

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

Regulations Establishing System )  
of Ratemaking

Docket No. RM2007-1

OCA COMMENTS IN REPLY TO THOSE FILED  
IN RESPONSE TO ORDER NO. 2  
(May 7, 2007)

The Reply Comments of the Office of the Consumer Advocate (OCA) are directed primarily at the issue of whether to apply the rate cap and pricing factors of the Postal Accountability and Enhancement Act (PAEA) to classes of mail, or to subclasses. This issue was raised by the Postal Service in its Comments.<sup>1</sup> OCA also challenges the Postal Service's proposal to combine all of the discrete Special Services into one class for purposes of applying §3622(d) of title 39. It is the position of OCA that Congress intends that the Commission begin the new regulatory system by carrying forward the current Domestic Mail Classification Schedule and applying pricing mechanisms at the subclass level, not at the class level. OCA also disagrees with the Postal Service's view that changes below the subclass level are not subject to the procedures of 39 U.S.C. §3642.<sup>2</sup>

Chapter 36 of title 39 contains the framework for the modern system of rate regulation. Section 3622 of the PAEA, like its predecessor in the Postal Reorganization

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<sup>1</sup> "Initial Comments of the United States Postal Service," April 6, 2007, at 12 – 13.

<sup>2</sup> Id. at 30 – 31.

Act (PRA), articulates the most important mechanisms, with the rate cap chief among them. Section 3622(d)(2)(A) provides that “the annual limitations . . . shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule [DMCS] as in effect on the date of enactment of the Postal Accountability and Enhancement Act.”

It is evident from this language that Congress envisioned application of the price cap according to the practices and traditions of the Commission developed over decades. The DMCS embodies a careful balancing of classification and pricing theory that best protects the interests of the public and maintains the financial health of the Postal Service.

The most important policy statement of the Commission on the role of classes, subclasses, and rate categories in the DMCS was presented in PRC Op. MC95-1, beginning at para. 3019, in a section entitled “The Distinctions among Classes, Subclasses, and Rate Categories.” There, the Commission described its longstanding practice of establishing subclasses of mail that have “unique characteristics . . . which would warrant an independent application of all of the §3622(b) ratemaking criteria . . . .”<sup>3</sup> The Commission continued: “[T]he classes should only be subdivided when a valid reason to do so exists, *such as to allow better application of the statutory ratemaking criteria.*”<sup>4</sup> “[T]he Commission during the last two decades has developed a classification schedule composed of classes, subclasses, and rate categories within subclasses. To allow for more precise tailoring of rates to the full extent of the Act’s

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<sup>3</sup> PRC Op. MC95-1, para. 3019, quoting PRC Op. 77-1 at 247.

<sup>4</sup> Id. (emphasis added).

criteria, the Commission has extended both the distribution of attributable costs and the assignment of institutional costs *to the subclass level*.”<sup>5</sup>

More than 35 years of price setting has led the Commission to cleave to the view that application of the pricing criteria at the subclass level is the best way to fulfill Congressional principles and objectives. Section 3622(b) pricing criteria should be applied at the subclass level since it is at this level that mail groupings have been established to reflect “unique content, value of service, elasticity of demand [and] required levels of service.”<sup>6</sup> It is only at the subclass level that a separately determined cost coverage is relevant and appropriate.<sup>7</sup>

In Docket No. MC95-1, the Commission created two new subclasses out of Bulk Regular Rate Third-Class Mail. The new subclasses were Enhanced Carrier Route and Regular. This decision was based, in part, on the cost differences between the two types of mail, but, more importantly, the Commission found that the two types of mail had significantly different own-price elasticities. This allowed for the creation of “more homogeneous subclasses,” by grouping mailers with similar price sensitivities.<sup>8</sup> The Commission’s goal of applying the pricing factors to more homogeneous groups of mail

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<sup>5</sup> Id., para. 3021 (emphasis added).

<sup>6</sup> Id., para. 3035.

<sup>7</sup> PRC Op. R77-1 at 248.

