

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
ON RECONSIDERATION OF RATES FOR STANDARD MAIL
(May 11, 2007)

On February 26, 2007, the Commission issued its first Opinion and Recommended Decision in this proceeding. On March 19, 2007, the Governors of the Postal Service issued their Decision in response, allowing the recommended decision to take effect under protest, and returning three matters to the Commission for reconsideration. Pursuant to Commission Order No. 13 (April 27, 2007), on May 4, 2007, the Postal Service and other parties filed initial comments with respect to the reconsideration of rates for Standard Mail. Also in accordance with that Order, the Postal Service hereby provides its reply comments in response to the initial comments submitted by other parties.

In addition to those filed by the Postal Service, eight sets of initial comments in response to Order No. 13 were filed on May 4.¹ Comments were filed on that date by the American Bankers Association (ABA), CCM, DMA, Discover, MOAA, Postcom, and

¹ An earlier set of comments was filed on May 2 by ABM, but those comments were limited to explaining why mailers of publications have an interest in Standard Mail as well as Periodicals rates, and expressing (without details) general support for some reduction in rates for Standard Mail flats.

Valpak, while a set of joint comments was filed by Financial Services Roundtable, MMA, NAPM, and NPPC (hereinafter “Joint Comments”). In general, the parties at least express sympathy with the view taken by the Governors that the magnitude of some of the rate increases recommended for Standard Mail flats created legitimate cause for concern. (The sole exception to this appears to Valpak, but based on its understanding that Standard ECR rates are not within the scope of reconsideration – an understanding certainly shared by the Postal Service – Valpak has made no affirmative suggestion other than that the Commission base its reconsideration on record evidence.) Beyond this, however, the comments vary widely in terms of how the Commission should address such concern.

For example, the comments of both Discover and the ABA seek to preserve the previously recommended rates for letters, and would therefore limit any rebalancing to rate cells within flats, as opposed to between flats and letters. Neither of those two comments, however, provides any general guidance (much less any details) on exactly how meaningful and appropriate rebalancing within the rates for flats could be accomplished. In Order No. 13, the Commission expressly invited parties advocating that rate adjustments be limited to flats to identify the specific rate cells to be increased or decreased. Since neither Discover or ABA, nor any other set of comments, provide the requested specificity, it is obvious that the difficulties with the flats-only approach identified by the Postal Service (Initial Comments at 9-10) have not been addressed. Based on those difficulties, as well as on the failure of its advocates to present any concrete proposals, the Postal Service submits that the flats-only approach should not

be pursued further.

On the other hand, the comments of MOAA and CCM express support for rebalancing between flats and letters. The CCM comments, in particular, provide further explanation of why an attempt to confine rate adjustments to the rates for flats would not be appropriate. CCM Comments at 11. CCM also expressly defers to the Postal Service for identification of specific rate adjustment proposals for flats and letters. *Id.* at 10.

The Joint Comments, in contrast, urge the Commission to make no change in its rate recommendations for either flats or letters. To reach this recommendation, the Joint Comments correctly conclude that any rate reductions for some types of mail emanating from this reconsideration process will necessarily need to be offset by rate increases for others. Rate rebalancing is indeed a zero-sum game (see Joint Comments at 2-3), a conclusion which seems to have eluded certain other parties, as discussed below.

Nonetheless, despite hitting the mark on this portion of the argument, the Joint Comments are plainly off the mark on other portions. For example, the Joint Comments claim:

No one has disputed that shape-related rate differentials which fail to cover 100 percent of shape-related cost differences violate ECPR, and are therefore inefficient. See R2006-1 PRC Op. & Rec.Decis. ¶¶ 4001-4020 (explaining why postal rate relationships should satisfy the Efficient Component Pricing Rule); *id.*, at ¶¶ 4023-4038 (explaining why ECPR requires that rates reflect cost differences caused by shape).

