

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Regulations Establishing System  
Of Ratemaking

DOCKET No. RM2007-1

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REPLY COMMENTS  
OF  
MAIL ORDER ASSOCIATION OF AMERICA

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**Introduction.**

The Mail Order Association of America (“MOAA”) recognizes that establishing the entirety of the regulatory system under the PAEA is a difficult task that will require the Commission to make numerous, and in some instances, difficult judgments. At the same time, however, MOAA urges that the task not be overcomplicated. The overriding purpose of the legislation is a simpler, more responsive system for establishing postal rates and classifications. The heart of that system is the authority of the Governors to raise rates periodically as they deem appropriate, provided that the rates do not exceed the CPI for any class of mail. Despite the Comments of some parties, the PAEA cannot be interpreted as vesting all authority for the establishment of rates and classes in the Commission, rather than the Postal Service. To do so would result in the failure of postal reform before it has had an opportunity to succeed.

The PRC has been given a strengthened role under the PAEA, as implied in the change of name from “Rate” to “Regulatory”. The enhanced authority of the Commission is set forth in the provisions of the PAEA and should end what has been at times a disruptive struggle between the Postal Service and the PRC over costing and other issues. That authority should permit the Commission to carry out its responsibilities in a way that will bring “transparency” to the entire process and ensure that the Commission and mailers have full access to all financial and service information. Only then will the Commission be able to fulfill its “watchdog” role.

Just as fundamental, however, there has been a shift in the authority for rate and classification decisions. Under the PRA, it was the Commission that had the final authority to

establish postal rates, subject only to procedures permitting the Governors to modify those rates by a unanimous vote finding that the rates recommended by the Commission would fail to produce adequate revenues. 39 U.S.C. § 3625. Classification changes required the approval of, but could not be initiated by, the Commission.

The new procedures under the PAEA represent a profound change. The PAEA is intended to permit the Postal Service, an enterprise consisting of multiple products and types of customers, to function as it must if it is to survive and prosper. Under the new regulatory approach, the role of the Commission is not to “second guess” pricing and other management decisions, but rather to ensure that the Postal Service has not exceeded its authority.

The initial Comments of a number of parties appear to envision a process of rate setting that, in substance, does not differ materially from the establishment of rates and classifications under the PRA. The PAEA, however, was not intended to perpetuate the old system of establishing rates and classifications pursuant to revised procedures, but rather to entirely replace it with a system that will allow the Postal Service pricing freedom provided that it operates within the CPI cap and the other statutory requirements set forth in the PAEA. The PAEA gives the Commission enormous authority, authority which as a practical matter is subject to judicial review only in the event that the authority is abused. Unless, however, the Commission exercises its authority in a manner consistent with the underlying purpose of the PAEA, as it applies to the establishment of prices and classifications, the PAEA will surely fail.

### **The Postal Service’s Pricing Authority Is Subject Only To The Annual Limitation Of The CPI.**

Notwithstanding the complexities of a number of the provisions, the basic framework of the PAEA as it governs the establishment of rates is straightforward.

The system for regulating rates and classes for market-dominant products shall--

(A) include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;

(B) establish a schedule whereby rates, when necessary and appropriate, would change at regular intervals by predictable amounts;

(C) not later than 45 days before the implementation of any adjustment in rates under this section, including adjustments made under subsection (c)(10)--

- (i) require the Postal Service to provide public notice of the adjustment;
- (ii) provide an opportunity for review by the Postal Regulatory Commission;
- (iii) provide for the Postal Regulatory Commission to notify the Postal Service of any noncompliance of the adjustment with the limitation under subparagraph (A); and
- (iv) require the Postal Service to respond to the notice provided under clause (iii) and describe the actions to be taken to comply with the limitation under subparagraph (A);

(D) establish procedures whereby the Postal Service may adjust rates not in excess of the annual limitations under subparagraph (A);

#### PAEA § 3622

Upon the Postal Service providing a notice of rate adjustments, the Commission's only authority under the above provisions, is "to notify the Postal Service of any non-compliance of the adjustment with the limitation under subparagraph (A); and ... require the Postal Service to respond to the notice ... and describe the actions to be taken to comply with the limitation under subparagraph (A)".

Subparagraph (A)'s limitation is equally clear and simple. The rate increase is subject to "an annual limitation ... equal to the change in the Consumer Price Index for All Urban Consumers ... over the most recent available 12-month period preceding the date that the Postal Service files notice of its intention to increase rates". Finally, subparagraph (D) authorizes and requires the Commission to "establish procedures whereby the Postal Service may adjust rates not in excess of the annual limitations under subparagraph (A)".

