

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

Regulations Establishing System
Of Ratemaking

Docket No. RM2007-1

**COMMENTS OF THE
NEWSPAPER ASSOCIATION OF AMERICA
ON SECOND ADVANCE NOTICE OF PROPOSED RULEMAKING
(June 18, 2007)**

The Newspaper Association of America (“NAA”) hereby respectfully submits its comments on the Second Advance Notice of Proposed Rulemaking (“*2d ANPRM*”)¹ in this proceeding. In these comments, NAA will address Questions 1, 3, 8, and 9.

NAA supports the proposed “moving average” method of calculating the CPI-U as being more likely to yield predictable and stable rates. In addition, the Postal Service must submit sufficient cost data to show compliance with Section 3622(e) at the time it provides notification of rate adjustments, the attribution of city carrier costs should be improved significantly to reduce the risk of cross-subsidy and facilitate compliance with Section 3633, and the Commission should address on a case-by-case basis the classification of negotiated service agreements as separate “products” or not.

¹ Order No. 15 (May 17, 2007).

I. THE “MOVING AVERAGE” METHOD OF CALCULATING THE PCI-U IS PREFERABLE TO THE “POINT-TO-POINT” METHODOLOGY

The Commission asks for comment on two methods of calculating the revenue cap CPI-U. One is a method suggested by the Postal Service in earlier comments in this proceeding, which the Commission labels a “point-to-point” method. The other is a “moving average method” described in the *2d ANPRM*. The Commission also invites discussion of “how each method conforms to the language in section 3622(d), as well as how each method comports with the objectives in section 3622(b) and the factors in section 3622(c).” Order No. 15 at 4.

NAA submits that the moving average described by the Commission is preferable, as a matter of policy, to the point-to-point average proposed by the Postal Service. The moving average methodology would better advance the statutory objective of creating “predictability and stability in rates” while promoting transparency in rates and assuring that the Postal Service is financially sound. Thus, it appears more consistent with the congressional intent.

A. The Moving Average Method Enhances The Predictability Of Rate Changes By Smoothing Monthly Variations While Allowing The Postal Service To Recover Adequate Revenues

Figures 1 and 2 in the *2d ANPRM* compare the 12-month moving average and point-to-point percentage changes in CPI-U for the years 2005 and 2006. As the Figures illustrate, the two methodologies produce different outcomes. In general, the moving average approach results in a smoother line with smaller variations from the mean percentage change in CPI-U than the point-to-point approach. NAA submits that this smoothing effect offers an attractive way of

satisfying the statutory objective of “predictability and stability in rates”² because mailers could, by monitoring the 12-month trend line, obtain a fairly accurate expectation of what the likely overall rate change will be.

In contrast, the point-to-point approach could yield widely varying percentage changes due to monthly fluctuations in the CPI-U. Real and significant postage consequences would turn on which month the Postal Service chooses to base a notification of rate adjustment. For example, using Figure 2, if the Postal Service were to base its rate adjustment on August 2006 data, it could raise rates by about 3.8 percent. If it waited merely one month, the limitation based on September data would be about 2.1 percent. If it waited two months, the October index would allow an increase of less than 1.5 percent.

If Postal Service annual revenues are approximately \$70 billion, each percentage point equates to about \$700 million in additional postal revenue. A rate adjustment based on the September data would be about \$1.2 billion less than one based on August data. One based on the October data would be about \$1.8 billion less than if the August data were used. In contrast, because the moving average experienced much smaller variations during the same periods, rate adjustments based on that average would have seen far smaller swings. It is difficult to believe that Congress intended the Postal Service’s rate adjustments to depend on such monthly fluctuations.

During periods when the rate of inflation is declining, the moving monthly average methodology would allow the Postal Service a larger rate increase than

² Section 3622(b)(2).

if the increase were measured using the point-to-point approach. This could give the Postal Service an opportunity to raise rates by less than the maximum permitted levels, to build some retained earnings, or to restore financial shortfalls.

Conversely, in periods of rising inflation, the 12-month average may be below the then-current inflation rate. That creates some risk that the CPI-U cap might not allow the Postal Service to raise rates sufficiently to maintain fiscal soundness. While the Postal Service could, like any business, address this through dipping into retained earnings or engaging in some belt-tightening, the Service also would have the option, if circumstances truly so warranted, of filing a request for above-cap increases under the “exigent circumstances” provision of Section 3622(d)(1)(E). However, this situation is not unique to the monthly average methodology, because the Service might find itself in a similar position under the point-to-point methodology if it happened to rely on a month, such as October 2006, when the CPI-U dropped significantly.

