. The PAEA repealed the prior review-on-the-record process. In its place is a process in which the Postal Service will have greater leeway to set rates. Under the new system envisioned by PAEA, there will be three basic ways in which rate changes generally will be reviewed.<sup>13</sup> One is the Commission's review of announced rate changes in the minimum of 45 days

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<sup>13</sup> This discussion does not address the particular procedures and substantive requirements applicable to market tests of new services and service agreements under PAEA.

prior to the rates taking effect. However the Commission chooses to conduct that review (which this proceeding will establish), it unquestionably will be faster and less detailed than the 10-month adjudication under the former law. That is why the annual review and complaint processes will be so much more important under PAEA.

The second manner in which the lawfulness of rates will be assessed is the annual review process. One consequence of this process is that nearly 15 months can pass from the time a new rate takes effect until its ultimate lawfulness is determined. It is understandable that an aggrieved mailer may not want to wait that long for relief from unlawful rates, especially considering that newer rates might be implemented during that time.

Recognizing the limitations of these two ways of reviewing rates, Congress wisely chose to strengthen the complaint process by amending Section 3622. This new statutory provision provides a potentially valuable mechanism by which legitimate challenges to rates will be heard.

It is vital, however, that the Commission give real meaning to the new complaint process by updating its complaint procedures to accommodate the new statutory provisions. In particular, the Commission should address, among other matters, the conditions under which the timetables may be accelerated and how the burden of proof is allocated. NAA respectfully refers to the Joint Comments for elaboration regarding these procedures.

#### IV. CONCLUSION

For the foregoing reasons, the Newspaper Association of America respectfully urges the Commission to establish a ratesetting system that:

- Provides an express opportunity for public comment during the 45-day period following a notification by the Postal Service of rate changes, and consider allowing the Postal Service to announce rate changes that will occur at later dates;
- Requires the Postal Service to make additional justification for rate changes that exceed CPI by some measure, such as by an additional two percent, in order to enhance predictable and reasonable rates;
- Assures the Postal Service's ability to obtain revenues adequate to sustain financial stability by producing rates that recover all costs, and that fairly, equitably, and reasonably apportion the institutional costs of the Service in light of the changing composition of the mailstream; and
- Initiates soon separate rulemakings on costing methodologies and the complaint process.

Respectfully submitted,

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Certificate of Service

I hereby certify that I have this 30th day of March, 2007, caused to be served the foregoing document in accordance with the rules of practice.

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