There are other provisions that limit the Postal Service's rate adjustments as found in PAEA § 3622 (d)(2). That section provides that the annual limitations shall apply at the class level, authorizes the Postal Service to round rates and fees to the nearest whole integer and permits the use of unused rate authority subject to certain limitations. None of those provisions, nor any other portion of the PAEA, however, can be interpreted to modify the fundamental and core authority given to the Postal Service to adjust rates as it sees fit, subject to annual CPI limitations. Most importantly, there is nothing in the PAEA that permits the Commission to substitute its judgment for that of the Postal Service on rate levels, provided that the statutory requirements have been met. The Commission should reject the position of some parties that the Commission should set rate

levels based upon its own judgments, rather than leaving those judgments to the Postal Service. The proper determination of that core issue is essential to the success of postal reform.

### **The Complaint Procedures Should Not Be Crafted To Allow The Commission's Pricing Judgment To Override That Of The Postal Service.**

The Commission should reject the counsel of parties that apparently see the complaint process as a way of litigating the propriety of rates in much the same manner as they have been litigated over the past 35 years, albeit on a retroactive rather than a prospective basis. There are parties seeking not only to perpetuate the current complaint process, but also arguing that the Commission's authority should be enhanced. That approach would not serve the interests of mailers. Instead, given the anticipated annual rate cycle, it would result in nearly continuous litigation, requiring vast expenditures of the Commission's and Postal Service's time and resources, as well as the time and resources of mailers.

For example, the Joint Comments of American Business Media, Greeting Card Association, and Newspaper Association of America<sup>1</sup> contend: "No complaint should be dismissed only because the complainant has not made a *prima facie* case within the four corners of the complaint." Joint Comments at 5. That position is premised upon the contention that because of confidentiality or unavailability, a party may not be able to make a *prima facie* case. There may be circumstances that conceivably would justify the entertainment of a complaint by the Commission with less than perfect data because of those reasons. At the same time, however, the Commission should continue to insist that a complaint will be entertained only if a complainant is able to make a *prima facie* case that a real issue exists. Otherwise, as stated above, the Commission, the Postal Service and the parties will find themselves in virtually continuous litigation under the PAEA.

### **The Commission Should Not Impose Any Particular Theory Of Pricing Upon The Postal Service.**

The Commission should also reject the proposition that there is any single theory that should be an exclusive, determining factor governing Postal Service pricing. The threshold issue, as set forth above, is that the authority to price resides with the Postal Service; not the Commission.

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<sup>1</sup> Joint Comments of American Business Media, Greeting Card Association, and Newspaper Association of America with respect to the Complaint Process.

There is nothing in the PAEA that suggests the Postal Service should adopt a single overriding approach to the establishment of rates.

In particular, MOAA is concerned about the approach to rate setting urged upon the Commission by Dr. John C. Panzar. Dr. Panzar's review of worksharing as developed under the PRA is useful. His contentions about the Efficient Component Pricing Rule (ECPR) are well-presented, but neither the ECPR nor any other single theory should be imposed upon the Postal Service. Adoption of the ECPR could prevent the Postal Service from adopting pricing approaches that will enhance its ability to obtain sufficient volumes to continue to carry out universal service at affordable rates, a central purpose of the PAEA.

Dr. Panzar's description of the virtues of the ECPR, as found at pages 8-10 of his Comments<sup>2</sup>, is a clear presentation of arriving at the most "efficient" division of labor between the Postal Service and mailers. So far, so good. The problem is that the economic theory may produce a perfectly efficient division of labor while at the same time resulting in postal prices that would preclude mail volumes at levels necessary for the Postal Service to survive. In particular, MOAA submits that Dr. Panzar overreaches by contending that "despite the *theoretical* arguments for global price cap regulation of postal markets, it cannot be part of the modern rate regulation regime mandated by the PAEA." (emphasis in original) Panzar Comments at 13. MOAA disagrees, if by that statement Dr. Panzar is arguing, as he apparently is, that the Postal Service would not be allowed to set prices that comply with the CPI limitations if they do not comply with the ECPR or any other particular approach to pricing. Satisfying the Objectives and Factors of the PAEA cannot be reduced to a single formula.

The Postal Service frequently is urged to act more as it would in the private sector. Businesses do not establish prices by applying the ECPR or any other economic theory. Rather, they determine how they can price their goods or services to permit the continuation of the enterprise. Prices that meet the ECPR prescriptions perfectly could nevertheless result in the demise of the enterprise. The Postal Service could implement a perfect economic model, such as the ECPR, only to find that the perfect economic model is driving away, rather than attracting particular mail products essential to the Postal Service's future.