Joint Comments at 4. Not only is this claim demonstrably and egregiously false, but

citation to the portion of the Commission's Opinion which would provide facts to the contrary appears to have been deliberately obfuscated. In ¶ 4022, one of only two paragraphs between ¶¶ 4001 and 4038 omitted from the citations shown above, the Commission itself acknowledged:

Most parties ... agreed that ECP applies to worksharing only and that worksharing does not include shape.

PRC Op., R2006-1 at 86. Clearly, the parties filing the Joint Comments are entitled to express their opinion on this subject, and are likewise free to observe that the Commission's Opinion in Docket No. R2006-1 to some extent appears to support their opinion, but that is no excuse for distorting whether or not other parties have "disputed" that view. While just one dissenting voice would be sufficient to belie the claim that "no one" has disputed that ECP theory can be extended beyond worksharing to shape-based cost differences as well, in actuality, as the Commission states, "most parties" engaged in the debate have disagreed with that contention. The Postal Service has sided with the majority, for example, presenting rebuttal testimony from Dr Kiefer (USPS-RT-11 at 15-19) in which he agrees with Prof. Sidak (and thus disagrees with the Joint Comments) on exactly this issue. The Joint Comments (at 4-6) build an elaborate house of cards using the alleged "silence of the flat mailers and their allies" as its foundation, but such a foundation can be sustained only by ignoring the evidence of record.

Equally disturbing (and erroneous) is the apparent claim that the Commission lacks the legal authority upon reconsideration to recommend different rates on the basis

of the same evidentiary record. The Joint Comments suggest that providing rate relief for flat mailers would cause the Commission to “deviate” from the findings in its first Opinion, and would therefore be arbitrary and capricious. Joint Comments at 13. The implicit assumption upon which this claim must be premised is that there is one, exclusive set of rates which are lawful, and any rate recommendations which deviate from this set of rates consequently must be unlawful. The Commission long ago rejected such a mechanistic approach to its ratemaking responsibilities:

Developing rate recommendations in an omnibus rate case involves balancing a great number of factors to derive literally thousands of rates which all must qualify as fair and equitable. Some of these factors are complementary, but others are less so – there are valid reasons for restraining rate increases for all classes of mail, and arriving at a balanced recommendation is an iterative process.

There is no single set of rates which is so “right” that any deviation from it would produce rates which would be unlawfully unfair or inequitable. But the task of developing a single set of rates which all meet the test of being consistent with the numerous policies set out in the Postal Reorganization Act requires innumerable value judgments.

PRC Op, R87-1, Vol. 1 at 360 (emphasis added); PRC Op. R2001-1 at 45. The Governors have requested the Commission to reconsider its recommendations for Standard Mail to explore whether an acceptable alternative set of rates, one which rebalances rate increases for flats and letters, could be selected. Very clearly, the Governors are asking the Commission to revisit some of the “innumerable value judgments” implicit in the Standard Mail rate design.

The case cited on page 13 of the Joint Comments, *Assoc. of Oil Pipe Lines v FERC*, 281 F3d 239 (DC Cir 2002), is thus inapposite. In that case, for purposes of

calculating the price cap index for rates charged by oil pipelines, FERC substituted a new computational methodology for the one used previously. On appeal, the court held that FERC failed to provide an adequate explanation for the change in methodology. In this situation, however, the issue is not the relative merits of competing empirical methodologies (such as might be the case if the Governors were contesting the Commission's estimates of cost differences), but the much more subjective process by which all of the ratemaking factors are balanced, as described by the Commission in the above quotation from its Opinion in Docket No. R87-1. Moreover, while the Joint Comments on page 13 would prefer to focus on the Commission's alleged statements in ¶ 5470 of the Opinion regarding the "unfairness and inefficiency of incomplete pass through of shape-related cost differences", in the very next paragraph, ¶ 5471, the Commission itself noted one instance of its departure from ECP with respect to Standard Mail flat rates because of rate shock concerns. PRC Op., R2006-1 at 249. Thus, additional departures from ECP based on the same rationale (potential rate shock) could not accurately be characterized as an attempt to "reverse course" (Joint Comments at 13) of the type challenged in the FERC case, as opposed to an extended application of a balancing approach already embraced by the Commission in this proceeding.