B. The Moving Average Is Consistent With Section 3622(d) Of The PAEA

Section 3622(d) of the PAEA limits the annual percentage change in rates for market-dominant postal products, measured at the class level, to the Consumer Price Index “over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to change rates.” This provision is not self-executing: Congress directed the Commission to

develop a modern rate regime that includes that limitation.³ That delegation of rulemaking authority vests the Commission with discretion in how best to implement the price cap provision in the system for regulating market-dominant products. See *Chevron USA Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984); *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001).⁴

The moving average approach is consistent with the statutory objective of enhancing the “predictability and stability in rates” and the smoother inflation adjustment will help “assure adequate revenues” per objective 5. The same process would also advance the objective of transparency in the ratemaking process. As such, the smoothing approach would comport with the statute and advance statutory objectives. While the point-to-point approach also appears lawful under PAEA, it does not advance the “predictability and stability” and transparency objectives as well as the smoothing methodology.

II. THE POSTAL SERVICE MUST FILE SUFFICIENT DATA TO SHOW THAT ALL WORKSHARE DISCOUNTS COMPLY WITH THE LAW WHEN PROVIDING NOTIFICATION OF RATE CHANGES

Question 3 focuses on how to enforce the workshare discount provision of Section 3622(e). Section 3622(e) directs the agency to “ensure that workshare

³ See 39 U.S.C. §3622(a) (authorizing Commission to “by regulation establish” the system for regulating the rates of market-dominant products) & 39 U.S.C. §3622(d)(1)(A) (Commission is to “set” the annual limitation in percentage changes).

⁴ In *Mead*, the Supreme Court held that administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority. Accord *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 257 (1991) (less deference is owed in absence of delegation of authority to agency to adopt regulations).

discounts do not exceed the cost that the Postal Service avoids as a result of the workshare activity” (emphasis supplied) except in certain specified situations. In particular, the Commission asks, “In the context of a Notice of Rate Adjustment for a class of mail —

- a. What information and/or data are needed to allow the Commission to evaluate whether new workshare discounts are consistent with this standard?
- b. What information and/or data are needed to allow the Commission to evaluate whether unchanged workshare discounts remain consistent with this standard?
- c. What information and/or data are needed to allow the Commission to evaluate whether changed workshare discounts remain consistent with this standard?”

The Section 3622(e) workshare discount provision is a cost-of-service requirement enacted to ensure that worksharing discounts do not exceed postal costs avoided from worksharing activities except in specified exceptional situations.⁵ In so doing, Congress sought to prevent the Postal Service from offering excessive or mismeasured discounts to its financial detriment.

In each case, the Postal Service should be required to provide data sufficient to establish that the statutory requirement is met before the rate adjustment is allowed to take effect. An after-the-fact review will not “ensure” that either past or then-current discounts do not exceed the cost savings. In general, the Postal Service should file the same type of data as it has filed in recent rate cases to justify worksharing discounts, but improved and tailored more closely to the discounts being offered.

⁵ This illustrates why it is far too simplistic to regard the PAEA as simply replacing cost-of-service with price cap regulation.

A. In Each Situation, The Commission Will Need The Same Type Of Data As Has Been Filed In Recent Rate Cases, But With Improved Quality

Section 3622(e) requires accurate data regarding the Postal Service's costs avoided from worksharing activities. The necessary data include the Postal Service's best information regarding the postal costs avoided (including employee time and applicable wage rates), equipment costs avoided, and any changes in operations that affect these costs. It goes without saying that the data must be accurate and reliable.