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<sup>2</sup> Initial Comments of John C. Panzar on behalf of Pitney Bowes Inc. in response to Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking.

The ECPR may have utility, but to accept it as an approach that must be adopted by the Postal Service to the exclusion of all other approaches would be a major and quite possibly fatal error. The ECPR remains a cost-of-service approach to ratemaking. Congress rejected cost-of-service ratemaking in favor of a rate cap regime. Those parties that seek to impose the ECPR's rigid formula take a position that is entirely antithetical to a principal purpose of the PAEA.

Many of the Comments of the parties, some explicitly endorsing the ECPR as the holy grail of postal pricing, present interesting discussions on the various approaches to pricing. Where many of them fall short, however, is proceeding from the underlying assumption that it is the task of the Commission in establishing the "system" to adopt a regulatory regime that will require the Postal Service to use a particular approach to pricing its products. The pricing flexibility to be given to the Postal Service is one of the lodestones of the PAEA. Insisting upon a particular theory of pricing is entirely antithetical to that central purpose.

Although there may not be a "perfect" legislative history to assist the Commission in interpreting the provisions of the PAEA, it is not as though there is a total absence of such history<sup>3</sup>. One of the most important facts is that the ratemaking provisions ultimately adopted by Congress differ significantly from the ratemaking provisions contained in the Bill as passed by the House. Most importantly, under the House Bill, the Commission would have been permitted to adopt "cost-of-service" regulation for market-dominant products. The fact that the PAEA, as ultimately enacted, requires price cap regulation to the exclusion of other forms of regulation (for the first ten years) is not incidental. As discussed in MOAA's Comments, the Congress decided to abandon cost-of-service regulation for the reasons explained in the Senate Report. The whole cost-of-service system had become too cumbersome, rigid, and unresponsive to the need to establish realistic, market-based prices.

The goal is not to price products on the basis of a theoretical construct, even one that may arguably produce perfect allocative results, as is contended by the supporters of the ECPR. The goal of the Postal Service is to price products in a manner that will permit volumes to be sustained at a level that will permit the survival of the enterprise. The ECPR might produce an economic result as elegant as is Dr. Panzar's explanation and defense of the concept. In the absence of taking into account market realities, however, the net result is likely to be the demise of the enterprise, albeit in a state of perfect theoretical balance.

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<sup>3</sup> See Comments of Mail Order Association of America.

A central and overriding purpose of enactment of the PAEA was to eliminate the cumbersome PRA procedures. Just as clearly, a central purpose was to give to the Postal Service greater control over its prices and products. The Commission should reject the counsel of some parties that a cumbersome, rigid process should continue, with only a change in format rather than a change in substance, while providing to the Postal Service even less control than it had under the PRA.

### **Ramsey Pricing Would Better Serve The Needs Of The Postal Service And Mailers.**

MOAA suggests that a pricing tool that would be far more valuable than the ECPR in enhancing the viability of the Postal Service is Ramsey pricing. Peter Bernstein, on behalf of the Postal Service, submitted testimony explaining the principles and application of Ramsey pricing to postal products in Docket # R2000-1. Unlike the proponents of the ECPR, neither the Postal Service nor any other party advocated that Ramsey prices should be the sole determinant of prices, but rather that Ramsey prices provided important information to the Postal Service.

The underlying philosophy of this testimony is that there is important information contained in the demand characteristics of different mail products. Price elasticities of demand quantify how mail volumes respond to changes in postage rates and, in so doing, reveal how mailers value different postal products, what they are willing to pay for those products, and how they react to changes in the price of those products.

Ramsey pricing uses the price elasticity information to develop prices that reduce the overall burden on mailers resulting from the need to satisfy the Postal Service breakeven requirement. But whether one uses Ramsey pricing, the trade-offs inherent in the Ramsey formula exist. The increase in the price of one product that is needed to exactly offset the decrease in the price of another depends on how the volumes of each of those products respond to price changes. The volume responses, as measured by price elasticities of demand, indicate whether the price change is having a net positive or net negative impact on the users of the two mail products in question. These impacts occur regardless of the method used to develop postal rates. The Ramsey pricing theory merely makes those trade-offs explicit.

R2000-1, USPS-T-41 at 107.

The conclusion of his testimony about the value of Ramsey pricing is just as pertinent today as it was when given during the R2000-1 proceeding.

