

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

REGULATIONS ESTABLISHING SYSTEM)
OF RATEMAKING)

Docket No. RM2007-1

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
REPLY COMMENTS ON REGULATIONS ESTABLISHING A SYSTEM OF
RATEMAKING IN RESPONSE TO COMMISSION ORDER NO. 2
(May 7, 2007)**

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.
(hereinafter "Valpak"), pursuant to Commission Order No. 2, submit these reply comments to
comments filed on April 6, 2007 by various parties.

**I. NEITHER PRICE-CAP REGULATION, NOR PRICING FLEXIBILITY,
DIMINISHES THE IMPORTANCE OF COSTS.**

A. Price Cap Regulation.

Several parties have observed that the modern regulatory system demanded by the
Postal Accountability and Enhancement Act ("PAEA") is a **price-cap system**, that would
replace the Postal Reorganization Act of 1970 ("PRA") **cost-of service system** in its entirety.
Although this mantra is repeated often, it would be a mistake to make too much of this one
observation.

For example, Alliance of Nonprofit Mailers, National Association of Presort Mailers,
and National Postal Policy Council ("ANM/NAPM/NPPC") argues that "[i]mposing an index-
based cap on postal rates, while leaving traditional cost-of-service rate regulation in place,
would be at odds with the legislative intent" (ANM/NAPM/NPPC Comments, p. 15). First,

the PAEA provides the Commission with virtually no sources of legislative intent. *See* Valpak Comments (Apr. 6, 2007), pp. 3-6. Second, even if there were a conference committee report which could be looked to as a reliable source of legislative intent, the Commission's analysis is required to be grounded in the words of the statute (*see id.*, p. 3), and many parties neglected to provide any meaningful analysis of the text of the statute. Third, this statement is a non-sequitur. The "**cost-of-service**" in cost-of-service regulation and the "**price cap**" in price-cap regulation both exist at the level of the firm and not at the level of a product, or a rate category, or a rate cell.

In his Comments, John C. Panzar, on behalf of Pitney Bowes Inc. ("PB"), explains: "In contrast, *pure* price cap regulation 'decouples' the firm's revenues from its expenditures. As a result, any cost savings achieved by the firm would go directly to its bottom line" (Panzar Comments, p. 11). Truly, price cap regulation is a "bottom line" issue. The difference between these two alternative schemes is whether a firm (i) is assured of total revenues equal to **total costs**, or (ii) is assured of total revenues consistent with a certain **price cap**.

Similarly, as quoted in the Comments of Time Warner Inc., Michael Crew and Paul Kleindorfer explain: "Under the current system of cost-of-service regulation, the only reason for granting a rate increase is that the Postal Service can show that it can no longer cover its costs or that it is in danger in the near future of not being able to cover its costs. The more the Postal Service can show that its costs have increased, the greater the total increase in revenue requirements it can seek (and obtain). As with all systems of regulation that condition revenues on costs in this way, cost-of-service provides no incentives for cost economy or intertemporal efficiency" (p. 11).

Thus, when properly understood, a decision by Congress to implement price-cap regulation tells us nothing concerning the importance of, or the attention that should be given to, recognizing **costs below the level of the overall Postal Service** (and certainly below the class level where the cap is imposed). Costs may or may not be important (Valpak would argue that they are; *see* Valpak Comments, pp. 15-26), but the advent of price-cap regulation does not render them irrelevant.

B. Pricing Flexibility.

Several parties have also confused the issue of pricing flexibility with the importance of costs below the level of the overall Postal Service.¹

Mail Order Association of America (“MOAA”) argues that “[t]he intent of the PAEA is to move beyond cost-of-service pricing and give Postal Service management pricing flexibility, without which there is little, if any, prospect that the purposes of the PAEA will be fulfilled” (MOAA Comments, p. 3). Actually, there is no conflict between either cost-of-service or price-cap regulation and giving “Postal Service management pricing flexibility.” Pricing flexibility can be given or withheld under either regulatory scheme.

The Association for Postal Commerce (“PostCom”) sweepingly asserts that “[t]he language of the statute itself, the hearings before Congress and the antecedents to congressional action make it clear that the ratemaking provisions of the PAEA entirely replace the rigid, overly restrictive and cumbersome cost of service ratemaking under the 1970 Act” (PostCom

¹ The degree to which some have overstated PAEA “pricing flexibility” is discussed generally in Valpak Comments, p. 25, and *infra*. The analysis in this section applies irrespective of the degree to which the Postal Service is intended to have pricing flexibility under PAEA.

