

**BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001**

REGULATIONS ESTABLISHING SYSTEM)
OF RATEMAKING)

Docket No. RM2007-1

**REPLY COMMENTS OF
ALLIANCE OF NONPROFIT MAILERS
NATIONAL ASSOCIATION OF PRESORT MAILERS
AND NATIONAL POSTAL POLICY COUNCIL
ON ADVANCE NOTICE OF PROPOSED RULEMAKING**

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Pursuant to Order No. 2, the Alliance of Nonprofit Mailers (“ANM”), National Association of Presort Mailers (“NAPM”) and National Postal Policy Council (“NPPC”) respectfully submit these joint reply comments.

SUMMARY

The most striking aspect of the initial comments is the consensus they reveal against heavy-handed further oversight of rates that satisfy the class-wide CPI cap established by 39 U.S.C. § 3622(d). There is general agreement that Section 3622(d) has priority in the statutory scheme over the “objectives” of Section 3622(b) and the “factors” of Section 3622(c); and that residual regulation of below-cap rates is limited. The supplemental rate constraint and safe harbor proposed by ANM, NAPM, NPPC and Pitney Bowes based on the Efficient Component Pricing Rule is consistent with this light-handed regulatory scheme. The elaborate further ratemaking constraints proposed by the OCA, and the advance review of Negotiated Service Agreements proposed by APWU, are not.

The initial comments of other parties also confirm that the CPI-based rate adjustment mechanism established by Section 3622(d) should be implemented to safeguard against excessive overall rate increases; create incentives for the Postal Service to achieve greater productivity; and avoid time-consuming and burdensome rate litigation during the 45-day period established for Commission review of proposed rate changes.

Finally, the comments also reveal a consensus that the Commission should promulgate rules implementing Section 201 of PAEA as expeditiously as possible. Doing so will minimize the risk of an additional omnibus rate case under the old law. The parties' comments explain how the Commission can minimize the time needed to implement Section 201 by adopting general guidelines, while reserving more detailed determinations for case-by-case adjudication.

COMMENTS

I. REGULATORY OVERSIGHT OF RATES THAT SATISFY THE INDEX-BASED CAP ESTABLISHED BY 39 U.S.C. § 3622(d) SHOULD BE LIGHT-HANDED.

The initial comments reveal a general consensus among the parties that regulation of rates on market-dominant products, apart from the CPI-based rate cap, should be limited. While 39 U.S.C. §§ 3622(b) and (c) specify a variety of factors and objectives beyond the § 3622(d) index mechanism, Congress clearly did not mean to perpetuate (let alone intensify) the traditional regulatory scheme.

Section 3622 establishes a hierarchy of regulatory authority. Congress has directed the Commission to enforce the CPI-based cap of § 3622(d)(1) as an absolute

requirement (“shall . . . include”). Subordinate to this requirement are the nine objectives of § 3622(b). Subordinate in turn to those objectives are the 14 factors of § 3622(c). The rate index mechanism thus clearly has priority in the statutory scheme over the “objectives” of 39 U.S.C. § 3622(b) and the “factors” of § 3622(c). The ultimate objective of this statutory hierarchy is to “replace[] the current lengthy and litigious rate-setting process” for market dominant products. Cong. Rec. S11675 (Dec. 8, 2006) (Sen. Collins); *accord, id.* at S11676 (Sen. Carper); *id.* at S11676-77 (Sen. Frist). ANM-NAPM-MPA at 15-16; *accord, USPS* at 7-8.

Imposing an index-based cap on postal rates, while leaving traditional cost-of-service rate regulation in place, would be at odds with this legislative intent. *Id.* As Senators Collins and Carpers have noted:

The *primary requirement* . . . is the requirement that, for at least ten years, the system “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.” We intended the objectives to supersede the factors in issues affecting the system’s design.

Collins/Carper at 1 (emphasis added).

The parties’ initial comments reveal is a near-universal consensus on these matters. Time Warner emphasizes, for example, that “the Act is intended to substantially increase the flexibility afforded to Postal Service management in design products and setting rates” and “is intended to substantially reduce the burden imposed on the Postal Service and on postal stakeholders by the regulatory process.” Time Warner at 7-9 & n. 4 (quoting statements by various participants at March 13, 2007 PRC/USPS summit in Potomac, Maryland); *accord, Advo* at 2-3, 6-9; *MOAA* at 2-3;

PostCom at 4-10; Time Warner at 8-9, 18-20. The Association for Postal Commerce states that the new legislation gives the Postal Service

unilateral authority to raise prices within the cap limitation, and therefore . . . much greater authority than under the 1970 Act to redefine and reshape its products and service services in accordance with the needs and concerns of its market dominant customers. Second, the price cap regime makes the whole question of the apportionment of institutional costs within the market dominant basket irrelevant. Third, the Commission's rules and its evaluation of the Postal Service's business decisions is not to be judged by a fairness test.