In a sense, Ramsey pricing is a fairly easy exercise. It is based on two straightforward goals: satisfying the break-even requirement and reducing the resulting burden on mailers. The Postal Service and the Postal Rate Commission have a far more complex set of considerations in determining postal rates and the rate-making criteria appear to require them to examine concerns beyond economic efficiency. Thus, Ramsey pricing can only be a tool to be used in assessing the impacts of including these different rate-making criteria. Nonetheless, an important advantage of Ramsey pricing, or more generally, of the calculation of changes in consumer surplus, is that the results are largely free of judgment. The rate-making criteria, on the other hand, appear to be much more subjective. In fact, a large portion of intervener testimony is dedicated to advocating a specific interpretation of these criteria. In assessing these different positions, rate-makers should not lose sight of the fact that regardless of what mailing interests say, what they will do is ultimately revealed by their underlying demand for mail.

*Id.* at 108.

It is not MOAA's position that the Commission should adopt or require the Postal Service to adopt a Ramsey pricing formula. That should no more be done than the Commission should require that the Postal Service adopt the ECPR as an absolute "rule". The importance of the Postal Service being allowed to assess approaches to pricing and make its own judgments, rather than the Commission imposing rigid approaches to pricing, cannot be overemphasized. Certainly, however, the use of a Ramsey pricing model would facilitate the Postal Service's ability to set prices that would ensure that it is able to attract volumes from those types of mail that are most sensitive to price increases, while ensuring that the overall "cost" to the economy imposed by Postal Service rates will be kept to a minimum.

### **The Limited Nature Of The PAEA Reforms Argues For Providing The Postal Service With Maximum Flexibility.**

The Postal Service's authority under the PAEA is far from a whole loaf. The Service had sought more control over "people, products, and prices". The "people" part of the prescription was not adopted; the PAEA contains no provisions that will directly assist the Postal Service in controlling labor costs. The price cap mechanism is intended to act as an incentive to the Postal Service to live within the CPI index. Otherwise, however, there is nothing in the PAEA that changes the existing procedures for determining its labor costs, costs that represent all but a minor percentage of expenditures. Those costs continue to be left to the control of an independent

arbitration process. That reality is another reason that the Postal Service must be given maximum authority to manage its business, particularly including its prices and products.

**The Commission Must Adopt Regulations That Will Enhance The Ability Of The Postal Service To Fulfill Its Functions.**

The Commission has a vital role, all as specified in considerable detail in the PAEA. The Commission, however, cannot bring about the kind of changes within the Postal Service which were envisioned by the Report of the Presidents Commission on the United States Postal Service<sup>4</sup> and the PAEA. Ultimately, the success of the Postal Service will be dependent upon its management. Management must be permitted to exercise the kind of freedom that will enable it to make pricing and product decisions that will best ensure the future of the Service. As stated in the Commission's Report, "the biggest threat today is being too timid in the area of postal modernization and gambling with the future of affordable, universal mail service, in the process." Report at V. The President's Commission's report well summarizes the appropriate role of the Commission.

Rather than a sole focus on rate-setting and mail classifications, the Postal Regulatory Board would be tasked with broad public-policy oversight, including: ensuring financial transparency; guarding against the cross-subsidization of competitive products; [and] reviewing the scope of the postal monopoly; limiting the prices charged for non-competitive products; overseeing the scope of the universal service obligation; reviewing worksharing and other discounts; reviewing changes to service standards that may have a substantial and negative national impact;

*Id.* at XIII.

The biggest threat "today" is that the Commission will adopt an entangling, stifling regulatory regime that will ensure the demise of the Postal Service. As stated in the Senate Report:

Replacing one inflexible system with another will not address the needs of the postal community or ensure the long-term survival of the American public's postal system.

S. Rep. No. 108-318 at 8 (2004).

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<sup>4</sup> Embracing the Future, Report of the President's Commission on the United States Postal Service, July 31, 2003

MOAA submits that some of the Comments that have been submitted to the Commission in this rulemaking procedure have been “too timid” in the sense that they seek to perpetuate a continuation of past procedures for the establishment of rates and classifications by supporting new procedures that would not be changed in substance, but only in the mechanics. The adoption of that approach surely would represent “gambling with the future of affordable, universal mail service ....”

**With Only A Limited Exception, The Rates For All Mail Classes Will Readily Recover Attributable Costs.**

One of the issues under PAEA is the extent to which the rates for any given class of mail must be sufficient to return revenues necessary to meet attributable costs. There are parties contending that there is no statutorily required cost floor. MOAA will not enter into that discussion. It is obvious, however, that only the Periodicals class is faced with any danger of not meeting its attributable costs. Given the high percentage of total costs represented by institutional costs, the rates for all other mail classes must be set well above attributable costs levels. The importance of that reality is that under a price cap regime there need no longer be an elaborate, convoluted process of determining costs to the most infinitesimal level, and then determining the markup above those costs necessary to meet the total costs of the Postal Service.