Comments, p. 2). However, allowing more frequent rate increases, but restricting each increase to the level of a cap, is not any more rigid, restrictive, or cumbersome than allowing rates to rise to the level of overall costs.

Pitney Bowes refers to the desirability — using the word “should” — of “afford[ing] the Postal Service **maximum** flexibility.” PB Comments, pp. 11-12 (emphasis added). (PAEA refers to flexibility in sections 3622(b)(4) and (c)(7), although in subsection (c)(7) flexibility is discussed generally, not imparted upon the Postal Service.) Similarly, Advo, Inc. (“Advo”) takes the position that “the Commission should allow similar [to private sector] pricing flexibility to the **maximum** extent possible” (p. 6 (emphasis added)), and Sprint-Nextel refers to “**maximum** flexibility” and states that “[f]lexibility is the hallmark of PAEA” (p. 2 (emphasis added)). (Greeting Card Association (“GCA”) refers to flexibility with less flourish, only as a “mandatory” objective (p. 2).) This argument of several mailers illustrates the danger of allowing sweeping rhetoric drown out sound textual analysis, for nowhere does PAEA refer to **maximum** flexibility, or any variation thereof. No basis exists for elevating flexibility and reading such superlatives into PAEA. If Congress wanted “maximum” flexibility, it certainly knew how to so provide. Many factors are highlighted in PAEA as important; flexibility is just one of them.

It is true, as Panzar suggests, that “one of the attractions of price cap regulation is to give the firm increased pricing flexibility without the need for rate by rate cost justification” (Panzar Comments, p. 12). But this does not mean that costs are unimportant or that the Postal Service should be given a license to neglect them. In fact, Panzar’s own conclusion is: “I do strongly recommend that the Commission’s regulations establishing a modern ratemaking

system carry over the fundamental principle of cost-based worksharing discounts established during the PRA regulatory regime” (*id.*, p. 5).

Valpak explained in its initial comments that “[c]ost-based rates have been defined as rates that are based on a recognition of appropriate costs and then on reasoned and informed decisions concerning how far rates should be above costs, *i.e.*, on what the markup should be” (Valpak Comments, p. 22). Allowing the Postal Service a measure of additional pricing flexibility would be given full effect by either (i) reducing the time required to increase rates, or (ii) granting additional latitude to the reasoning provided by the Postal Service for its pricing decisions, rather than the Commission reviewing the record and selecting its own **one best** result in the first instance. However, pricing flexibility certainly does not mean that either the Postal Service or the Commission can disregard costs in rate setting.

II. TRANSPARENCY, DUE PROCESS, AND LIMITS ON WORKSHARE DISCOUNTS REQUIRE THAT THE COMMISSION REVIEW POSTAL SERVICE RATES, SUPPORTING DATA, AND ANALYSIS BEFORE NEW RATES ARE IMPLEMENTED.

Beyond its introduction at (a) and “Transition Rule” at (f), new 29 U.S.C. section 3622 contains four subsections required for the **rate setting** process.

- (b) “Objectives,”
- (c) “Factors,”
- (d) “Requirements” (including the price cap), and
- (e) “Workshare Discounts.”

Then, PAEA describes the other two components of the Commission’s rate responsibilities:

- Section 3652 discusses the Commission’s **annual compliance review**, and
- Section 3662 discusses the **complaint process**.

Commenting parties addressed the relative role to be played by these various tools in the rate setting process, but there is little consensus.

- Alliance of Nonprofit Mailers/Magazine Publishers Association, Inc. (“ANM/MPA”) puts primacy on the **rate cap**. “At the top of the hierarchy, however, is the CPI-based cap established by § 3622(d)(1). This is the only ratemaking standard that the legislation requires the Commission to enforce as an absolute requirement (‘shall ... include’)” (ANM/MPA Comments, p. 4).
- Pitney Bowes puts primacy on the **complaint process** as “the primary avenue of protection for mailers” (PB Comments, p. 15).
- PostCom sees **complaints** as playing a “lesser” role (p. 6).
- American Postal Workers Union (“APWU”) argues that, “to avoid unnecessary complaint proceedings, the Commission should allow for public comment on the rate proposals during this [45 days, or more] notice period” (APWU Comments, p. 8).
- Advo, however, goes the furthest and denies to the Commission virtually any meaningful role:

