

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

**Regulations Establishing System
of Ratemaking**

Docket No. RM2007-1

**REPLY COMMENTS OF PITNEY BOWES INC.
IN RESPONSE TO ADVANCE NOTICE OF PROPOSED RULEMAKING
ON REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING**

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I. INTRODUCTION

Pursuant to PRC Order No. 2, the Advanced Notice of Proposed Rulemaking (ANPRM),¹ Pitney Bowes Inc. (Pitney Bowes) hereby submits its reply comments. Pitney Bowes has benefited greatly from the initial comments of others. We appreciate the efforts of the Postal Regulatory Commission (PRC) and the United States Postal Service (Postal Service) through this proceeding, and joint and separate events and meetings with stakeholders, to seek to understand and take into account the concerns and needs of the mailing community as implementation of the Postal Accountability and Enhancement Act (PAEA or Act) proceeds.²

In its initial comments Pitney Bowes urged the Commission, in the regulations that eventually result from this proceeding, to provide advance, comprehensive guidance as to the requirements and boundaries of the modern system of ratemaking. On reply, Pitney Bowes again urges the Commission to promulgate regulations that will promote and sustain a vibrant, growing mailing industry, enhance the value of the mailstream for senders and recipients, and ensure universal, affordable postal service by:

- requiring the Postal Service to price consistent with the principles underlying Efficient Component Pricing (ECP) to promote increased efficiency and reduce total postal sector costs, primary objectives of the modern system of ratemaking;
- creating a presumption of validity for ECP-compliant rates to reduce the administrative burden of the ratemaking process and promote greater predictability;
- requiring the Postal Service to achieve the objectives of the Act, and take into account its factors, through rate incentives, discounts, and rules;
- promoting the Postal Service's pricing flexibility;
- establishing a rate cap that provides predictability and stability with respect to the upper bounds of rate increases;
- establishing a rate adjustment schedule that provides flexibility, minimizes burden, and protects the rights of interested parties; and
- preserving a meaningful right to challenge unlawful rates.

¹ See 72 Fed. Reg. 5230 (February 5, 2007).

² Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). Many provisions of the PAEA amend title 39 of the United States Code. In these comments section references are to sections of title 39 unless otherwise noted.

II. DISCUSSION

A. The Role of the Commission in Establishing and Administering the Modern System of Ratemaking is More Important than Suggested by Some.

In its initial comments, Pitney Bowes stated its view that going forward the Commission should (1) establish *advance* comprehensive guidance for all stakeholders in establishing the modern ratemaking system, and (2) play a continuing *active* role under the new system in order to ensure compliance with the statutory requirements and to give effect to and balance the statutory objectives and factors. *See* Pitney Bowes Comments at 2.

Specifically, the Commission must, through its rules, implement the requirement for an annual limitation and the requirement that rates reflect costs. 39 U.S.C. §§3622(c)(2), (d). It must direct the Postal Service to achieve the statutory objectives and take into account the statutory factors. It also should require, through the compliance process, that the Postal Service report annually on how its rates and classifications take into account the factors, achieve the objectives, and satisfy the requirements of the PAEA.

Nothing in the initial comments alters this view. The comments of a few, however, require reply.

1. Dr. Panzar's Comments Explain Why the PAEA Requires an Active Commission.

Dr. Panzar described “[t]wo important features of any PAEA-based postal regulatory environment: (1) Postal rates will *not* be determined under a textbook-style rate cap regime; and (2) The U.S. Postal Service will continue to dominate some segments.” Panzar Comments at 5. These are distinguishing features that require an active regulator and advance rules.

a. *“Postal Rates Will Not Be Determined Under a Textbook-style Price Cap Regime.”*

Most commenters recognize that there will be a “rate cap,” in the form of an annual limitation, under the PAEA. This is a requirement. *See* 39 U.S.C. §3622(d). But the PAEA imposes other pricing requirements. Thus, the Postal Service does *not* enjoy “unilateral” pricing flexibility, subject only to a rate cap, as suggested by some. *But see* PostCom Comments at 2, 6. For example, section 3622(e) imposes limits on discounts that may be afforded for worksharing

activities. This is also a requirement. Section 3622(c)(2) imposes “the *requirement* that each class of mail or type of mail service bear the direct and indirect costs attributable” to that mail or service.³ 39 U.S.C. § 3622(c)(2)(emphasis added). This is yet another requirement. In addition, the PAEA requires the Commission to ensure that Postal Service rates are consistent with the numerous statutory objectives and factors. The PAEA does not, therefore, provide unfettered pricing flexibility under the rate cap, it requires an active regulator.

b. “The U.S. Postal Service Will Continue to Dominate Some Segments.”

Rules are needed to safeguard against the potential abuse of the Postal Service’s market dominant power, particularly with respect to rate regulation. Many commenters expressed concern about potential harm from the exercise of unfettered Postal Service pricing flexibility. The Postal Service remains a public institution as part of the Executive Branch of the United States Government. *See* 39 U.S.C. § 201. It has a legal monopoly over the statutorily defined “market dominant” products that comprise 99 percent of its volume and 87.7 percent of its revenue, approximately \$64 billion annually. Because of the statutory monopoly over these products, the Postal Service also has monopsony power as the only buyer of upstream services provided by the private sector (e.g., presortation).⁴

Numerous commenters agree that the Commission has a statutory obligation to protect and expand upstream access for mailers and consolidators who have invested in and developed the workshare industry over the past 30 years. *See* ANM, NAPM, NPPC Comments at 16-19; Panzar Comments at 13-15. Even PostCom, which generally argues for a light-handed approach to regulation, recognizes “[a]t the same time, the Commission has very important functions to carry out to guard against monopoly abuse and has been given the procedural devices that it needs to do so.” PostCom Comments at 3.