PostCom at 2-3. "So long as the statutorily imposed price cap limitation is observed and the Postal Service does not engage in predatory pricing of competitive products at the expense of the market dominant products or otherwise abuse its legal and *de facto* monopoly over the market dominant products, responsibility for the matter of defining products and pricing is not vested in a 'partnership' between the Commission and the Postal Service. Those powers rest with the Postal Service itself." *Id.* at 5; *see generally id.* at 4-10.

In their initial comments, ANM, NAPM and NPPC explained why a supplemental rate constraint (and safe harbor) based on the Efficient Component Pricing Rule ("ECPR") would protect ratepayers from potential abuse of the Postal Service's residual market power, while giving effect to the Congressional mandate for more light-handed regulation. Coupled with the CPI-based index, the ECPR constraint would require that: (1) aggregate rate increases for each class not exceed the index-based cap established by Section 3622(d), and (2) rate relationships within each class satisfy the Efficient Component Pricing Rule. ANM-NAPM-NPPC at 16-26. The initial comments of Pitney Bowes and Professor John C. Panzar provide additional support for the reasonableness

of this standard. See Pitney Bowes at 3-4, 18-20, 28, 35-36; Panzar Comments, *passim*.

The OCA, by contrast, proposes a variety of elaborate additional constraints on rates for market-dominant rates. OCA at 8-14. These proposals include a scheme for setting rates through “access charges” and “universal-service” fees (*id.* at 9-13); a variant of fully-distributed cost pricing (*id.* at 13-14); a proposal to constrain rates within a specific range of markups above “delivery access costs plus Universal Service costs” (*id.* at 14); and a requirement that each “rate element within a subclass” cover 100 percent of attributable cost plus an unspecified markup, presumably to be set by the Commission (*id.* at 14). Whatever the economic merits of these proposals, they would constitute heavy-handed forms of price regulation at odds with the philosophy of PAEA.

The proposal of APWU to subject each Negotiated Service Agreement (“NSA”) to advance Commission review of whether a proposed NSA “will improve the financial position or enhance the performance of the Postal Service” (APWU at 10-11) is likewise inconsistent with PAEA. As noted above, the only ground contemplated under Section 3622(d)(1)(C) for challenging a proposed rate change during the 45-day review period is that the rate increase exceeds the level authorized by the Section 3622(d) index mechanism. NSAs, however, typically involve *reductions* from generally available rates.

Moreover, an NSA that “enhance[s] the performance of mail preparation, processing, transportation, or other functions” is not required to increase the “overall contribution” of the mail “to the institutional costs of the Postal Service.” 39 U.S.C. § 3622(c)(10)(A). Whether an NSA “enhances the performance” of the specified postal

“functions” is a judgment call clearly not susceptible of regulatory review during the 45-day review period.

Finally, and most fundamentally, the enactment of PAEA has eliminated the putative threat of harm to other mailers that supposedly justified Commission oversight of NSA discount terms in the first place. The Commission has repeatedly emphasized that it exercised this oversight to protect against the risk that the “burden of recovering” any loss in “contribution” resulting from unnecessary or needlessly large NSA discounts “would fall largely on captive monopoly mailers not party to the agreement.”¹ PAEA, however, has eliminated this risk by breaking the link between the contribution from NSAs and the regulatory ceiling on other postal rates. Regardless of the profitability of any individual NSA (or all NSAs in the aggregate), 39 U.S.C. § 3622(d) caps overall increases on other rates to the levels justified by the CPI. If the Postal Service offers excessive or needless discounts to an NSA partner, the Postal Service alone will bear the financial consequences. BAC Comments at 5-7.

For all of these reasons, the APWU proposal for advance review of proposed NSAs should be rejected as inconsistent with PAEA. *Accord*, Advo at 9-11; MOAA at 4-5; PSA at 21-22; Pitney Bowes at 16-17, 31-32.

¹ *Bank One NSA*, MC2004-3 PRC Op. and Further Rec. Decis. ¶ 1004 (April 21, 2006); *accord, id.*, PRC Op. & Rec. Decis. ¶ 1010 (Dec. 17, 2004); *Capital One NSA*, MC2002-2 PRC Op. & Rec. Decis. ¶¶ 1008 (if an NSA reduced the net contribution to the Postal Service from the mailer, “other mailers’ rates would have to increase to make up the difference”), 3062-63, 5061, 5084-85, 8036-37, 8043.