(a) as to **rate setting**, Advo would require the Commission to defer to the Postal Service on its compliance with all factors, objectives and requirements of the act, stating that ‘[s]o long as the rate increases for a class, on average, fall within

the CPI-U rate cap, [the] Postal Service will be free to implement the rates on an expedited basis, without hearings” (Advo Comments, pp. 1-2);

(b) as to **worksharing**, Advo believes any non-narrow application of “the workshare discount provision could effectively freeze almost all rate relationships within a mail class, thereby undermining the pricing flexibility extolled by the statute” (*id.*, p. 6);

(c) as to the **annual compliance review**, Advo asserts that PAEA “contains ambiguous and potentially troublesome overlaps” (*id.*, p. 6), and that a “‘noncompliance’ determination under section 3653 is an extremely powerful and potentially disruptive tool for dealing with postal rate issues” (*id.*, p. 6). Therefore, according to Advo, the “annual review process is not well suited for addressing complex rate and service issues” (*id.*, p. 7). Further, “the next year’s annual rate increases will overlap in confounding ways with the Commission’s annual rate compliance review for the just-completed preceding year, raising thorny issues at the last moment that the Postal Service [and mailers] could not possibly have contemplated at the time it prepared its new rate request” (*id.*, pp. 7-8, footnote omitted). Finally, Advo asserts that the “Commission should, at least

initially, exercise restraint [in the annual compliance review]”

(*id.*, p. 8).

(d) as to the **complaint** process, while acknowledging some role for it (*see id.*, p. 8), Advo states that it (and the annual compliance review) “should be carefully applied by the Commission in light of its changed role. If interpreted improperly and applied expansively ... [it] could lead to micromanagement of the Postal Service...” (*id.*, p. 2).

However, PAEA cannot work unless the Commission plays a meaningful role. Thoughtful comments were filed by PB, which understands that the Commission must ensure that the **rate process be based on** “transparency” and “due process”:

Enhanced pricing flexibly [sic] must be balanced with the need for **transparency** and with **due process** considerations. Accordingly, the Commission’s regulations should require that the Postal Service’s notice of intention to increase rates under section 3622(d)(1)(A) **include sufficient information to allow interested parties a meaningful opportunity to assess the underlying cost basis for and relationships between rates and to determine compliance with the Act’s objectives and factors.** [PB Comments, p. 14 (emphasis added)].

Valpak agrees with the vital importance of transparency and due process. Further, Valpak believes that these objectives are best achieved in a ratesetting process in which the Commission (not the Postal Service with its monopoly over most letter mail and the use of the mailbox) has the final word in ensuring that the factors, objectives, and requirements of PAEA are achieved.

Lastly, the Commission should be cognizant of the problem raised by placing all of the compliance burden on annual reviews and the complaints process. Any rate changes which emanate from annual reviews or the complaint process will increase the risk of multiple rate changes per year. Despite all of the times that various parties have described the “very short 45-day timeframe” for rate increases (*see, e.g.*, Advo Comments, p. 4), PAEA describes this period as neither a fixed period nor a maximum period, but a minimum period. There is no question that PAEA provides plenty of flexibility to ensure that mailers have both transparency and due process before rates are set.

It should not be burdensome for the Postal Service to lay on the public record the homework that underlies the rates it develops. Indeed, if the Postal Service does not want to develop solid analysis, that would be all the more reason to require that it be filed, so it would need to be developed. Mailers need to be able to inquire into and provide comment on the Postal Service’s rates. The Commission needs to ensure that Postal Service rates comply with the factors, objectives, and requirements of PAEA. Requiring Postal Service analysis be laid on the record and allowing early comment is a good way to lessen the burden on the annual review and the complaint process, likely resulting in a reduction in overall effort.² Since both

² Except for an apparent suggestion of Pitney Bowes that complaints might be filed at or before the date of implementation, most of the above discussion assumes that a complaint would be filed after the annual compliance review, at which time supporting analysis might be most readily available. As American Business Media, Greeting Card Association, and Newspaper Association of America (“ABM/GCA/NAA”) point out, the interaction between the compliance review and the complaint is complex, perhaps deadening: (1) if a complaint were active, and thus already deemed worthy of detailed consideration, no conclusion of compliance could be reached in an annual compliance review, even though the review has a deadline; and (2) it might be difficult for the Commission to conclude that a complaint is worthy of detailed consideration when it has just recently issued a notice of

the annual review and complaint process could result in rate changes, a meaningful review before rate increases are made would maximize the chances that rates are changed no more frequently than annually.