³ Some requirements may conflict. For example, it is possible to envision a situation where the annual limitation applied to a class of mail will collide with the requirement that each class of mail bear its own costs. In such a situation, it appears the annual limitation controls.

⁴ A monopsonist is the sole buyer of a factor of production, in this case upstream presortation and transportation services. *See* David W. Pearce, *The MIT Dictionary of Modern Economics* 291 (4th ed. 1992).

The best way to prevent the potential abuse of the Postal Service's statutory position is to employ ECP.⁵ The Commission's regulations should facilitate the Postal Service's growth through economic efficiency and innovation, and should prohibit the abuse of the Postal Service's market dominant position. The Commission can do so by prescribing rules that require the Postal Service to price market dominant products, to the maximum extent practicable, in accordance with the principles of ECP.

PostCom is correct that the Commission should enforce section 403(c) to prevent the Postal Service from unduly or unreasonably discriminating between or among mail users. See PostCom Comments at 9. However, the Commission must also ensure that the Postal Service cannot use its statutorily defined market power to discriminate in favor of itself and against private sector "competitors" who provide upstream services. This is consistent with the command of section 404a which prohibits the Postal Service from using its governmental authority for competitive advantage. The "specific power" of the Postal Service under section 404(a)(2), the power "to prescribe, in accordance with [title 39] the amount of postage and the manner in which it is paid," is specifically "[s]ubject to section 404a." 39 U.S.C. § 404(a).⁶

There is a clear need for the Commission to continue to preserve efficient upstream access.⁷ It would be particularly ironic if the very same regulatory body that addressed this issue

⁵ Efficient Component Pricing (ECP) theory holds that worksharing discounts should be set *equal* to the per unit avoided costs of the Postal Service. See PRC Op. R2006-1, ¶ 4016; ECP-based worksharing discounts set equal to the per unit avoided costs of the Postal Service will promote productive efficiency and reduce the total costs of the postal sector because mailers will be induced to perform work *if and only if* they can do it more cheaply than the Postal Service. See Testimony of John C. Panzar On Behalf Of Pitney Bowes Inc., Docket No. R2006-1 PB-T-1 at 16-17. As the Commission stated in its last Opinion the "virtue of ECP or an ECP approach beyond worksharing is that it continues to promote productive efficiency[,] and "should provide incentives to minimize costs in the case of shape and other mail characteristics." PRC Op. R2006-1, ¶ 4024.

⁶ See 39 U.S.C. §§ 404 and 404a.

⁷ See *e.g.*, Testimony of Dr. John C. Panzar on behalf of Pitney Bowes Inc., Docket No. R2006-1 at 4: Public policy toward the terms under which competitors may obtain access to the natural monopoly or so-called "bottleneck" portions of infrastructure industries has proven to be an important determinant of the success or failure of liberalization policies. Examples include long distance telecommunications services and the transmission and electric power generation. In each case, the success of liberalization of the more structurally competitive vertical segment (i.e., long distance transmission, power generation) turned out to depend quite crucially on the ability of would be competitors to gain access to the "bottleneck" portions of the network (i.e., the local exchange, transmission and distribution grids). *It is somewhat ironic that this crucial issue of access was addressed in the monopolized postal sector relatively early (i.e., during the 1970s); long before it became the subject of regulatory and court proceedings in telecommunications and electric power.* As Cohen, et. al. (2006) point out, the policy focus of the Postal Rate Commission has been on using the pricing of worksharing discounts, and thereby *access* to the delivery network of the Postal Service, to promote the productive efficiency of a monopoly letter mail industry. (citing R. Cohen, M. Robinson, J. Waller, and S. Xenakis (2006), "Worksharing: How

“long before it became the subject of regulatory and court proceedings in telecommunications and electric power” now abdicates its responsibility to ensure efficient markets and continued upstream access. *Accord* ANM, NAPM, NPPC Comments at 16-19.

2. Rules are Necessary to Ensure that the Postal Service Acts Consistently with the Objectives and Factors of the Act.

Factors and objectives have been in every comprehensive postal reform bill since 1997. An active Commission will ensure that they are given effect. The Commission’s regulations should require that the Postal Service achieve the objectives and take into account the factors in establishing rates and introducing experimental and new products. The Postal Service should be required to do this through rate incentives, discounts, and rules. The Commission’s regulations also should require the Postal Service, in its annual report to the Commission under section 3652, to describe the actions it has taken to “achieve the objectives” and “take into account the factors” of the Act. Indeed, such a report is necessary for the Commission to ensure that “all products during such year complied with all applicable requirements of this title.” 39 U.S.C. §3653(b)(1).