For example, with regard to presortation/walk-sequencing discounts in Standard Mail, the Postal Service must provide information of the type found, in Docket No. R2006-1, in Library Reference USPS-LR-L-67, but (unlike as filed in that docket) disaggregated to *each* worksharing category and shape for which a discount is offered. Ideally, the Postal Service should also provide similar data for all costs pertaining to the workshare discount.⁶

In its comments and reply comments on the initial *ANPRM* in this proceeding, NAA pointed out that the Commission has the legal authority, during its review of a notification of rate changes, to check for at least facial compliance with the provisions of Section 3622(e) regarding workshare discounts.⁷ NAA submits that only by reviewing the proposed worksharing discount rates before

⁶ However, aggregated data may be superior to unreliable data due to "tally thinness" or other factors. For example, in Docket No. R2006-1, the Postal Service concededly did not have reliable data as to any mail processing cost differences between the high-density and saturation categories in Standard Enhanced Carrier Route mail. See *R2006-1 Op.* at 283 ¶¶5562 & Tr. 13/3610 (Talmo).

⁷ Reply Comments of the Newspaper Association of America at 25 (May 7, 2007).

they take effect can the Commission “ensure” that the Postal Service does not offer discounts that exceed the costs avoided.

To facilitate proper compliance with Section 3622(e), the Postal Service should both file the required cost support at the time of providing notice of rate changes and submit an assessment of the actual results and cost savings in its annual compliance report under 39 U.S.C. § 3652(b).

B. The Same Information Must Be Filed Whether A Discount Is Changed Or Unchanged

The Commission also invites comment on whether the data which the Postal Service must file at the time of the filing of a notice of rate adjustment would vary depending upon whether a discount is being introduced, changed, or not changed. NAA submits that the statute does not distinguish among these situations, and that the same data must be filed in each of these cases.

Section 3622(e) provides that the Commission “shall ensure” that worksharing discounts “do not exceed the cost that the Postal Service avoids as a result of workshare activity” except in certain specified situations. “Shall” is language of legislative command – the Commission must “ensure” that workshare discounts do not exceed the Postal Service’s costs avoided. The Commission can do so only if the Postal Service submits, at the time of the filing of the notice of a rate adjustment, data sufficient to establish the amount of the costs avoided by the worksharing discount before the Postal Service begins to charge the discount.

Question 3 proposes three scenarios – in each, the Postal Service must file the data at the time that it provides notice of a rate adjustment.

First, if the Postal Service is introducing a new discount, the Postal Service at that time must provide its best estimates of the costs avoided. This will enable the Commission to determine compliance. Furthermore, it should do so even if it seeks to avail itself of one of the exceptional circumstances in which the discount may exceed avoided costs. This should not increase the administrative burden on the Postal Service, because the Service presumably would estimate its likely costs avoided before deciding to offer the discount.

Second, when the amount of a discount is changed, the Postal Service must show that the new discount rate meets the avoided costs test in the year in which it will be in effect. Otherwise, the Commission would have no grounds on which to evaluate whether the new discount amount complied with the statutory limitation.

Third, the same holds true when a discount is unchanged from one year to the next. In that scenario, although the rate may not change, the costs avoided may well change due to changes in labor costs or in postal operations.⁸ Therefore, the Postal Service must show how labor costs and operations have affected the costs avoided and show that the unchanged discount continues to comply with the statutory test. Only if such data are provided can the Commission fulfill its duty of ensuring that discounts do not exceed the costs avoided.

⁸ Surely Congress did not expect that the Postal Service could simply leave a discount unchanged for years without having that rate subject to Section 3622(e).

III. THE COMMISSION SHOULD IMPROVE THE ATTRIBUTION OF CITY CARRIER COSTS

In Question 8, the Commission asks:

“Regarding the term “costs attributable” —

- a. Identify any costs currently classified as attributable that, in light of PAEA, should be classified as institutional. The rationale for the proposed change should be explained.
- b. Identify any costs currently classified as institutional that, in light of PAEA, should be classified as attributable.”

Although this question is posed in the context of competitive products, the same issue has relevance to the market-dominant products that are of primary interest to NAA as well.

As NAA stated in its comments in response to the first *ANPRM* in this proceeding,⁹ there are significant cost areas in which attribution could be improved. In Docket No. R2006-1, only 55.38 percent of the Postal Service’s costs were classified as attributable. *R2006-1 Op.*, Appendix E, at 3 (February 27, 2007).¹⁰ That left some \$34.263 *billion* – an amount larger than the annual revenues of all but the top 64 businesses in the Fortune 500¹¹ -- as institutional costs. These percentages follow a trend, over the past decade, of a declining proportion of costs being attributed.