If there is any observation about PAEA which is incontestable, it is that the Postal Service is given greater authority to set rates for competitive products than for market dominant products. However, many parties are encouraging the Commission to give the Postal Service virtually the same broad authority to set rates for market dominant products. That would read the factors, objectives, and requirements of PAEA for market dominant products out of the Act. To the contrary, PAEA requires that the Commission devise a ratemaking system by which the Commission ensures that all of the factors, objectives, and requirements are adhered to, each time rates are to be increased.

III. PAEA DOES NOT REQUIRE THE COMMISSION TO MAKE ANY CHANGES IN ITS RULES APPLICABLE TO NEGOTIATED SERVICE AGREEMENTS.

In their initial comments, three parties (Advo, MOAA, and Sprint Nextel) explicitly address new PAEA subsection 3622(c)(10), which states that, in establishing the system for regulating rates and classes for market dominant products, the Commission shall take into account:

10. The desirability of **special classifications** for both postal users and the Postal Service in accordance with the policies of [Title 39], including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that —

compliance in an annual review. ABM/GCA/NAA Comments, p. 6. Such tangles should be avoided where possible.

- (A) either —
 - (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or
 - (ii) enhance the performance of mail preparation, processing, transportation, or other functions; and
- (B) do not cause unreasonable harm to the marketplace. [Emphasis added.]

Subsection (c)(10) is but one of 14 factors included in section 3622(c). The words “negotiated service agreement” are nowhere used, but this subsection appears to apply to both niche classifications and negotiated service agreements. For reasons discussed below, Valpak suggests that the Commission need not, and should not, make any changes in its rules and procedures for negotiated service agreements (“NSAs”) at this time.

First, the Commission needs to focus its principal attention on procedures for implementing omnibus rate changes for market dominant products under the PAEA.

Second, the Commission also needs to focus attention on the Postal Service’s implementation of service standards and service measurement for all classes of mail. Currently, service measures exist only for single-piece, stamped First-Class Mail, Express Mail, and Priority Mail, which together constitute less than 25 percent of all mail volume. Establishing service measures for all the other classes and subclasses of mail is a major task, far more important than any new rules or procedures for NSAs, and likely will consume substantial time and resources by both the Commission and the Postal Service. As various parties already have commented that it is essential in its effort to reduce costs and earn a profit, that the Postal Service not be allowed to degrade service under the PAEA. *See, e.g., ANM/NAPM/NPPC Comments, pp. 7-9.*

Third, although the PRA did not contain language similar to subsection (c)(10), inclusion of this factor in the PAEA simply gives statutory sanction to what the Commission has been doing for the last five years. PAEA's sanctioning of "special classifications," including niche classifications and NSAs, both of which already exist, does not mandate any change in the Commission's rules, regulations, or procedures. And, contrary to the assertion by MOAA, not one word in subsection 3622(c)(10) provides "**legislative encouragement** of the use of NSAs." MOAA Comments, p. 4 (emphasis added).

Fourth, NSAs are contracts between the Postal Service and one individual mailer. Unlike a special "niche" classification, therefore, by definition, each NSA excludes all other mailers. Under subsection (b), *supra*, each NSA should "not cause unreasonable harm to the marketplace." Valpak suggests that "no unreasonable harm to the marketplace" is a standard that requires prior review and approval by the Commission. It should not "be subject to challenge only through a complaint process," after harm has occurred, as suggested by MOAA (MOAA Comments, p. 5). This statutory requirement could not be fulfilled if the Commission were to dispense with a prior hearing and simply give blank check approval to each and every NSA negotiated by the Postal Service, as urged by MOAA.

Fifth, the legislation expressly mandates that "the Commission shall take into account ... the desirability of special classifications," including NSAs, that "either — (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or (ii) enhance the performance of mail preparation, processing, transportation, or other functions." 39 U.S.C. § 3622(c)(10). Nothing in this section says that the Commission should

ignore the financial implications of NSAs, and any assertion that the Commission should not concern itself with the financial implications of NSAs is a clear misreading of the plain language of the Act.³

Sixth, NSAs between mailers and the Postal Service are comparatively new, experience with NSAs is limited, and the merits of NSAs are still relatively untested and unproven, contrary to assertions about great innovations and potential benefits. Following extended discussions with numerous mailers, the Postal Service recently testified that it sees little potential for cost savings resulting from NSAs.⁴ At least for now, Valpak recommends that the Commission leave in place current regulations for NSA's involving market dominant products and focus on other, more important matters, discussed above.