B. Numerous Commenters Recognize the Continuing Relevance of Cost-Based Rates.

1. The Modern System of Ratemaking Should Embrace Cost-Based Rates, NOT Cost-of-Service Regulation.

Advocating in favor of a modern ratemaking system that recognizes the relevance of cost-based rates is not an endorsement of a continuation of a cost-of-service ratemaking system. Pitney Bowes and other commenters have called for a modern ratemaking system in which rate differences, to the maximum extent practicable, reflect cost differences within that class. *See* ANM, NAPM, NPPC Comments at 4, 25; MOAA Comments at 3; Pitney Bowes Comments at 4. This approach differs from cost-of-service regulation in two important respects. First, under the PAEA the overall rate level for each class is constrained by the rate cap. Under a cost-of-service approach the rate level is dependent on costs. Second, under a cost-of-service approach

Much Productive Efficiency, at What Cost and at What Price?” in *Progress Toward Liberalization of the Postal and Delivery Sector* (Springer), edited by M. Crew and P. Kleindorfer, at 2).

overall revenue is determined by cost and the “breakeven” constraint. This is not so under the modern ratemaking system. The rate cap controls overall revenue.

A few commenters suggest abandoning all past rate setting considerations. Proponents of “unilateral” rate setting authority for the Postal Service ignore the existence of important Commission regulatory responsibilities under the PAEA. *See* pp. 2-4, *supra*; PostCom at 2; Postal Service at 20. In arguing for this “unilateral” authority, PostCom says “[t]he ratemaking provisions of the PAEA are intended to – and do – entirely supplant the provisions of the 1970 Act.” PostCom Comments at 4. In fact, as discussed in Pitney Bowes’ initial comments, the PAEA ratemaking provisions include, with some modification, nearly all of the ratemaking “factors” of its predecessor, the Postal Reorganization Act of 1970 (“PRA”), Pub. L. No. 91-375, 84 Stat. 719. *See* Pitney Bowes Comments at 17; 39 U.S.C. § 3622(c). The restatement of these PRA statutory ratemaking provisions evidences Congress’ intent to maintain a cost-based rate nexus and a continuing, active Commission role with respect to how rates are set for market dominant products. *See id.*; ANM, NAPM, NPPC Comments at 14 (“the expanded lists of “objectives” (§ 3622(b)) and “factors” (§ 3622(c)) enacted by the new law appear, at least on first blush, to require consideration of many criteria for which product-specific costs are necessary, or at least highly relevant.”); Valpak Comments at 22 (arguing that the modern ratemaking system must be founded on good costing and that cost-based rates should continue to be a hallmark of postal ratemaking); OCA Comments at 9 (same).

2. Efficient Component Pricing is Necessary to Promote Economic Efficiency and Protect Competitive Access.

In its initial comments Pitney Bowes pointed out that improved economic efficiency is a paramount objective of the PAEA. It is a means to promote a vibrant mailing industry and to ensure continued universal, affordable mail service. *See* Pitney Bowes Comments at 28. One means to promote economic efficiency is to pursue “lowest combined costs.” Pitney Bowes first suggested this in 1998.⁸ Many other commenters in this proceeding, and most recently the Postmaster General, have also embraced this view. ANM, NAPM, NPPC Comments at 20; Postal Service Comments at 2; Valpak Comments at 11; *The Road Ahead: Implementing Postal*

⁸ Letter dated April 7, 1998, from David Nassef, Vice President, Federal Relations, to The Hon. John McHugh, at 3 (“The USPS must focus on lowering end-to-end (total system) mailing costs to continually enhance and improve its core business.”).

Reform: Hearings Before the Senate Comm. on Homeland Sec. and Governmental Affairs - Subcomm. on Fed. Fin. Mgmt., Gov't Info., Fed. Serv., and Int'l Sec., 110th Cong. (April 19, 2007) (statement of John E. Potter, Postmaster General/CEO).

The Commission should require the Postal Service to adopt ECP-compliant rates, to the maximum extent practical, for two important reasons. First, because there is viable competition for the upstream components of the mail service, using ECP to price access to the downstream network produces lowest combined costs for the postal sector. Second, ECP is also the most effective means for the Commission to safeguard upstream competition from potential abuses of the Postal Service's market dominant power (i.e., excluding more efficient upstream competitors by setting discounts which are less than costs avoided).

With so much to gain and so little to lose, the Commission's regulations establishing the modern ratemaking system should require the Postal Service to adopt ECP-compliant rates. Such a requirement will encourage the Postal Service to focus on financial stability through innovation and cost control, rather than by abusing its market dominant position.