For example, in Docket No. R2001-1, the Commission attributed 62.15 percent of postal costs. *R2001-1 Op.*, Appendix E, at 5 (March 22, 2002). This

⁹ Comments of the Newspaper Association of America, Docket No. RM2007-1 at 14-16 (March 30, 2007).

¹⁰ The Postal Service’s preferred methodologies would have attributed only 52.25 percent of its costs.

¹¹ See http://money.cnn.com/magazines/fortune/fortune500/2007/full_list/index.html.

proportion was a decline from Docket No. R97-1, in which the Commission was able to attribute 66.13 percent of the Postal Service's costs. *R97-1 Op.*, Appendix E, at 4 (May 11, 1998).

In sum, the percentage of postal costs that were attributed has declined by more than ten percent in less than a decade. While several factors may account for this decline, including inadequate data and insufficient time to evaluate complex econometric models, the growing proportion of institutional costs causes doubt that costs are attributed properly and that all mail classes are covering their true costs.

In particular, city carrier costing is one area in which both data and attribution methodologies need substantial improvement, as it appears that an excessive proportion of carrier street time is currently treated as institutional rather than attributable. The PAEA has given the Commission the legal authority to act to improve cost attribution in those areas.

A. The Commission Should Commence A Proceeding To Establish Cost Attribution Methodologies

In its opening comments on the first *ANPRM* in this proceeding, NAA observed that the accurate measurement of attributable costs is fundamental to the proper implementation of the worksharing discount provision of PAEA. NAA also noted that in the PAEA, Congress gave this Commission the final responsibility to prescribe the costing methodologies upon which the lawfulness of postal rates will be evaluated. 39 U.S.C. § 3652(a). Accordingly, NAA urged the Commission to initiate a proceeding to improve cost attribution in parallel with proceedings to implement the ratesetting and complaint processes:

Given the importance of costing methodologies to the enforcement structure, the prevention of cross-subsidies, and their role in determining the ultimate lawfulness of rates, the Commission should begin consideration of the costing methodologies simultaneously with its consideration of the ratesetting system.

NAA Comments at 14-15. NAA also observed that “establishing costing methodologies promptly would be fair to the Postal Service” by enabling it to develop rates using the costing methodologies that will serve as the basis for the ultimate judgment as to the lawfulness of the rates charged. *Id.* at 15.

Question 8 illustrates the importance of the need for the Commission to improve cost attribution by establishing improved costing methodologies. This is a matter clearly within the regulatory power of this Commission. The proper attribution of costs is essentially not only for purposes of Section 3633, but also for other provisions of the PAEA, including but not limited to the worksharing discount provision of Section 3622(e).

B. The City Carrier Street Time Cost Component Has Substantial Institutional Costs That A Review May Show Should Be Classified As Attributable

The *2d ANPRM* asks what currently unattributed costs should be attributed in light of the PAEA. This is an important inquiry both as a matter of general policy and because Section 3633 of the PAEA prohibits cross-subsidies of competitive products both individually and as a whole.

NAA respectfully submits that city carrier street costs potentially could be attributed to a greater extent than at present. Only 35.77 percent of Cost Segment 7 (city carrier street costs) were attributed in Docket No. R2006-1. That

left nearly \$7.5 billion in unattributed city carrier street time costs that were recovered through the institutional cost assignment process. So large a pool of unattributed costs calls into question the accuracy of attribution techniques. It also poses a considerable risk of cross-subsidy because the amount of unattributed costs greatly exceeds the *total* costs attributed to many mail products. For example, the \$7.5 billion of unattributed Cost Segment 7 costs far exceeds the attributable costs of Priority Mail (\$3.466 billion), Express Mail (\$0.467 billion), and Parcel Post (\$1.28 billion), which all (except for single-piece Parcel Post) are classified as competitive products.

City carrier costs incurred in delivering only competitive products should be allocated to the competitive category. This means, by way of illustration, that city carrier costs incurred in delivering only Priority Mail and bulk Parcel Post should be charged fully to competitive products. Likewise, city carrier costs incurred in delivering only market-dominant products should be attributed to the market-dominant category and should not burden competitive products.