IV. PERIODICALS FACE A POTENTIAL CONUNDRUM WITH WIDE-RANGING CONSEQUENCES.

Cost and Revenue Analysis ("CRA") reports show that revenues from Periodicals have failed to cover their attributable costs in many recent years. Despite the fact that the Periodicals class has repeatedly experienced above-average rate increases, shortfalls in revenue have occurred because the cost of handling periodicals has increased even faster. It therefore

³ Advo Comments urge the Commission to abdicate its responsibilities and not concern itself with financial implications of NSAs because "any losses on improvident NSAs will be borne by the Postal Service, not mailers" (p. 11). Advo assumes that PAEA provided the Postal Service with a residual shareholder who could absorb losses, but it did not. Under the PAEA, as under the PRA, any losses the Postal Service should incur would need to be made up in the future by mailers.

⁴ See Docket No. MC2005-3, testimony of witness Plunkett, p. 6.

is not surprising that Periodicals mailers, in their initial comments in response to the rulemaking, reflect a keen awareness of the tension and potential conflict and that exist between (i) the CPI-based rate cap and (ii) one factor of the act which contains as a “requirement” that revenues from each class of mail cover their attributable costs.⁵ ABM Comments notes, for example, that:

if Periodical costs continue to increase more rapidly than the CPI, the system devised by the Commission must deal with and solve this question. [ABM Comments, p. 4.]

ABM’s statement summarizes the potential conundrum. Importantly, it should be understood that failure of the Periodicals class to cover attributable costs is not only an “across-the-board” phenomenon. Additionally, a considerable amount of **cross-subsidization** exists **within** the Periodicals class. That is, revenues from some publications — typically those that have a larger circulation and are more finely presorted — cover their attributable costs, often by a substantial margin, while revenues from a number of publications fail, by varying amounts, to cover their attributable costs (such publications typically are those that are circulated nationally, but have a relatively low volume).

A. The Position of Periodical Mailers.

ABM’s proposed resolution of the potential conundrum is that the CPI price cap should “trump” the requirement that revenues from each class of mail cover their attributable costs.

According to ABM Comments at page 4:

⁵ 39 U.S.C. section 3622(c)(2) identifies: “The requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliable identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to each class or type.”

To provide otherwise, and thus to permit excessive cost increases to obliterate the price cap, would be precisely the wrong message and would undermine what is likely the single most important provision of the PAEA.

Other organizations that represent periodical mailers, such as Magazine Publishers of America, Inc. (“MPA”) and Alliance of Nonprofit Mailers (“ANM”), take a similar position. As discussed below, the position that the price cap trump all else is part of a “box” that periodical mailers would create for themselves.

Those periodical mailers who would have the CPI rate cap trump all else apparently also resist any attempt to permit the exigency clause in section 3622(d)(1)(E) to be invoked in a way that would let rates for the Periodicals class increase above the cap, while the CPI-cap stays in effect for all other classes. Their position is that the exigency clause, which allows rate increases in excess of the cap, should come into play only when finances of the entire Postal Service are threatened, not when revenues fail to cover attributable cost in only one class of mail. This position completes the “box” that periodical mailers would create for themselves.

Note that this analysis does not address (1) whether the rate cap should trump all other considerations, or (2) how the exigency clause should be interpreted, but rather focuses on the fully foreseeable consequences that would arise if the above recommendation of the Periodicals class mailers, most of whom supported PAEA, were to be implemented in the new system.

B. The Potential Conundrum May Not Arise.

It is possible that deployment of the new Flats Sorting Machine (“FSS”) machine may enable future costs for the Periodicals class to increase in line with the costs of other classes,

and allow aggregate costs to remain within aggregate revenues provided by the CPI rate cap.

Should this happy event occur, the potential conundrum would become a non-issue.

Moreover, it also is conceivable that the new rate structure approved for the Periodicals class in Docket No. R2006-1, which strengthens the inducements for periodical mailers to reduce the Postal Service's cost of handling their mail, may result in costs for the Periodicals class to increase in line with the costs of other classes, and to remain within revenues provided by the CPI rate cap. This eventuality also could make the potential conundrum a non-issue.