3. Efficient Component Pricing is Fully Consistent with a Rate Cap and Pricing Flexibility.

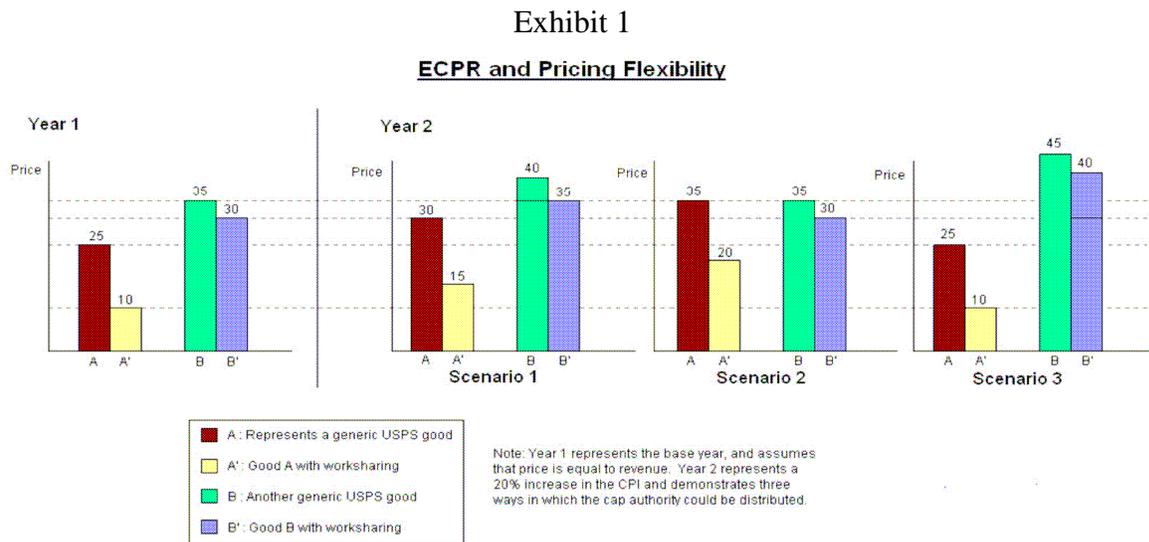
ECP is fully compatible with the Postal Service's expanded pricing flexibility under the PAEA. ECP is also consistent with the Commission's longstanding goal, now stated as the paramount objective of the modern ratemaking system, to increase efficiency and reduce total postal sector costs.

a. ECP Allows Pricing Flexibility in Conjunction with the Rate Cap.

ECP speaks only to the relationships between rates, not the rate levels themselves. For a product with a workshare component, ECP only affects the part of the composite price that is open to upstream competition. ECP does not affect the Postal Service's ability to price the downstream "closed" part of the product price and, thus, the total price overall.

Consider, for example, a class of mail with two product categories, Product A and Product B (e.g., Standard Mail Regular and Standard Mail Enhanced Carrier Route). Under a rate-cap ratemaking system in which the Postal Service were required to adopt ECP-compliant prices, it would have to price each product such that rate differences within the product fully reflected cost differences (e.g., workshare-related cost avoidances and other cost-causative

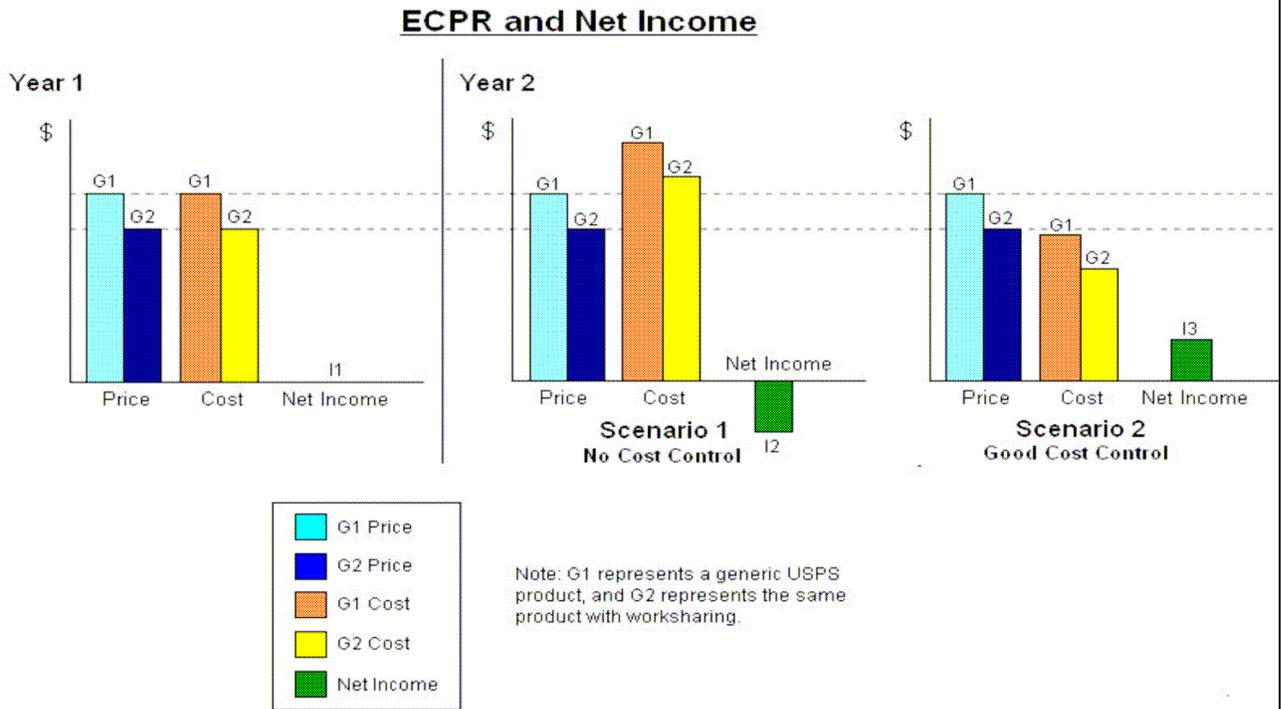
attributes of the products, such as shape, payment evidencing, address quality, and others). Under this system ECP would not impinge upon the Postal Service’s pricing flexibility as to how much of the cap authority provided by PAEA should be used to increase the price for Product A and how much should be used for Product B. Even with ECP, the Postal Service retains total flexibility in this decision. As illustrated in Exhibit 1, the Postal Service could use its cap authority to increase the rates for both products by the *same* percentage, it could use its cap authority to *increase* the rates for Product A and *decrease* the rates for Product B, or it could use its cap authority to *decrease* the rates for Product A and *increase* the rates for Product B. All three scenarios are fully compliant with ECP. Thus, ECP does not limit pricing flexibility across products within, between or among classes.



b. ECP Would Not Impair the Postal Service’s Ability to Retain Earnings.