**Other Rate Cap Issues.**

MOAA supports the overall approach to the establishment of the “system” advocated by the Postal Service. Specifically, MOAA concurs with the Postal Service that the Commission should proceed with an “as needed” approach to the regulatory requirements. The Service is correct in contending that the “precise determinations of what exactly this standard means with regard to postal pricing in the context of the PAEA and the price cap can be worked out over time.”<sup>5</sup>

MOAA endorses the Postal Service’s view concerning the need to adopt a regulatory calendar that will harmonize the various sections of the PAEA, a task which could prove to be somewhat difficult. *Id.* at 23-25. In particular, MOAA would prefer a date early in the calendar year

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<sup>5</sup> Initial Comments of the United States Postal Service at 19.

for rate changes, but endorses the commitment of the Postal Service to work with stakeholders to arrive at a workable and harmonious approach.

MOAA agrees with the Postal Service that a determination of whether new rates comply with a price cap should be based upon a review of actual revenues in a prior 12-month period to determine the CPI ceiling. That would eliminate the difficult and uncertain process of predicting future revenues.

MOAA generally endorses the Comments concerning classifications for market dominant products. *Id.* at 29-31. The Postal Service is correct that “a classification change which rises to the level of adding, removing, or transferring a subclass ... must follow the procedures specified in § 3642”. *Id.* at 29-30. MOAA also concurs with the Postal Service’s position that classification changes short of the subclass level should be governed by the provisions of § 3622 (d)(1)(C). In particular, MOAA concurs with the Postal Service’s conclusion that “the pricing flexibility afforded the Postal Service under the new regime should extend to classification changes as well.” *Id.* at 31.

### **Banking Should Be Done On A Class Basis.**

In response to the Comments of a number of parties, MOAA supports the proposition that “the banking” provisions of the PAEA should be applied on a class basis. To do otherwise, would be contrary to the PAEA’s capping of rates at the class level. To permit the banked amounts to be used globally, i.e. to permit the banked amounts for a particular class to be used to benefit another class, while not explicitly dealt with in the PAEA, would be contrary to the overall spirit of the Act. All banked amounts should be maintained on a class basis.

### **The Comments Of The Office Of The Consumer Advocate Are Useful, But A Number Of The Suggestions About The “System” Should Be Rejected.**

MOAA disagrees with the apparent suggestion by the Office of the Consumer Advocate (OCA)<sup>6</sup> that the “system” required to be established under the PAEA authorizes the Commission to adopt specific, and mandatory, approaches to the establishment of postal prices. Although apparently not a complete endorsement, the OCA Comments suggest that the ECPR, as discussed

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<sup>6</sup> OCA Comments in Response to Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking.

in the Commission's R2006-1 Decision, is something that could be incorporated into "the modern system of regulation." OCA Comments at 6. As discussed herein, the ECPR may be a useful tool that can be employed by the Postal Service in making its pricing decisions. The judgment as to whether, and the extent to which, that tool should be used and how it should affect specific price decisions, however, should be left to the Postal Service. It should not be imposed as a part of the "system" to be established by the Commission. The Commission should not impose any single theory of pricing upon the Postal Service, an approach which would all too quickly devolve into rigid pricing, the elimination of which was one of the primary purposes for the enactment of the PAEA.

MOAA also opposes the OCA's suggestion that the Commission adopt a list of techniques which, if followed, would amount to *prima facie* compliance with the requirements of the PAEA. *Id.* at 8. It would be no less than disastrous for the Commission to establish any kind of a *prima facie* test at this time. As the process proceeds under the Commission's compliance reports, and pursuant to complaint proceedings, it may very well develop that certain approaches will be deemed as *prima facie* compliance with the PAEA. The process should be allowed to develop naturally over time. It should not be imposed at the outset, an approach that not only risks, but probably guarantees, the imposition of rigid approaches to pricing, allowing some and barring others, which would not serve the purposes of the PAEA.

On their face, the OCA's Comments provide a compelling basis for the rejection of the *prima facie* test approach. The OCA argues that by adopting such an approach "the Commission would create incentives for the Postal Service to conform to the Commission's views on proper rate relationships – even though the PAEA delegates all initial ratemaking authority to the Postal Service." *Id.* at 8-9. That is precisely the problem. Nothing should be done to create incentives for the Postal Service to adopt a particular system of establishing rates. Rather, management should be encouraged to adopt ratemaking approaches that will advance the overall goals of the PAEA in accordance with the ratemaking authority which the OCA concedes has been delegated to the Postal Service.