Finally, by substituting a rate cap for cost-of-service regulation, the PAEA allows the Postal Service to earn a profit and pay managers a bonus out of any higher profits. This is a significant change, cloaking the Postal Service with at least one of the attributes of a business. By design, the new law gives management both an incentive and a mandate to control all costs, including the cost of handling Periodicals, through whatever means are available.⁶ If management now is better able to control costs generally, including costs for the Periodicals class, this also could result in the potential conundrum becoming a non-issue.

C. Foreseeable Consequences if the Potential Conundrum Materializes.

In Docket No. R2006-1, the Commission proposed, and the Governors approved, a coverage for the two Periodicals subclasses of 100.1 percent (for Within County), and 100.2 percent (for Outside County).⁷ With such a low coverage, it seems fairly obvious that, if costs of handling Periodicals were to increase faster than the CPI, then from the very outset of the

⁶ One early measure taken by the Postal Service to control costs is increased contracting out for carrier services.

⁷ Docket No. R2006-1, *Op. & Rec. Dec.*, App. G, Schedule 1, p. 1.

PAEA, revenues from the Periodicals class would fail to cover their attributable costs. Such an event would result in the potential conundrum materializing, and turn it into a real issue, which the Commission then would need to resolve. In this scenario, the Commission (as well as periodical mailers) should be aware of the following:

1. Not allowing Periodicals rates alone to increase more than the CPI cap — *i.e.*, restricting the exigency provision so that it applies only when revenues from all classes of mail are inadequate to support the Postal Service — has two immediate consequences.
 - First, it forecloses any possibility of increasing all Periodicals rates in excess of the cap so that revenues from [larger] publications with low costs could continue to cross-subsidize [smaller] publications whose revenues fail to cover their individual attributable costs.
 - Second, if failure of the Periodicals class to cover its attributable costs is allowed, the result will be continuing, permanent cross-subsidization of the entire Periodicals class by other classes of mail (which was contrary to the PRA, and which would contravene the factor in section 3622(c)(2), and therefore appears contrary to any intent of the PAEA). In other words, it would transform the **intra-class cross-subsidy** into a **inter-class cross-subsidy**. Most mailers can be expected to be strongly opposed to any such cross-subsidy between the classes of mail. If magazines with high distribution costs are to be cross-subsidized, any such cross-subsidy should be kept within the Periodicals class.
2. Since the PAEA allows the Postal Service to retain earnings, management now has an incentive to focus on any segment or sub-segment within any class of mail that is unprofitable, and attempt to make it profitable. The most obvious way to do this is to use whatever flexibility it has within the rate cap, and focus rate increases on those components within a class of mail that fail to cover their

attributable cost.⁸ With respect to the Periodicals class, this would mean focusing future rate increases on publications with negative contributions to overhead, which typically are thought to be those magazines which are circulated nationally and have a low volume.⁹

- For those magazines on which the Postal Service loses money, if an increase in rates — even a substantial one — does not eliminate the shortfall between revenues and attributable costs, then the Postal Service nevertheless will continue losing money on that publication, even though the unit loss may be less on each issue.
- What this means is that, under the PAEA, the Postal Service now has a strong vested interest in seeing all publications whose attributable costs exceed their postage revenues either pay more, **or cease distribution through the mail**. In other words, **all publications that require a cross-subsidy in order to distribute their product may be in jeopardy**. This could be an unintended consequence of the PAEA, but it seems a possible, even likely, outcome.

3. Finally, under the PAEA, the “requirement” that revenues from each class of mail cover their attributable costs could be interpreted to mean that the Postal Service has an obligation to focus rate increases on the group of publications

⁸ In the context of the new Periodicals rate structure, this would mean increasing the passthrough of costs up to 100 percent in all rate elements.

⁹ In Docket No. R2006-1, the American Bankers Association’s Initial Comments on Reconsideration of Standard Mail Flats Rates states that:

The new law [PAEA] intends that the Postal Service, in making ... pricing decisions, act more like a business. Indeed the new law specifically creates a regulatory mechanism — a price cap — to force the Postal Service to do just that. By requiring the Postal Service to act more like a private business and operate under a price cap, Congress is seeking to force the postal system to become more efficient, **to eliminate cross-subsidies**, and **to ensure that the rates that are charged actually track costs** and comport with the realities of the modern business environment. [*Id.*, p. 2 (emphasis added).]

that fail to cover their attributable costs. Moreover, should the Postal Service not take any such action (*e.g.*, because of the publicity and political pressure it might generate), such failure to act might constitute valid grounds for (i) a determination of noncompliance of rates during the preceding year, as part of the section 3653 annual review, or (ii) a complaint by affected mailers under section 3662 of the PAEA.