ECP does not affect the Postal Service’s ability to accumulate the retained earnings it will need for future investment in, and improvements to, the postal system. As illustrated in Figure 2, if the Postal Service can control costs such that cost increases are below the CPI, it will be profitable whether or not it prices using ECP. If the Service cannot control costs, and cost increases are above the CPI, it will not be profitable whether or not it prices using ECP.

Exhibit 2



4. The Commission Should Establish a Rebuttal Presumption that Rates which Satisfy the Efficient Component Pricing Rule Also Satisfy the Other Factors and Objectives of the Act.

In its initial comments Pitney Bowes proposed that “[t]he Commission’s regulations should provide that rates comporting with the principles underlying efficient component pricing principles are presumptively valid under the Act.” Pitney Bowes Comments at 4; *accord* ANM, NAPM, NPPC Comments at 3. ANM, NAPM, and NPPC went a step further arguing that the best way to achieve the competing goals under the Act is to establish 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”).” ANM, NAPM, NPPC Comments at 3. As they explain:

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.

Ibid.

Moreover, “because ECPR pricing promotes, or is consistent with, all of [the goals of the Act], adoption of a rebuttable presumption that rates which comply with the CPI index and ECPR comply with the Act as a result is clearly within the Commission’s discretion under 39 U.S.C. §§ 3622(a) and (b).” *Id.* at 25.

C. There is Substantial Support for Pricing Flexibility.

The PAEA specifically calls out pricing flexibility as an “objective” and a “factor” of the modern ratemaking system, *see* 39 U.S.C. §§ 3622(b)(4), 3622(c)(9), and promotes expanded pricing flexibility across a number of different dimensions for both market dominant and competitive products. Numerous commenters discussed the importance of the new flexibility afforded to the Postal Service. *See* ADVO Comments at 5; ANM, NAPM, NPPC Comments at 22; DMA Comments at 1, 3; MOAA Comments at 2; Pitney Bowes Comments at 5, 12; PostCom Comments at 5; Time Warner Comments at 7; Postal Service Comments at 2; Valpak Comments at 25. Key elements of the Postal Service’s enhanced pricing flexibility identified in the initial comments are as follows.

1. Procedural Pricing Flexibility.

Many commenters recognized the PAEA affords increased procedural pricing flexibility through the elimination of the requirement for an advance, on-the-record Commission review and approval of Postal Service rate adjustments. *See e.g.*, DMA Comments at 1; Pitney Bowes Comments at 5. The PAEA makes clear that Congress intended procedural pricing flexibility as a means of reducing the administrative burden on the Postal Service. *See* 39 U.S.C. § 3622(b)(6). The elimination of the complicated, cumbersome and expensive adjudicatory process will substantially reduce the administrative burden on the Postal Service, the Commission, and the mailing community.

Numerous commenters also recognized the procedural flexibility afforded through the possibility of more frequent rate adjustments and a minimal “quick look” cap compliance review prior to rate adjustments. *See* ADVO Comments at 4; ANM, NAPM, NPPC Comments at 4; DMA Comments at 2; Pitney Bowes Comments at 12, 14; PostCom Comments at 7.

The PAEA requires the Postal Service to provide public notice at least 45 days in advance of a proposed rate adjustment, but does not require public comment. 39 U.S.C. § 3622(d)(1)(C)(i). Further, the PAEA provides that the Commission’s advance review of proposed rates is a limited “quick look” that is only concerned with whether the proposed rate adjustment complies with the annual limitation, i.e., the rate cap. *See* 39 U.S.C. § 3622(d)(1)(C)(iii). These streamlined procedures will reduce the administrative burden on and enhance the pricing flexibility of the Postal Service.

The Commission should reject the suggestion that it conduct a “mini-rate case” during the 45-day notice period as an unreasonable restriction on the Postal Service’s pricing flexibility. *Compare* ABM Comments at 4; APWU Comments at 7-8; Valpak Comments at 30.

2. Dynamic / Seasonal Pricing.

Several commenters also recognized that the PAEA affords the Postal Service the pricing flexibility to adopt seasonal, variable, or other dynamic pricing tools to manage mail flows and operational costs, address seasonal demands, and respond to unanticipated changes in operational or market conditions. *See* 39 U.S.C. § 3622(c)(7); DMA Comments at 6; MOAA Comments at 2; NAA Comments at 8; Pitney Bowes Comments at 12, 21, 30; Postal Service Comments at 24.

Seasonal, variable, or other dynamic pricing also affords the Postal Service the flexibility to make rate adjustments more frequently than once a year. The Postal Service should be allowed to adjust prices for market dominant products within a published range of prices throughout the year to meet its needs and those of the mailing public. The Commission’s regulations should facilitate this dynamic pricing. As noted in the initial comments of Pitney Bowes, to ensure compliance with the annual limitation, seasonal or dynamic rate adjustments, as least initially, should be limited to rate reductions. *See* Pitney Bowes Comments at 13.