II. THE COMMISSION SHOULD IMPLEMENT THE SECTION 3622(d) INDEX MECHANISM CONSISTENTLY WITH THE POLICIES OF THE ACT.

A. Adjusting Index For Quality Differences

For the reasons explained in the initial comments of several parties, the Commission needs to develop procedures for adjusting the index-based cap to reflect actual changes in the quality and specification of postal services that have a significant and nationwide effect on the cost of supplying or using such services. Failure to do so would allow the Postal Service to evade the index by degrading the quality of its services, or by imposing additional mail preparation requirements on mailers without compensation. ANM/NAPM/NPPC at 7-9; *accord*, DMA at 6; Mulford Associates at 3; NNA at 10-12; OCA at 18-20; Pitney Bowes at 9.

B. Applying Index To New Services

For the reasons noted by ANM, NAPM and NPPC, the Postal Service should be permitted to set the price for a new service with only two regulatory constraints: (1) the “new” service must be an additional option, not a substitute for an existing service; and (2) if the Postal Service offers a less fully bundled version of the new service, the relationship between the prices of the new and existing services must satisfy the Efficient Component Pricing Rule. ANM/NAPM/NPPC at 9; *accord*, Pitney Bowes at 8.

C. Sharing Efficiency Gains With Postal Service Management And Labor

To preserve managerial incentives for efficiency, the Commission should take steps to allow the Postal Service’s management and workers to receive a share of the

Postal Service's future surpluses. ANM/NAPM/NPPC at 10; *accord*, Pitney Bowes at 22, 29.

D. Exigency Clause

- 1. The Commission should decline to specify in advance the circumstances that qualify as sufficiently “extraordinary or exceptional” to allow above-index rate increases.**

The initial comments also confirm that the exigency clause established by 39 U.S.C. § 3622(d)(1)(E) should be applied as sparingly and narrowly as possible. Moreover, the Commission should not attempt to specify in advance the circumstances that qualify as “extraordinary or exceptional,” beyond holding that their adverse financial consequences should be (1) large enough to threaten the Postal Service's financial integrity (i.e., ability “to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States”), and (2) not due to an unreasonable failure to hedge and insure against risk, or any other form of inefficient or uneconomical management. No finding of exigent circumstances should be made without giving mailers and other interested parties the opportunity for the fullest possible hearing on the record, including the rights of discovery, cross-examination and rebuttal, possible within the 90-day period prescribed by 39 U.S.C. § 3622(d)(1)(E). ANM-NAPM-NPPC at 10-12; *accord*, PostCom at 16-17; DMA at 8; Pitney Bowes at 10-11. See *also* USPS at 16 (it would not be “necessary or prudent, in this rulemaking, to specify the situations this exigency standard might cover in advance of an actual need to do so, since it would appear to call for a highly fact-intensive analysis”).

2. The exigency provision of 39 U.S.C. § 3622(d)(1)(E) applies only to cost increases that simultaneously affect all major classes of mail.

The initial comments also confirm that 39 U.S.C. § 3622(d)(1)(E) does not authorize rate adjustments that are limited to individual classes or subclasses of service—and certainly not for classes as small as Periodicals Mail. The “extraordinary or exceptional” circumstances contemplated by Congress are catastrophic and unforeseeable events with a impact comparable in system-wide impact to the 9/11 terrorist attacks and the subsequent anthrax mailings. ANM/MPA at 11-12; *accord*, Collins/Carper at 2; DMA at 8; Pitney Bowes at 10-11.

E. Banking Mechanism

1. PAEA does not authorize cross-class banking.

The Commission should reject APWU’s proposal to allow “cross-class application of banked CPI savings”—i.e., to allow the Postal Service to apply unused rate increase authority from one class as a basis for above-CPI increases on another class. APWU at 8-9. Cross-class banking would be at odds with the language and legislative history of Section 3622(d). *Accord*, Advo at 3; Pitney Bowes at 9.

Section 3622(d)(2)(C) explicitly states that the “annual limitations” imposed by the index under Section 3622(d)(1)(A) “shall apply to a class of mail.” Moreover, Section 3622(d)(2)(C)(i) defines “unused rate authority” as the difference between “the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year” minus “the amount of the rate adjustment the Postal Service actually makes in that year.” Each of these terms, which is stated in the singular, clearly refers to the

“maximum amount” and the “amount . . . the Postal Service actually makes” *for an individual class of mail*. APWU’s reading of the statute would require an elaborate volume-weighted calculation of the total unused rate increase authority (weighted by class), divided by the volume of the class(es) that would be the target of the cross-class bank “withdrawals.” Nothing in the language of the statute suggests that Congress had this Rube Goldberg arrangement in mind. *Accord*, Pitney Bowes at 9.