Moreover, the flaw in FERC's conduct identified by the court in the *Pipe Lines* case was not the change in approach *per se*, but rather a failure to provide an adequate explanation, particularly in light of objections raised by the parties during the proceeding. It is grossly premature for the Joint Comments to suggest that, if the

Commission were to decide upon reconsideration that rate adjustments are warranted, it would not adequately explain the reasoning by which that conclusion were reached. The Postal Service is confident that the Commission would provide appropriate explanation of any new recommendations it might make upon reconsideration.² If, however, the statutory option to seek reconsideration is to serve its intended purpose, the Commission must have the flexibility to refocus on the selected matters returned by the Governors and decide, after further deliberation, whether its initial recommendations can be improved, consistent with the evidentiary record and the policies of the Act. Contrary to the arguments made in the Joint Comments, neither the *Pipe Lines* case nor any other relevant legal authority suggests that the Commission lacks that flexibility.

The last two sets of comments, those of DMA and Postcom, offer similar arguments (relative to each other) in support of similar conclusions – the Commission should reduce the rates for flats, but not make any compensating adjustment in any other rates.³ Their proposals are, quite simply, untenable. They would have the Commission abandon its obligation to recommend rates designed to allow total postal revenues to equal total costs, thereby ignoring the breakeven requirement which is the bedrock of ratemaking under the Postal Reorganization Act. To attempt to support their

2 Good examples of how the Commission has recently done so with respect to the nonmachinable surcharge for First-Class Mail letters and the Priority Mail flat rate box can be found in the Commission's April 27, 2007 Opinion and Recommended Decision on Reconsideration in this docket.

3 The two differ in terms of what type of reductions they seek in the rates for flats. Postcom seeks an across-the-board reduction (of an unspecified magnitude) in each rate cell, while DMA seeks recommendation of the flat rates originally proposed by the Postal Service last year. Postcom's comments in this respect are much more in accord

proposal, these parties offer two lines of argument. First, they suggest, uncertainty about the volume forecasts would justify an asymmetric rate adjustment. Second, they argue, the Commission should consider the contingency provision as an appropriate source of funds to cover the revenue shortfall from an asymmetric rate adjustment. Neither line of argument, however, supports the extreme course of action the parties are urging the Commission to undertake.

With respect to their first line of argument, the parties start with the not unreasonable proposition that, as contemplated rate increases become larger and larger, reliance on forecasting models based on historical relationships between price and volume can become more tenuous. While that observation may be true, however, it does not alter the unavoidable reality that volume forecasts are still necessary for ratemaking, and they must be based on evidence of record. In this case, there is only one forecasting model on the record, and it was relied upon by the Postal Service in developing its proposed rates, and by the Commission in developing its recommended rates.⁴ Postcom, however, makes the rather incredible claim that “there is absolutely no evidence in the record to suggest that the elasticity of letters and flats influence Postal Service volumes and revenues in any way that would justify offsetting a downward adjustment in Standard Mail flats at the expense of rates for letters.” Postcom Comments at 4. In fact, the evidence of record is that, if rates for flats are adjusted

with the suggestions set forth in the Postal Service’s Initial Comments last week.

4 Had any parties been of the opinion that the only forecasting model on the record is not adequate for purposes of the current circumstances, they could have attempted to rectify that deficiency by seeking to reopen the record and augment the body of

downward, revenue from flats will be reduced, but if rates for letters are consequently adjusted upward, revenue from letters would increase, and this increase in revenue from letters could offset the decrease in revenue from flats. Not only is this perfectly consistent with the record, but it conforms with general notions of economics for products of less than unitary elasticity. Why Postcom feels that the record is lacking on this proposition is rather mystifying.

Even more troubling is the following:

As Mr. O'Brien has aptly put it in his letter of April 11, 2007 to the Commission, the elasticity assumptions "are subject to reasonable adjustment and the PRC can reasonably assume that with a lower Standard flat rate and higher volume levels, the same amount of revenue would be generated." Conversely, if the letter rates are increased, no matter how modestly, that may well have an adverse effect on volumes, revenues (and contributions) from letter mail, depriving the Postal Service of the very assurance of a specific revenue target for Standard Regular mail that it seeks.