3. Rate Changes of Unequal Magnitude.

Several commenters also observed that the PAEA affords the Postal Service explicit pricing flexibility to implement “changes of unequal magnitude within, between, or among classes of mail.” 39 U.S.C. § 3622(b)(8); *see* ADVO Comments at 1, 2; ANM, NAPM, NPPC Comments at 4; DMA Comments at 2; GCA Comments at 4; MOAA Comments at 2; Pitney Bowes Comments at 12; PostCom Comments at 8; Valpak Comments at 12-13. This is a significant change under the PAEA. The Commission’s regulations should enable the Postal Service’s to employ this new authority to price products such that rate differences fully reflect cost differences, irrespective of historical rate relationships.

Two commenters, ABM and the Newspaper Association of America (NAA), suggest that the predictability objective of the PAEA requires special constraints on the Postal Service’s pricing flexibility. Specifically, ABM and NAA argue in favor of a rate banding approach in which rate changes within a class may not exceed CPI by more than a predetermined percentage (e.g., 2 percent). *See* ABM Comments at 6; NAA Comments at 9.

The Commission should reject this suggestion as inconsistent with the PAEA, ECP, and pricing flexibility. The section 3622(b)(2) predictability objective relied on by ABM and NAA is amply satisfied by the section 3622(d) requirement of an annual limitation, i.e., the rate cap. In applying the cap to at the class level, *see* 39 U.S.C. § 3622(d)(2)(A), Congress limited pricing flexibility (and promoted predictability) to the extent it felt appropriate thereby addressing the concerns raised by ABM and NAA. A further constraint on pricing flexibility such as rate bands within individual classes is inconsistent with ECP and would frustrate the very pricing flexibility that the rate cap is designed to facilitate.

4. Additional NSA Opportunities.

Several commenters recognized that the PAEA provides a statutory foundation for negotiated service agreements, eliminates the need for advance, on-the-record hearings and review before the Commission, and significantly expands the bases for such agreements – which under the PRA were permitted in only limited circumstances and following often lengthy litigation. *See* 39 U.S.C. § 3622(c)(10); ADVO Comments at 10; MOAA Comments at 4-5; PSA Comments at 20-21; Pitney Bowes Comments at 31-32; Sprint Comments at 1. This is an important increase in pricing flexibility for the Postal Service.

The elimination of advance, on-the-record Commission review of NSAs should significantly enhance the Postal Service’s ability to meet the needs of mailers and to make NSAs more accessible to a larger pool of prospective NSA partners who have historically been precluded from pursuing a deal because of the prohibitive transaction costs involved in consummating it. Also significant is the expanded statutory bases for NSAs. In addition to NSAs that increase the overall contribution to institutional costs (e.g., volume deals), section 3622(c)(10) also authorizes NSAs which “enhance the performance of mail preparation, processing, transportation, or other functions.” 39 U.S.C. § 3622(c)(10).

Commission regulations protecting commercially sensitive information from disclosure are necessary to effectuate the Postal Service’s additional authority to negotiate and implement NSAs. More generally, the Commission’s regulations should encourage and promote NSAs that extend the benefits of these strategic partnerships to a wider spectrum of mailers, including smaller-volume mailers.

5. Expanded Classification Authority.

The PAEA gives the Postal Service significantly more flexibility than the PRA with respect to product classification changes and changes to rate elements for individual products. This affords additional pricing flexibility. As noted by several commenters, under the PAEA a “product” is synonymous with a “subclass” under existing postal jargon. *See* PSA Comments at 4; Postal Service Comments at 29. Importantly, however, the PAEA relaxes the statutory definition of a product / subclass, defining a “product” as “a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied.” 39 U.S.C. § 102(6) (emphasis added). Thus, the PAEA substitutes a disjunctive analysis requiring *either* a distinct cost basis *or* distinct market characteristics in place of the more restrictive analysis previously used by the Commission under the PRA which required *both* a distinct cost basis *and* distinct market characteristics.

This relaxed statutory standard will allow the Postal Service greater flexibility in rationalizing its product offerings and segmenting its customer base. Expanded classification authority at the product level will also allow for maximum Postal Service pricing flexibility under a system that requires rate differences to reflect, to the maximum extent possible, cost differences. Thus, the expanded classification authority is a key ingredient to reconciling the

potentially competing statutory objectives of pricing flexibility and increased productive efficiency (e.g., ECP-compliant rates).

For purposes of classification changes below the product level, the PAEA affords even greater flexibility. As noted in the Postal Service’s initial comments, for classification changes below the product level (i.e., a new rate category) the Postal Service may simply notice the change in its notice of rate adjustment under section 3622(d)(1)(C). *See* Postal Service Comments at 30-31. The Commission regulations should facilitate the Postal Service’s expanded classification authority as an important element of the PAEA’s promotion of expanded pricing flexibility.