Cross-class banking would also be inconsistent with the legislative history of Section 3622(d). The legislative history reflects years of debate and deliberation over the breadth of the baskets of products to which the index adjustment should apply. In S. 2468, the postal reform bill passed by the Senate Homeland Security and Governmental Affairs Committee in the 108th Congress, the choice of groupings for application of the index was to be left to the regulator. The committee noted:

The Committee expects that the Postal Regulatory Commission, in public proceedings and with the input of all interest parties, will fully and carefully evaluate the merits of a wide range of rate cap structures. This consideration should include, but should not be limited to . . . the definition of the product groupings to which the caps will be applied.

S. Rep. No. 318, 108th Cong., 2d. Sess. 10 (Aug. 25, 2004).

The predecessor of PAEA passed by the same Committee in the 109th Congress, however, abandoned this open-ended approach by specifying directly that the rate index must be applied at the class level:

The annual limitation under paragraph (1)(A) shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.

S. 662, 109th Cong., 1st Sess. (reported June 22, 2005), § 201(a) (proposed 39 U.S.C. § 3622(d)(2)(A)). This Senate Committee adopted this provision notwithstanding a letter from the Board of Governors of the Postal Service expressing a preference that the index be applied at the level of the Postal Service's aggregate revenues. Letter of the Board of Governors of the U.S. Postal Service to Chairman Susan Collins (February 24, 2005).

The predecessor of PAEA passed by the House of Representatives would have disaggregated the relevant product baskets even further, applying the index as a separate constraint on each *subclass*:

In the administration of this section, the Commission shall not permit the average rate in any *subclass* of mail to increase at an annual rate greater than the comparable increase in the Consumer Price index, unless it has, after notice and opportunity for a public hearing and comment, determined that such increase is reasonable and equitable and necessary to obtain the Postal Service, under best practices of honest, efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

H.R. 22 (reported by the House Committee on Government Reform on April 28, 2005) at § 201(a) (proposing language to be codified at 39 U.S.C. § 3622(e)) (emphasis added). "To ensure fairness," the Committee explained, "the new system provides that rates from any one subclass should not increase faster than CPI." H. R. Rep. No. 66, 109th Cong., 1st Sess. 48 (April 28, 2005).

The version of the legislation ultimately enacted into law resolved the conflict between the Senate and House bills by defining the relevant baskets as classes rather than subclasses. 39 U.S.C. §§ 3622(d)(2)(A); see *also* USPS at 12-13 (discussing

legislative history). The final version of the legislation did not, however, restore the earlier Senate version that would have a established single index basket consisting of market-dominant mail. See USPS at 12-13 (citing provisions). Allowing unused rate increase authority to spill over into other baskets would effectively merge the multiple class-specific baskets into a single basket, accomplishing precisely what Congress rejected.

F. Procedures For Rate Review During 45-Day Review Period.

1. Challenges to proposed rate changes during the 45-day review period should be limited to issues involving compliance with the index formula.

The initial comments also reveal a general consensus that the grounds for challenges to index-based rate increases during the 45-day review period should be limited to alleged noncompliance with the Commission rules defining the index formula. Parties wishing to raise other issues, including the lawfulness of below-cap rates, should be required to do so in the Commission's annual review of rates, or by initiating a complaint proceeding. ANM/MPA at 12.

APWU, however, urges the Commission to rewrite Section 3622(d)(1)(C) to allow consideration of ratemaking factors of Section 3622 apart from compliance with the CPI index. APWU at 7-8. Valpak proposes an advance review period of four months to allow an elaborate "multi-faceted" review of each set of proposed rate changes for compliance with all of the requirements, objectives and factors of PAEA. Valpak at 29-35.² The short answer to these proposals is that Congress limited the potential

² *Accord*, ABM at 5 & n. 2 (asserting, without explanation, that ABM "does not read" § 3622(d)(1)(C)(iii) as limiting the issues to be considered during the 45-day period).

remedies for a violation identified during the 45-day review period to (1) *notifying* the Postal Service that one or more rate increases exceeded the CPI-based limit (39 U.S.C. § 3622(d)(1)(C)(iii)), and (2) requiring the Postal Service to *respond to such a notice* from the Commission concerning a violation of the CPI-based limit (*id.*, § 3622(d)(1)(C)(iv)). Review of postal rates on other grounds must occur under the after-the-fact review mechanisms of §§ 3653 and 3662. *Accord*, Advo at 1-5; Collins/Carper at 2; Pitney Bowes at 14; Time Warner at 16.