### **Valpak's Comments Are Alarming.**

Valpak's positions on the timing of establishing the "system", procedural requirements thereunder and the Commission's role in pricing issues are erroneous. MOAA is opposed to the

Valpak recommendation that the Commission take the “full 18 months to complete the rulemaking process”.<sup>7</sup> (emphasis in original) Valpak Comments at 2. Instead, MOAA again expresses support for Chairman Blair’s suggestion at the Summit that the “system” can be completed, or at least such portion of the “system” necessary to initiate the rate cap system, by not later than October of this year.

Obviously, adoption of Valpak’s timing recommendation would ensure that the Postal Service would file another rate increase under the expiring statutory and regulatory requirements. Chairman Blair and the overwhelming majority of mailers are firmly opposed to the filing of another rate case under existing procedures. That filing could use FY 2010 as the Test Year which in turn could have the practical effect of a lengthy postponement of the rate cap system under the PAEA. Again, MOAA recommends that the regulatory framework necessary to enable the initiation of the rate cap system be put in place at the earliest possible date.

MOAA disagrees with Valpak’s suggestion that the Commission should not fully consider the legislative history of the PAEA. Anyone who has followed the development and enactment of the PAEA recognizes that important issues, including Postal Service pricing flexibility, were debated and determined in a way that should be recognized by the Commission in carrying out its responsibilities.

Valpak appears to take the position that the provisions of § 101 (d) should be interpreted as overriding the provisions of PAEA § 3622 (b)(8). The terms “just and reasonable”, however, were deliberately substituted for “fair and equitable” within the Objectives, and that important change should be recognized by the Commission. MOAA also disagrees with Valpak’s contention that the enactment of the PAEA did not sever the lockstep relationship between costs and rates that existed under the PRA. That is exactly what the PAEA was intended to do, and does. Thus, although the discussion of “good costing” as found in pages 15-26 of Valpak’s Comments is interesting as an historical review, and may even be useful to the Postal Service as it applies its new authority to establish postal prices under a wholly different approach, pricing judgments are to be left to the Postal Service.

MOAA disagrees with the position of Valpak that “the Commission should continue to place considerable emphasis on the importance of cost-based rates.” *Id.* at 23. Valpak’s argument

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<sup>7</sup> Valpak Direct Marketing Systems, Inc. and Valpak Dealer’s Association, Inc Comments on Regulations Establishing a System of Ratemaking in Response to Commission Order no. 2.

in support of that proposition supports the opposite conclusion. As acknowledged by Valpak, the PAEA applies rate caps at the class level. *Id.* at 22. The Act unambiguously provides that the Postal Service must be free to “make changes of unequal magnitude within, between, or among classes of mail.” PAEA § 3622 (b)(8). That authority is at odds with the contention that rates should be rigidly based on costs. The provision necessarily means that if the class as a whole has rates that do not exceed the CPI, the Postal Service is authorized to make its own judgments about particular rates.

Overall, Valpak appears to be supporting an interpretation of the PAEA in which ratemaking would remain essentially unchanged. The process of establishing rates and classifications would be subject to standards and procedures not unlike those which have prevailed over the past 35 years. Valpak contends that “it appears that the PAEA requires the Commission to undertake a meaningful, substantive, multi-faceted – not *pro forma* – review prior to implementation of any rate increase.” The statement causes the blood to run cold.

The statement, as amplified at pages 29-35 of Valpak’s Comments, makes it clear that Valpak is contending that the only thing that has changed is the timing and mechanics; not the very fundamentals of establishing rates. Valpak’s recommendation that there be a 4-month period for the completion of the Commission’s review demonstrates the fallacy of the approach, since one of the principal purposes of the PAEA is to allow the Postal Service to react quickly to current conditions.

Under the complicated requirements that Valpak would have the Commission impose, the Postal Service would be required to expend the same period of preparation as is expended under the current procedures. *See Embracing the Future, Report of the President’s Commission on the United States Postal Service, July 31, 2003 at XIII.* Valpak’s Comments do not address how the process, that would not differ significantly in substance from the process required under the PRA, could be completed in 4 months. Under the prior stringent timetable, participants have of necessity had to focus upon only a narrow range of issues. Even then, the 10-month deadline has been a significant burden. Valpak offers no explanation of how what has been an almost impossible task under the existing 10-month procedures could be compressed to 4 months, even assuming an ability and willingness of mailers to open the spigot without regard to costs.

Valpak relies in part on the differing PAEA provisions for market-dominant and competitive products. The Commission has a greater regulatory role for market-dominant than for competitive products. The statutory limitation upon the Postal Service’s pricing authority for the market-

dominant products, however, is clear. To the extent that the Postal Service sets rates within the price cap by class of mail, the Commission has no authority to prevent the implementation of those rates pursuant to the 45 day review process.