6. Pricing Flexibility for Competitive Products.

There is near-unanimity among the commenters regarding the substantial pricing flexibility afforded to the Postal Service with respect to its competitive products. *See* ABM, GCA, NAA Comments at 12; FedEx Comments at 4; PSA Comments at 3; Pitney Bowes Comments at 37-38; Postal Service Comments at 4, 20. The PAEA is clear that the authority to establish rates and classes for competitive products is vested in the Governors, *see* 39 U.S.C. § 3632, subject to the Commission’s regulations implementing section 3633 which “prohibits the subsidization of competitive products by market-dominant products.”⁹ 39 U.S.C. § 3633. The PAEA also expressly provides the Postal Service with enhanced authority to negotiate contract rates for competitive products. *See* 39 U.S.C. § 3632(3). As with contract rates (NSAs) for market dominant products, the Commission must adopt rules to protect commercially sensitive information and minimize the amount of information that must be publicly disclosed.

D. The Commenters’ Views are in Accord on Achieving Stability and Predictability.

The vast majority of commenters express support for rate stability and predictability – important goals of the Act expressed in the objectives and factors. These will be largely achieved through (1) the annual limitation under (the rate cap) and (2) a schedule of, and required notices concerning, future rate adjustments. These are required features of the modern

⁹ With respect to its competitive products the Postal Service is also subject to the Federal Trade Commission Act and the antitrust laws. *See* 39 U.S.C. § 409.

system of ratemaking. *See* 39 U.S.C. §3622(d). There is substantial agreement on the implementation of the first, and uncertainty with respect to the second.

1. There Is Substantial Agreement on an Approach to Determining the Annual Limitation (Rate Cap).

To the extent that commenting parties addressed how to determine the annual limitation (rate cap), there was substantial agreement. Four parties commented on cap mechanics – ADVO, DMA, Pitney Bowes, and the Postal Service. There was unanimity among the four parties that, for purposes of calculating cap compliance, volume weights should be backward looking to avoid forecasting issues and to provide predictability (i.e., a Laspeyres index). *See* ADVO Comments at 4; DMA Comments at 4; Pitney Bowes Comments at 7-8; Postal Service at 27-28. The Postal Service agreed that the relevant “base period” for purposes of calculating the volume weighted average revenue per piece should be the same 12-month period for which the CPI is calculated. *See* Pitney Bowes Comments at 7; Postal Service Comments at 28.

2. There Is Substantial Uncertainty Around the Required Schedule and Notices.

As the Postal Service points out, “[t]rying to produce a regulatory calendar that harmonizes the statutory provisions of the PAEA, such as the annual compliance review process under sections 3652 and 3653, with these business and customer needs is a challenging task that must receive careful consideration in this proceeding.” Postal Service at 24. Commenters’ suggested schedules and suggested requirements for notices of rate adjustments varied significantly resulting in an unpredictable situation. Following the submission of initial comments, the Postal Service, to its credit, surveyed its customers for their opinions as to the best time to adjust rates,¹⁰ and on April 25, 2007, convened a meeting of parties at which the Postmaster General discussed these issues and presented a possible scenario for an annual schedule and notices. These discussions are ongoing.

¹⁰ We expect the Postal Service will report the results of its survey in its reply comments.

3. The Schedule Should Provide Flexibility, Minimize Burden, and Protect the Rights of Interested Parties.

Although it is the Commission that, by law, must “establish a schedule whereby rates, when necessary and appropriate, would change at regular intervals by predictable amounts,” 39 U.S.C. §3622(d)(1)(B), the Postal Service should be given substantial deference with respect to the timing of rate changes for its products.

One scenario for rate adjustments discussed at the April 25 meeting could serve well as a schedule for the modern system of ratemaking.¹¹ Under this scenario, the notice of intention to increase rates, *see* 39 U.S.C. § 3622(d)(1)(A), and the notice of adjustment, *see* 39 U.S.C. § 3622(d)(1)(C)(i), would be filed concurrently in mid-October of each year. Under this schedule, the Commission would complete its “quick look” review, *see* 39 U.S.C. § 3622(d)(1)(C)(ii), in December, and new rates could be implemented in mid-January.

This scenario has several distinct advantages. First, a mid-October notice filing would allow the Postal Service to use information from the same 12 month period, the previous fiscal year (October to September), for purposes of (1) calculating the relevant CPI period, (2) calculating the relevant “base period” for the compliance determination, and (3) preparing its annual report to the Commission under section 3652. Second, because the Postal Service must file its annual report to the Commission in December, a mid-October notice and January implementation would assure that interested parties have access to contemporaneous cost data and information sufficient to allow a meaningful review or challenge of new rates.

With respect to the notice provisions of section 3622(d), Pitney Bowes urges the Commission and the Postal Service to be mindful of the fact that for mailers and technology providers the adequacy of the notice period will depend on the nature of the proposed adjustment in rates. Thus the length of the notice should depend on whether the Postal Service proposes to change rates alone, as opposed to changes in rates and classifications.

¹¹ This scenario does not address or resolve the myriad of issues complicating the transition to the modern system of ratemaking. All parties agree these issues must be resolved.

E. The Commenters Agree that a Meaningful Right to Challenge Unlawful Rates Must be Preserved.

Numerous commenters recognized the increased importance and expanded scope of the complaint procedures under the PAEA. *See* ABM, GCA, NAA Joint Comments at 1-3; APWU Comments at 12; DMA Comments at 7; NAA Comments at 17; Pitney Bowes Comments at 15-16.¹² A theme echoed throughout the initial comments is the need for the Commission to develop regulations to enable interested parties a meaningful opportunity to review and challenge the Postal Service’s operations, including proposed rate or classification changes. *See id.* Enabling an effective complaint process is fundamental to the transparency objective of the modern ratemaking system. *See* 39 U.S.C. § 3622(b)(6). Several commenters also noted that to give full effect to the complaint provisions the Commission must reconcile these provisions with the data production and annual review provisions. *See* APWU Comments at 13; ABM, GCA, NAA Joint Comments at 5-7; Pitney Bowes Comments at 16.