2. Section 3622(d) does not prescribe the frequency or timing of CPI-based rate adjustments.

Several parties recommend that the Commission prescribe the maximum frequency or implementation date of CPI-based rate adjustments. See, e.g., PostCom at 12 (once a year); DMA at 5; *cf.* Pitney Bowes at 30 (allowing multiple rate changes per year); Time Warner at 14-51. Section 3622(d), however, imposes no such constraints on the Postal Service, but merely requires that CPI-based rate increases occur “at regular intervals by predictable amounts.” 39 U.S.C. § 3622(d)(1)(B). Beyond those restrictions, the statute appears to leave the frequency of CPI-based rate increases to the discretion of the Postal Service. In any event, transaction costs—for both the Postal Service and its customers—will serve as a practical check on the number of rate changes implemented in any given year. And the aggregate *amount* of multiple increases taken within a year may not exceed the aggregate percentage increase in the CPI during the most recent 12-month period before the Postal Service first gives notice of an adjustment for the year. *Id.*, § 3622(d)(1)(A).

A related issue is the relationship between the 45-day review period and the pendency of annual review proceedings under Section 3653 and complaint proceedings under Sections 3662 and 3663. The pendency of either kind of proceeding should not be an obstacle to the filing of rate changes under 3622(d). The Postal Service should apply index adjustments to the rates in effect when it gives the requisite notice under Section 3622(d)(1)(C). If the Commission later prescribes changes to the underlying rates pursuant to 3653 or 3662, the Commission can simultaneously order changes to the increased rates as well.

III. PRC SHOULD PROMULGATE RULES IMPLEMENTING SECTION 201 AS EXPEDITIOUSLY AS POSSIBLE.

The parties' initial comments display a wide range of views on the appropriate timetable for issuing final rules in this proceeding. There is a general consensus that the Commission should issue final rules expeditiously, in accordance with the desire expressed by Chairman Blair at the March 13 summit to have a new ratemaking system in place within 12 months after enactment of PAEA. See DMA at 2; MOAA at 4; PostCom comments at 3; Time Warner at 20-21; USPS at 4, 7-8; *cf.* Valpak at 2 (recommending that the Commission "take the full 18 months" allowed by PAEA).

ANM, NAPM and NPPC agree with other parties that the Commission should attempt to issue new rules sooner than required by the statute. Among other things, this would avoid giving the Postal Service an occasion to file another omnibus rate case under pre-PAEA law.³ The Commission can minimize the time needed to issue new

³ *Accord*, DMA at 2. Senators Collins and Carper, the co-authors of the final version of PAEA as enacted, have both urged the Commission to implement Section 201 as quickly as possible for this reason. ". . . I would strongly discourage the Postal Service from filing a 'final' rate case under the old rate setting rules before postal reform is fully

rules by focusing on the standards and procedures needed to implement the CPI-based rate adjustment mechanism of Section 3622(d). To implement the remaining objectives, factors and provisions of the Act, the Commission might establish some more general guidelines such the proposed constraint and safe harbor based on the Efficient Component Pricing Rule (as suggested by the undersigned parties and Pitney Bowes), and reserve more detailed determinations for case-by-case adjudication. *See also* USPS at 4. We stand ready to provide any additional comments or other information that would assist the Commission in meeting its desired goal.

implemented. Filing a new rate case would divert resources and effort from developing a modern system of rate regulations are required under the new postal reform law.” Statement of Sen. Susan Collins, Hearings before the Subcom. on Federal Financial Management, Government Information, Federal Services, and International Security of the Sen. Comm. on Homeland Security and Government Affairs (Apr. 19, 2007). “I’d rather have the next rate increase occur under the new rules, not the old rules, so I look forward to hearing from you, Chairman Blair, about where we are in the rulemaking process and what help you might need from us and from the Postal Service in getting the new system up and running sooner rather than later.” Statement of Sen. Thomas R. Carper, Hearings before the Subcom on Federal Financial Management, Government Information, Federal Services, and International Security of the Sen. Comm. on Homeland Security and Government Affairs (Apr. 19, 2007).

CONCLUSION

The Alliance of Nonprofit Mailers, National Association of Presort Mailers and National Postal Policy Council respectfully request that the Commission adopt the standards and procedures proposed herein and in the same parties' initial comments.

Respectfully submitted,

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