A situation somewhat similar to that described above arises with respect to In-County publications. There, however, National Newspaper Association (“NNA”) blames the problem on poor data quality, rather than on inability of the Postal Service to control the costs of handling newspapers. NNA’s comments state that:

NNA could envision a **perfect storm** under PAEA where the Postal Service argues that the rate cap must be exceeded for all periodicals mail under Section 3622(c)(2), that a grossly uneven magnitude of adjustment for the subclass Within County mail is permitted under Section 3622(b)(8) and that mail processing costs measured within wide margins of error have continued to skyrocket, despite the absence of significant change in mailer behavior and that therefore substantial within county rate increases must be tolerated. [NNA Comments, pp. 8-9 (emphasis added).]

Since NNA represents a separate subclass, Within County publications, which cannot be subsidized by Outside County publications, it too sees the potential problem clearly, but perhaps not the box being created for publications with smaller volume.

V. PAEA DOES NOT SUPPORT WEAKENING THE COMMISSION'S *EX PARTE* COMMUNICATION RULES.

PostCom has stated that the Commission “urgently must give consideration,” in this docket or a separate docket, “to a complete overhaul of its *ex parte* rules.” PostCom Comments, p. 15.¹⁰ Stating that the Commission “did what it could to inform itself of the views of its constituents through site visits and public presentations,” PostCom argues that “in the modern world envisioned by the PAEA, that is simply not enough.” *Id.* PostCom further argues that the existing *ex parte* rules “pose a barrier to the understanding the Commission urgently needs of the industries that are profoundly affected” by the Commission’s regulations and non-adjudicative function procedures. *Id.*, pp. 15-16. PostCom suggests that the Federal Communications Commission (“FCC”) “permit-but-disclose” regulations “may serve as a model for adaptation” by the Commission.¹¹

It is not clear whether PostCom’s recommended “overhauling” of the Commission’s rules would amend existing rules in various unstated ways, or eliminate them, or supplement them.

¹⁰ Valpak did not identify any commenter other than PostCom suggesting that the Commission’s rules regarding *ex parte* communications needed to be overhauled, or even changed.

¹¹ The FCC’s “permit-but-disclose” *ex parte* rules constitute only a portion of the FCC’s intricate regulations concerning *ex parte* communications. *See* 47 C.F.R., Subpart H, §§ 1.1200-1.1216 (Ex parte Communications). *See also* 47 C.F.R. § 1.1206 (Permit-but-disclose proceedings). In other words, the “permit-but-disclose” rules (in any set of regulations) would be part of a greater body of rules, and would make sense only in that context.

Although it may be appropriate in a later rulemaking docket to address the Commission's *ex parte* rules, the urgency for change as part of the rate setting process is not apparent from the substance of PostCom's comments. It does not appear to Valpak that the existing *ex parte* rules have ever in the past constituted a barrier of any kind to the Commission's in-depth understanding of the postal industry, including the Postal Service and the mailing community, as PostCom seems to claim. Furthermore, existing *ex parte* rules appear to provide appropriate safeguards for the protection of the Commission, as well as the mailing industry and the Postal Service.

The Commission's rules regarding *ex parte* communications primarily appear at 39 U.S.C. section 3001.7. Section 3001.7(a) sets forth the definitions of "decision-making Commission personnel" and "non-decision-making Commission personnel." The prohibitions regarding *ex parte* communications are set forth at section 3001.7(b), as follows:

(b) *Prohibition.* In any agency proceeding that is required to be conducted in accordance with § 556 of title 5 [5 U.S.C. § 556] or a proceeding conducted pursuant to Subpart H of this part [Rules Applicable to Appeals of Postal Service Determinations To Close or Consolidate Post Offices], except to the extent required for the disposition of *ex parte* matters as authorized by law:

(1) Interested persons outside the Commission and non-decision-making Commission personnel shall not make or knowingly cause to be made to any Commission decision-making personnel *ex parte* communications relevant to the merits of the proceeding;