1. Meaningful After-the-Fact Review: Enhanced Complaint Process.

Simplified procedures for rate changes increase the importance of a meaningful “after-the-fact” complaint process. Under the PRA, interested parties could challenge the lawfulness and propriety of proposed changes in rates in an advance, on-the-record hearing. No longer. Under the PAEA the process for implementing new rates is simplified to promote pricing flexibility for the Postal Service. The Postal Service may introduce new rates without an advance, on-the-record hearing, and proposed rates are subject to only a “quick look” review by the Commission for purposes of determining compliance with the rate cap. As a consequence, the only opportunity for interested parties to review and challenge postal rates is through public comments on the Postal Service annual report under section 3653(a) and through complaints under section 3622. Because there will no longer be any prior review of rates, these “after-the-fact” rights will assume primary importance. *See* ABM, GCA, NAA Joint Comments at 1.

As noted by several commenters, the complaint provisions of the PAEA also are more significant because their scope has expanded dramatically. *See* ABM, GCA, NAA Joint Comments at 2; APWU Comments at 12. Section 3622(a) provides:

¹² We understand that the Commission will likely initiate a separate regulatory proceeding to develop rules for complaints, but believe that these issues are so integral to the development of the modern rate system as to warrant limited discussion here.

Any interested person (including an officer of the Postal Regulatory Commission representing the interests of the general public) who believes the Postal Service is not operating in conformance with the requirements of the provisions of sections 101(d), 401(2), 403, 404a, or 601, or [chapter 36] (or regulations promulgated under any of those provisions) may lodge a complaint with the Postal Regulatory Commission in such form and manner as the Commission may prescribe.

39 U.S.C. § 3662(a).

2. Meaningful After-the-Fact Review: Timely Availability of Relevant Data.

The statutory schedule for the Commission's annual compliance determination, however, creates the potential for a significant passage of time between the Postal Service's implementation of new rates and a substantive review of the data and information underlying them. For example, the Postal Service could file its notice of intention to increase rates under section 3622(d)(1)(A), and its notice of rate adjustment under 3622(d)(1)(C), in November 1 (Year 0) with an implementation date of January 1 (Year 1). Under section 3652 the Postal Service must submit its annual report to the Commission within 90 days of the end of its fiscal year, December 31 (Year 1). The Commission then has 90 days (January (Year 2) to March (Year 2)) to review the annual report, consider public comment, and issue a compliance finding under section 3653. Absent contemporaneous cost data and information underlying the adjustment, interested parties would not have a meaningful ability to review or challenge the new rates for an entire year.

3. Meaningful After-the-Fact Review: Reconciling the Complaint Provisions with the Commission's Annual Compliance Determination.

The Commission's regulations must address the interplay of the complaint provisions under section 3662 and the annual compliance determination under section 3653. Again, the Commission will likely initiate a separate regulatory proceeding to address the complaint rules, but care must be taken to ensure that the compliance process does not severely prejudice the complaint remedy. *See* ABM, GCA, NAA Joint Comments at 5-7; Pitney Bowes Comments at 16.

If the Postal Service does not include cost data and information contemporaneous with the notice of intention to increase rates, interested parties would have no basis on which to challenge an unlawful rate until the Postal Service filed its annual report. Limiting the ability of

interested parties to complain until the annual report is filed, however, diminishes the statutory protections afforded in the expanded compliant provisions and raises unwarranted procedural hurdles for complainants. *See id.*

4. Meaningful After-the-Fact Review: Regular, Periodic Reporting Is The Solution.

The Commission should establish, by regulation, routine data production and transparency requirements (e.g., monthly or quarterly operational reports and data). Routine data production and transparency requirements would facilitate the annual compliance determination process; ensure that interested parties have access to contemporaneous data necessary permitting timely and meaningful review of rate changes, and reduce the administrative burden on the Postal Service and the Commission by deterring unwarranted complaints.

III. CONCLUSION

Pitney Bowes urges the Commission, as it moves forward, to develop and implement regulations that will promote and sustain a vibrant, growing mailing industry, enhance the value of the mailstream for senders and recipients, and ensure universal, affordable postal service by:

- requiring the Postal Service to price consistent with the principles underlying ECP to promote increased efficiency and reduce total postal sector costs, primary objectives of the modern system of ratemaking;
- creating a presumption of validity for ECP-compliant rates to reduce the administrative burden and cost of the ratemaking process and promote greater predictability;
- requiring the Postal Service to achieve the objectives of the Act, and take into account its factors, through rate incentives, discounts, and rules;
- promoting the Postal Service's pricing flexibility;
- establishing a rate cap that provides predictability and stability with respect to the upper bounds of rate increases;
- establishing a rate adjustment schedule that provides flexibility, minimizes burden, and protects the rights of interested parties; and
- preserving a meaningful right to challenge unlawful rates.

Pitney Bowes looks forward to continuing to work with the Commission, the Postal Service, and other stakeholders as the implementation process continues.

Respectfully submitted,

/s/

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