The “exigency” provisions of the PAEA argue strongly against Valpak’s position that the review process under a CPI rate cap should not differ in substance from existing procedures. Rate increases above the CPI can be permitted only “after notice and opportunity for a public hearing and comments.” PAEA § 3622 (d) (E). The absence of those requirements for CPI rate increases is telling.

In sum, Valpak is urging upon the Commission an entirely erroneous approach to the new system. The Commission’s obligation under the PAEA is to afford the Postal Service the kind of pricing authority that it will need, and pursuant to a notice period that should not, and as a practical matter cannot, be used to perform an exhaustive review of the wisdom of the Postal Service’s pricing judgments.

### **The Comments Of The Newspaper Association Of America Seek Excessive Commission Regulations.**

The Commission should reject the positions taken by the Newspaper Association of America<sup>8</sup>. The NAA Comments proceed from the fundamentally erroneous premise that it is the Commission, and not the Postal Service, that is charged with the task of establishing rates. It is for the Postal Service to make a determination of the proper rates, taking into account all of the statutory objectives, factors and requirements. That judgment is not subject to reversal, except to the extent that a determination is made that the rates for any class of mail fail to comply with the price cap requirement. Thus, the Commission should reject the suggestion by NAA that an increase in rates for any particular category within a class that exceeds the CPI by anything more than a small amount should not be deemed “predictable” or “just and reasonable”. NAA Comments at 9. There is no statutory basis to support imposing that or any other predetermined requirement upon Postal Service pricing.

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<sup>8</sup> Comments of the Newspaper Association of America.

## The Comments Of The Greeting Card Association Do Not Accord With The PAEA.

The Comments of the Greeting Card Association<sup>9</sup> (GCA) fail to recognize the fundamental change in the relationship between the Commission and the Postal Service resulting from enactment of the PAEA. The Comments support the establishment of elaborate criteria governing how the Postal Service applies the objectives, factors, and requirements of the PAEA. The Comments also argue that the substitution of “just and reasonable” for “fair and equitable” should be denied any significance. Ignoring the change in terminology is simply not a rational approach and is directly counter to the reality of how the statutory language was chosen. The change in wording from “fair and equitable” to “just and reasonable” was intended specifically to escape from the gloss that had been put on those terms by the Commission’s interpretation of “fair and equitable” one of the “factors” of the PRA.

Thus, GCA’s argument about the “historical pattern” is particularly pernicious. GCA argues that a “full analysis of both the historical pattern and interrelationships of rates ... should make it impossible to argue that *only* that rate – and *only* that rate as currently established – may be considered.” (emphasis in original). GCA Comments at 6-7. The attempt to maintain the relevance of the Commission’s prior interpretations of the “fair and equitable” language as found in 39 U.S.C. § 3622 (b)(1) to the interpretation of the “just and reasonable” language should be rejected. The terms are different, were chosen specifically to escape the prior interpretation of “fair and equitable” and must be interpreted differently. The adoption of different terms was intended to move away from the history of the Commission’s interpretation and application of the meaning of “fair and equitable” so as not to bind the Postal Service to a concept of pricing in which a rate deemed not to be “fair and equitable” would be deemed not to comply with the Act.

As recognized in the Comments of the Postal Service, the terms “just and reasonable” should be given the interpretation given to those terms by the courts, citing *Farmer’s Union Central Exchange v. FERC* 734 F.2d 1486, 1502 (D.C. Cir. 1984).

We begin from this basic principle, well established by decades of judicial review of agency determinations of “just and reasonable” rates: an agency may issue, and courts are without authority to

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<sup>9</sup> Comments of the Greeting Card Association in Response to Advance Notice of Proposed Rulemaking.

invalidate, rate orders that fall within a “zone of reasonableness,” where rates are neither “less than compensatory” nor “excessive.

Initial Comments at 19

**The Comments Of The Alliance Of Nonprofit Mailers, National Association Of Presort Mailers, And National Postal Policy Council Take Erroneous Positions.**

The argument of the Alliance of Nonprofit Mailers, *et al*<sup>10</sup> that the ECPR is an approach to pricing products that should be imposed upon the Postal Service by the Commission is based upon an erroneous premise of Postal Service “market power”.