One way that this statutory objective could be accomplished is by use of the “combinatorial cost test” for cross subsidization introduced by economist Gerald Faulhaber in 1975. Under this methodology, the Postal Service first would calculate the costs attributable to each mail product by itself. Next, the costs incurred in common across each combination of two or more mail products would be calculated and attributed to that combination as an incremental cost floor. In the first example, costs incurred in delivering Express Mail and bulk Parcel Post would be combined to provide an incremental cost floor for those two

competitive products. The revenue of each product must equal or exceed its incremental (attributable) cost, and the revenue of each possible combination of products must equal or exceed the incremental cost of that combination. This test protects all mailers against cross-subsidy.

IV. NSAs ARE GENERALLY NOT LIKELY TO BE SEPARATE “PRODUCTS” BUT MOST LIKELY WILL BE OPTIONS WITHIN A PRODUCT

Question 9, which primarily concerns competitive products, asks whether each negotiated service agreement (“NSA”) constitutes a separate “product.” Although directly relevant to competitive products,¹² that question has relevance to market-dominant products as well. NAA respectfully submits that the Commission should not try to establish a hard and fast rule regarding whether NSAs are separate “products.” Instead, the Commission should determine the status of NSAs on a case-by-case basis.

A review of the PAEA suggests that the term “product” is synonymous neither with “subclass” or “rate category.” Instead, the term “product” appears to have a meaning more consistent with everyday understandings than with traditional postal nomenclature.

The PAEA defines a “product” as “a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied.” 39 U.S.C. § 102(6). At first blush, the PAEA’s definition of a “product”

¹² The PAEA establishes a rate floor for each competitive product consisting of attributable costs. § 3633(a)(2).

resembles the Commission's traditional test for a rate category.¹³ However, a closer reading of the statute suggests that Congress did not intend to adopt the Commission's pre-existing definition of a rate category as that of a product. Instead, it intended a more general understanding of the term.

In Section 3621, which lists the mail subject to the market-dominant system of rate regulation, Congress used the term "mail matter" to describe that mail. The Section 3621 listing includes "mail matter" currently classified as classes (Standard mail), subclasses (First-Class letters and sealed parcels, bound printed matter), and smaller disaggregations (single-piece parcel post). Interestingly, however, in Section 3642, Congress referred to the "list of market-dominant *products* under Section 3621" (emphasis supplied), suggesting that Congress regarded the Section 3621 list as consisting of "products."¹⁴

The corresponding listing of competitive mail in Section 3631 also refers to the items listed therein as "mail matter." 39 U.S.C. § 3631(c). However, Subsection 3631(b) also uses the term "product." These provisions suggest that Priority Mail, "expedited mail," bulk parcel post, bulk international mail, and mailgrams are all "products" without need for further disaggregation. Furthermore, Section 3642 contemplates the transfers of subclasses or subordinate units between the market-dominant and competitive groupings,

¹³ See Opinion and Recommended Decision, *Mail Classification Schedule, 1995, Classification Reform I*, Docket No. MC95-1, at III-9 (January 26, 1996) (stating that Commission "has consistently expected proponents of separate subclass treatment to show differences in both costs and demand" as well as other factors). Rate discount categories have been justified on the basis of a difference in cost due to the worksharing activity.

¹⁴ Likewise, Section 3632 refers to a competitive "product" as something different from a "rate" or a "subclass."

which suggests that “subclasses” and “subordinate units” are something different from “products” although either may be a “product” in some cases.

Still further indication that Congress did not intend for rate categories to be products *per se* is Section 3622(e), in which “discounts” are associated with postal “services.” However, nowhere does PAEA call a discount a “product.” Section 3622(e)(3) also refers to “subclasses” and “categories” without using the term “product.”

In the absence of a “new product” under Section 3641, NSAs are in many instances likely to be optional variations within the groupings of existing products. For example, the *Capital One* baseline NSA and the NSAs functionally-equivalent to it would seem to fit best within the First-Class mail letters and sealed parcels product as an optional variation. However, the Commission not rush to make a hard-and-fast determination at this time, but rather classify NSAs as separate “products” or not on a case-by-case basis.¹⁵

¹⁵ In any event, the Postal Service’s annual compliance report required by Section 3652 should present separately all rate categories and NSAs.

V. CONCLUSION

For the foregoing reasons, the Newspaper Association of America respectfully urges the Commission to adopt regulations consistent with these comments.

Respectfully submitted,

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Certificate of Service

I hereby certify that I have this 18th day of June, 2007, caused to be served the foregoing document upon the United States Postal Service and the Office of the Consumer Advocate in accordance with the rules of practice.

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