Postcom Comments at 6. First of all, elasticity assumptions in a postal ratemaking proceeding are not "subject to reasonable adjustment" on a non-record, *post hoc* basis.

Even if they were, the only way that lower flat rates would generate the same amount of revenue would be if the elasticity for flats were exactly -1.0. But the amount of after-rates flat revenue that the Commission estimated for its recommended rates was based on an elasticity substantially below -1.0 (in absolute value). The fallacy in the argument quoted by Postcom is that the only way to achieve consistency with the Commission's after-rates flat revenue is to assume an elasticity that is inconsistent with the elasticity upon which the Commission's after-rates revenue is premised. This makes no sense.

forecasting materials in evidence as necessary. No party did so.

Turning to letters, Postcom postulates potential adverse revenue effects from an increase in letter rates, which would only be possible if the elasticity for letters were above -1.0 (in absolute value). Once again, such an assumption is utterly inconsistent with the only elasticity estimate on the record.

To summarize with respect to volumes, the situation is much more straightforward than suggested by Postcom and DMA. The Commission's estimate of breakeven was based on a certain amount of revenue from Standard Mail, using the established volume forecasting methodology. If the Commission at this late date were to attempt to substitute some new volume forecasting methodology, along the lines of what FERC did in the *Pipe Lines* case, the prospects of running afoul of the court's criticisms in that instance would indeed be serious. Under the established forecasting methodology, as well as under common sense, if rates for flats are to be reduced, and breakeven is to be maintained, rates for something else must go up. No amount of posturing by the parties allows either them or the Commission to elude that fundamental truth.

In apparent recognition of the weakness of the volume argument, both Postcom and DMA attempt to bolster their support for an asymmetric rate adjustment by suggesting that the provision for contingencies is available to fund any shortfall in revenue from Standard Mail if flat rates are reduced and no other rates are increased. Postcom Comments at 7, DMA Comments at 3-4, 10-11. This argument fails for a number of reasons. First, it is unquestionably an attempt to challenge the revenue requirement already accepted by the Commission, and is thus well outside of the scope

of the matters returned by the Governors for reconsideration. Second, even if the revenue requirement were an issue on the table, which it is not, the parties have pointed to nothing that would justify a reversal of the Commission's earlier finding that a one-percent contingency provision is well within the zone of reasonableness.⁵ Third, even if a reduction in the amount of the contingency were warranted, which it is not, there is no particular reason why rate adjustments would necessarily be limited exclusively to Standard Mail flats. The parties' ill-advised attempt to mount a back-door challenge to the revenue requirement should be rejected.

In conclusion, in its initial comments in response to Order No. 13, the Postal Service stated that its primary goal was "to illustrate what changes might be made to reconcile the Governors' concerns with the Commission's recommendations, keeping in mind the impact on all mailers and on the Postal Service's financial needs." Having reviewed the initial comments submitted by other parties, the Postal Service submits that none of those comments offer any well-founded basis to improve on the Postal Service's suggestions. In particular, the Postal Service urges the Commission not to attempt to rebalance solely within the rates for Standard Mail flats. Moreover, recommending lower rates for some mailers without recommending higher rates for

⁵ In fact, at this point, the suggestion that the contingency is available to fund a shortfall in contribution from Standard Mail is mere wishful thinking. Not only has the contingency already been spent on additional expenses associated with the passage of reform legislation (PAEA), but increases in fuel prices have likewise burnt up financial resources well beyond what was anticipated in the filing. The Commission correctly anticipated these sources of potential adversity in responding favorably to the Postal Service's determination of the reasonableness of a one-percent provision for contingencies.

others, while certainly attractive at a superficial level, would be fundamentally inconsistent with the breakeven requirement of the statute. It is not a realistic solution to the concerns raised by the Governors.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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