The best way to achieve these competing goals is to preserve the right to seek relief through complaints or the annual review process for alleged violations of the objectives of the Act, while establishing a presumption that rates are lawful if (1) overall rate increases for each class comply with the 3622(d) rate cap, and (2) rate relationships *within* classes satisfy the Efficient Component Pricing Rule (“ECPR”). A regulatory system built around this presumption would promote predictability and minimize the transaction costs of regulation, while safeguarding against the two greatest potential threats from the Postal Service’s market power over mail delivery: (1) unreasonably high rates for market dominant elements of service, and (2) impaired competition for mail sorting, transportation and other potentially competitive elements of service. This regulatory scheme also would provide strong incentives for the Postal Service to control its costs and maintain quality, while preserving its necessary pricing flexibility and allowing it to earn adequate revenues.

Comments of Alliance of Nonprofit Mailers, *et al* at 3.

Notably absent from the above discussion is any recognition of the fact that the Postal Service is faced with enormous competitive forces with which it has not been able to cope. The Service is faced with structural cost increases in the form of ever increasing delivery points and structural revenue decreases in the form of volume losses. Unless the Postal Service is able to price its products in a way that allows it to compete in the marketplace it will be doomed. The suggestion that the Postal Service should be required to set prices “within classes [that] satisfy the ECPR” would impose a serious, and quite possibly fatal, impairment upon the Postal Service’s pricing

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<sup>10</sup> Comments of the Alliance Of Nonprofit Mailers, National Association Of Presort Mailers and National Postal Policy Council on Advance Notice of Proposed Rulemaking.

flexibility, a flexibility that is essential to its survival. Rigid allocative rules simply will not work and the Commission should refuse to impose them.

The Comments claim that the Postal Service has “market power over mail delivery”. That is accurate, insofar as it is limited to statutory limitations upon the physical delivery of certain kinds of mail. Whatever “market power” the Postal Service may have, however, has certainly not served to preserve its volumes. The “market power” of the Postal Service to deliver letters has not preserved its market for First Class letters. Similarly, the “market power” of the Postal Service over the delivery function has not served to preserve its market for Standard Mail ECR.

Additionally, the Service does not have “market power” over even the entirety of the delivery function. Newspapers, and other private enterprises, have been able to compete effectively for the delivery function for mail not covered by the postal monopoly. Further, there is dominant competition to the Service’s “mail delivery” function in the parcel, and overnight “letters” market, and from fax and email.

The real dilemma facing the Postal Service is the lack of market power and the severe structural problems of increasing costs and declining volumes, combined with wage levels over which it has little control. The contention that the Postal Service has “market power” over anything is simply a delusion. The reality was summarized by Postmaster General Potter in recent testimony before the Senate Subcommittee.

My position is not meant as criticism; rather it is an acknowledgement that the dynamics of the 21st century communications market have altered — forever — the basic assumptions of postal economics in a monopoly environment. The traditional postal monopoly, while it still exists as a matter of theory and law, particularly for what the new statute terms our “market-dominant products,” does not exist in actual practice.

The explosive growth of electronic communications and an intensely competitive package delivery sector have led to the diversion of messages, transactions, and packages from the mail channel. Competition exists for every piece of mail that moves through our system. This has significantly slowed overall volume growth, with actual declines in some products, and resulted in shifts from higher-margin products to those making a lesser contribution.

In a practical sense, this means that mail volume growth can no longer match the historic trends of the last three decades and appears to be beginning to flatten. We can no longer depend on volume growing at a rate necessary to produce the revenue required to cover the costs of an ever-expanding delivery infrastructure.

Statement of Postmaster General/CEO John E. Potter Before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security of the Committee on Homeland Security and Governmental Affairs, United States Senate, Washington DC, April 19, 2007.

In sum, the contention that the Postal Service has “market power” that poses actual or “potential threats” is fallacious. To enforce upon the Postal Service the use of the ECPR, or any other rigid approach to costing as advocated by the Alliance, *et al*'s Comments, would be to destroy the Postal Service's pricing flexibility in direct contravention of the purpose of the PAEA, and prevent the Postal Service from competing for any segment of the market.

### **Conclusion.**

The Comments of Federal Express Corporation<sup>11</sup> (FedEx) succinctly summarize the vital importance of ensuring Postal Service pricing and classification flexibility for market-dominant products.

USPS must be able to deliver those services and other market-dominant products, in a more flexible, businesslike manner.

FedEx Comments at 2.

We believe that USPS as a modern service provider must have flexibility to serve large customers, to develop new products for all types of users, and to make its pricing more attractive to large users without undercutting the overall goal of basic, affordable postal service for all citizens”

*Id.* at 4

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<sup>11</sup> Comments of Federal Express Corporation.

The above is an admirable summary of what is needed and should serve as a guide to the Commission's regulatory approach.

Respectfully submitted

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