<sup>8</sup> PRC OP. MC95-1, para. 5344.

was satisfied by creating two subclasses with distinctly different cost and market characteristics.

A close reading of §3622 under the PAEA shows that Congress intended that the Commission continue to apply the theory evolved over decades of successful ratemaking and classification decisions – the annual price cap limitations “shall apply to a class of mail, *as defined in the Domestic Mail Classification Schedule on the date of enactment of the Postal Accountability and Enhancement Act.*”<sup>9</sup> It is evident that Congress had great respect for the work performed by the Commission since the enactment of the PRA – whatever classification schedule the Commission had devised as of December 20, 2006, would be the basis for rate caps for the entire decade following PAEA enactment. Congress did not suggest the slightest deviation from the schedule that had resulted from earlier Commission decisions.

In the other parts of paragraph §3622, namely parts (b) “Objectives” and (c) “Factors,” there are tiers of pricing criteria that follow the structure and format of former §3622 under the PRA. The factors, largely, are taken verbatim from the PRA. This includes numerous references to “class of mail or type of mail service,” e.g., (c)(1) “the value of the mail service actually provided each class of mail or type of mail service” and (c)(2) “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.” As was indicated above in Commission statements quoted from PRC Ops. MC95-1 and R77-1,

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<sup>9</sup> Emphasis added.

the Commission has never deviated from its position that “class of mail” actually means “subclass of mail” for purposes of applying the §3622 pricing criteria.

In order that a coherent, harmonious system of pricing operate as effectively under the PAEA as it did under the PRA, the Commission should continue to apply the pricing criteria of §3622, including the new price cap requirement, to subclasses, not classes of mail.

At page 13 of its Comments, the Postal Service presents a list of the classes that it believes are subject to application of the price cap. While OCA disagrees with the groupings listed, it does concur in a premise implicit in the list – the list of mail groups to which the price cap should be applied is not the same as the list of market-dominant products set forth in §3621. For example, while “first-class mail letters and sealed parcels” and “first-class mail cards” are listed as separate products, the Postal Service has collapsed the two into a single First-Class Mail group. Likewise, the Postal Service combines the four distinct Package Services subclasses – single piece parcel post, media mail, library mail, and bound printed matter into one mail grouping. As argued above, OCA has concluded that Congress intends that the Commission use its expertise, sharpened over decades of postal ratemaking experience, to apply the price caps and pricing criteria to subclasses of mail. This is true of periodicals and standard mail, which are listed as single mail groups. The logic for treating Special Services as discrete products for pricing purposes is unassailable.

The Postal Service’s comments wrongly suggest that the CPI-U price cap should treat all Special Services as one class for purposes of applying the CPI-U price cap.

The import of this position is that the Postal Service would allow the Postal Service to place into one large pot all of the rates of the various special services for purposes of adjusting the individual rates so that, pursuant to a rate increase, only the total of all special service rates would need to be consistent with the CPI-U, while at the same time adjusting the individual Special Service fees as the Postal Service chooses. It is difficult to even imagine how this would be administered on a practical level because of the variety of services within the rubric of Special Services. Apart from the practical difficulties the Postal Service's suggestion engenders, a careful reading of the PAEA indicates that Congress did not intend the Special Services to be combined into one group or class for purposes of implementing the CPI-U.

The Postal Service recognizes its suggestion is based only upon its reading of the statute. The Postal Service states: "Based on this language *as well as the PAEA's categorization of which products are market-dominant* the Postal Service *interprets* this [PAEA language] to mean that the CPI -U price cap should be applied separately at the class level to the following classes:...Special Services." (Emphasis supplied, footnote omitted, USPS Comments at 13). The Postal Service's interpretation is not supported by the specific language, or even the structure, of the Act.

First, the Postal Service draws a convenient but erroneous conclusion by pointing to the list of categories including "Special Services" defined as market-dominant in §3621 of the PAEA and suggests those are the classes of service contemplated by the language in §3622 that shall be subject to the CPI-U adjustments. Yet, that list merely defines the types of mail to which the Market-Dominant provisions of the PAEA are applicable.