(2) Commission decision-making personnel shall not make or knowingly cause to be made to any interested person outside the Commission or to non-decision-making Commission personnel *ex parte* communications relevant to the merits of the proceeding;

(3) Commission decision-making personnel who receive *ex parte* communications relevant to the merits of the proceeding shall decline to listen to such communications and explain that the matter is pending for determination. Any recipient thereof shall advise the communicator that he/she will not consider the communication and shall promptly and fully inform the Commission in writing of the substance of and the circumstances attending the communication so that the Commission will be able to take appropriate action;

(4) Commission decision-making personnel who receive, or who make or knowingly cause to be made, communications prohibited by this paragraph shall place on the public record of the proceeding:

- (i) All such written communications;
- (ii) Memoranda stating the substance of all such oral communications; and
- (iii) All written responses, and memoranda stating the substance of all oral responses, to the materials described in paragraphs (b)(4)(i) and (b)(4)(ii) of this section.

(5) Requests for an opportunity to rebut, on the record, any facts or contentions contained in an *ex parte* communication which have been placed on the public record of the proceeding pursuant to paragraph (b)(4) of this section may be filed in writing with the Commission. The Commission will grant such requests only where it determines that the dictates of fairness so require. Generally, in lieu of actually receiving rebuttal material, the Commission will direct that the alleged factual assertion and the proposed rebuttal be disregarded in arriving at a decision. [39 U.S.C. § 3001.7(b).]

Obviously, there could be certain questions not addressed by the regulations, including questions about what constitutes a “proceeding,” but the existing rules prohibiting *ex parte* communications appear to be reasonable in scope. Furthermore, the regulations specify precisely when the prohibitions apply:

(c) *Applicability.* (1) The prohibitions of paragraph (b) of this section shall apply beginning at the time at which a proceeding is noticed for hearing or appeal unless the person responsible for the communication had knowledge that it will be noticed, in which case the prohibitions shall apply beginning at the time of his/her acquisition of such knowledge. [39 U.S.C. § 3001.7(c)(1).]

Finally, the Commission's existing regulations set forth in 39 U.S.C. section 3001.7(d), the penalties for violation of the *ex parte* rules.

PostCom's claim that the *ex parte* rules need to be "overhauled," without any specifics concerning any problem with the existing rules, appears to be greatly exaggerated. For example, nothing in the existing rules precludes the Commission from understanding the needs of the mailing community, and PostCom has made no showing whatsoever that the existing regulations would even impact deliberations of the Commission with respect to non-adjudicative functions. *See* PostCom Comments, pp. 15-16. Certainly, however, if PostCom means to say that the Commission's existing prohibitions against *ex parte* communications should be eliminated, Valpak would strongly disagree. The existing rules appear to be reasonable, as well as appropriate, with respect to an important facet of adjudication involving persons and entities having adverse interests. Whether the rules should be modified, in view of the Commission's redefined role under PAEA, presents a different question.

The Commission's current *ex parte* rules protect mailers from concern that the Postal Service and the Commission have engaged in backroom meetings regarding adjudicatory proceedings which could compromise the independence of the Commission. Likewise, these rules protect mailers from concern that other mailers and the Commission have engaged in

such backroom meetings. PAEA has not so altered the role of the Commission that PostCom's recommended "overhaul" is necessary.

ABM Comments raise the concern that PAEA re-institutes a "political" element to ratesetting that had been removed during the existence of the PRA, and now "rate-setting ... will be accomplished, in private, at L'Enfant Plaza, rather than, as previously, on Capitol Hill. The location will have changed, but the importance of access will not have." ABM Comments, p. 7. Indeed, if these concerns are well founded, rather than *ex parte* rules being weakened, it will be more important than ever that mailers are able to view the Commission as the final authority that will ensure the mandates of PAEA are adhered to — completely independent of influence from both the Postal Service and powerful mailing interests.

CONCLUSION

The task entrusted to the Commission to develop a modern regulatory system is highly complex and vitally important. This first period of comment has exposed the number of issues that will need to be resolved in this process. Valpak agrees with NNA that "this round of public commentary could well include a second set and even a third set of questions from the PRC to permit both USPS and the stakeholders to address concerns raised by others." NNA Comments, pp. 2-3. Now that many of the issues have been identified, Valpak looks forward to the opportunity to provide additional comments.

Respectfully submitted,

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