The types of mail listed in §3621 are not deemed “classes” of mail for purposes of the PAEA. Section §3621 does not refer to the ten items on its list as “classes.” Rather, the items listed are referred to specifically in the next subsection (§3621(b)) as “mail matter,” rather than “classes” of mail. Moreover, §3621(b) further states the mail matter “shall, for purposes of this subchapter, be considered to have the meaning given to such mail matter under the mail classification schedule....” Thus, the list of mail matter in §3621(a) cannot be construed as indicating a Congressional intent to define each of the enumerated items in that list as the “classes” of mail referenced in the other section of the PAEA, §3622, which provides that a “class” of mail shall be subject to the annual limitations of the CPI-U.

Second, Special Services is an amalgam of services bunched together in the DMCS for purposes of convenience. Special Services is not a class. Rather it is a catch-all phrase that includes various, miscellaneous services that are themselves ancillary to the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, or transportation, as postal service is defined in §102 of the PAEA.

Each of the Special Services defined in the DMCS is a separate class of mail. For instance, each Special Service has its own independent fee schedule unrelated to the fee schedules of other special services and not dependent upon the fees charged for any other service or type of mail. None of those fee schedules are related for pricing purposes. For purposes of pricing, the Commission treats each special service separately and distinctly from each of the other special services. That is, each special

service has its own costs and fees derived from the demand for that particular service. None of the costs for any special service are combined with the costs of any other special service or apportioned among other special services. The Commission does not consider historic inter-subclass cost coverage relationships among the special services when special service classes are adjusted or created. See PRC Op. MC95-1 at II-29.

When creating a new special service, the PRC does not treat each special service as a subclass, rather it treats it as a new class because it does not reexamine the effective coverage which would apply to any service remaining in the former class. When a new special service is developed, each special service fee is calculated on the basis of the cost of the service provided and the demand for that service and only that service. When adjustments are made to the fees in one of the Special Services, the Commission does not make a corresponding and offsetting adjustment to any of the other special services in an attempt to maintain rate relationships within a subclass or class of Special Services. The Commission does not seek to maintain an overall level of contribution to institutional costs for all Special Services combined, but measures them individually. This is another clear indication that none of the special services is a subclass of a larger class, but that each is a class of service with its own costs, markups and demand for service.

Thus, regardless of whether the CPI-U should be applied to subclasses within the DMCS as the OCA believes, or whether the CPI-U should be applied only to classes as the Postal Service has suggested, Special Services are historically treated

separately as many individual classes rather than as subclasses which together comprise a single class of service. The Commission must, therefore, reject the Postal Service's interpretation of the PAEA that Special Services represent one single class of service to which the CPI-U price cap should be applied separately and should treat each Special Service as a separate class for purposes of the CPI-U limitations.

With respect to changes in mail classification, OCA agrees, for the most part, with the Postal Service's comments at pages 29 – 30:

The concept of a mail classification has not been abandoned under the new law.

The PAEA explicitly requires the Commission to maintain the lists of market-dominant and competitive products by adding new products, removing products, or transferring products. These are acts of mail classification.

There should be a prior review by the Commission of classification changes below the subclass level.

OCA disagrees, however, with the suggestion that the Commission must (or even should) follow the 45-day process specified in §3622(d)(1). Congress established the highly expedited 45-day price increase process in order to preserve the financial health of the Postal Service, i.e., give it a rapid infusion of new revenues on a regular, predictable basis. The addition, subtraction, or modification of rate categories, however, would rarely be essential to the Postal Service's financial well being. There is no reason that classification changes of all types cannot be processed in a more thoughtful, deliberative manner. If an emergency ever arises, requiring a highly expedited change (even in as little as 45 days), the Commission and most members of

the public would certainly cooperate in completing proceedings in the time required by the Postal Service.

Wherefore, OCA respectfully submits these reply comments and asks that they be considered by the Commission.

Respectfully submitted,

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