

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

**Regulations Establishing System
of Ratemaking**

Docket No. RM2007-1

**INITIAL COMMENTS OF PITNEY BOWES INC.
IN RESPONSE TO SECOND ADVANCE NOTICE OF PROPOSED RULEMAKING
ON REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING**

James Pierce Myers
Attorney at Law
1211 Connecticut Avenue, NW
Suite 620
Washington, DC 20036
Telephone: (202) 331-8315
Facsimile: (202) 331-8318
E-Mail: jpm@piercemyers.com

Michael F. Scanlon
KIRKPATRICK & LOCKHART
PRESTON GATES ELLIS LLP
1601 K Street, NW
Washington, DC 20006
Telephone: (202) 778-9000
Facsimile: (202) 778-9100
E-Mail: michael.scanlon@klgates.com

Counsel to PITNEY BOWES INC.

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I. INTRODUCTION

Pitney Bowes Inc. (Pitney Bowes) is pleased to provide these comments in response to PRC Order No. 15, the Postal Regulatory Commission's (Commission) Second Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking (Docket No. RM2007-1). The Postal Accountability and Enhancement Act (PAEA or Act), Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006),¹ imposes substantial obligations on the Commission to develop, establish, and administer a new postal regulatory system. Pitney Bowes commends the Commission for issuing a second advance notice inviting interested parties to focus their comments on certain implementation issues. It is critical that the forthcoming implementing regulations provide specific guidance to all stakeholders about the scope and contours of the new system. The regulations adopted by the Commission should be sufficiently detailed to minimize uncertainty and reduce the likelihood of litigation during and following implementation. Specific advance guidance will stimulate future investment in the postal sector, promote the stability and predictability goals of the PAEA, and ensure universal, affordable postal service.

II. DISCUSSION

A. Regulations Concerning Market-Dominant Products

1. The Commission Should Fashion Price Cap Rules That Promote Pricing Flexibility, Reduce Administrative Burden, and Provide Stability and Predictability.

- a. *The Commission's "12-Month Moving Average" Method Should be Used for Calculating the Annual Limitation.*

In its reply comments to the first advance notice, the Postal Service outlined its proposal for calculating Consumer Price Index (CPI) changes in connection with the price cap compliance determination. *See* Postal Service Comments, Appendix C. The Postal Service proposes a

¹ The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

“point-to-point” method. Under the Postal Service method “[t]he cap would be equal to the difference between the most recently available monthly CPI and the monthly CPI for the same month from the previous year, divided by the monthly CPI for the previous year.” PRC Order No. 15 at 3. The Commission presents an alternative that compares aggregated monthly CPI results, identified as the “12-month moving average” method. *Id.* at 3-4. The Commission’s “12-month moving average” method is a superior approach because it best achieves rate predictability and stability by minimizing variations that could result from the timing of proposed rate adjustments, *i.e.*, the selection of a specific month.

The PAEA provides that the system for regulating rates and classes for market-dominant products shall,

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 unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates.

39 U.S.C. § 3622(d)(1)(A).

Although the Postal Service’s proposed methodology is consistent with the U.S. Bureau of Labor Statistics’ method of calculating changes in the CPI, the Commission’s method exhibits greater fidelity to the language of section 3622(d) which requires that the annual limitation be tied to the change in the CPI index “over the most recent available 12-month period.” The Commission’s “12-month moving average” method takes into account the actual change in each of the 12 months occurring during the measuring period and, thus, better reflects the intent of the PAEA.

Moreover, the Commission’s “12-month moving average” method furthers the statutory objective that the new rate system “create predictability and stability in rates.” 39 U.S.C. §

3622(b)(2). As illustrated by the graphs comparing the CPI percent change computations under the Postal Service’s proposed “point-to-point” method and the Commission’s “12-month moving average” method, the Postal Service’s “point-to-point” method exhibits significant variation in the percentage changes in the CPI depending on the month that is selected. PRC Order No. 15 at 4. In contrast, the Commission’s “12-month moving average” method minimizes variation in the annual rate limitation and, therefore, seems a better choice for a system intended to achieve rate predictability and stability.

b. The Commission Should Adopt the Postal Service’s Proposed Use of Historical Data to Establish Volume Weights and Average Revenue Per Piece for Determining Compliance with the Annual Limitation.

“The Postal Service proposes to use the most recent 12 months of available data to establish the volume weights and to recalculate average revenue per piece by applying those weights to the current rates.” PRC Order No. 15 at 5. This use of historical volume weighted averages is consistent with the PAEA and has several advantages.

First, the use of historical volume weights provides a relatively simple and predictable means of determining whether proposed rate changes comply with the annual limitation. Second, a historical or “backward-looking” calculation also avoids the need for volume forecasting and, thus, is consistent with the PAEA’s promotion of administratively economical regulation. *See* 39 U.S.C. § 3622(b)(6). Third, a “backward-looking” calculation should also enable the Commission quickly to determine compliance with the annual limitation under section 3622(d), thus further promoting efficiency and reducing administrative burden. *See* 39 U.S.C. § 3622(b)(1), (6). Fourth, the use of historical weights automatically encourages the introduction of new products because the revenues earned in the introductory period would not count for purposes of determining compliance with the annual limitation (price cap). Finally, using

historical data has the advantage of relying on actual, verifiable data, thus promoting the predictability and stability objectives of the Act. *See* 39 U.S.C. § 3622(b)(2). For all of these reasons, the Commission should establish rules that allow for compliance determinations based on historical volume data as proposed by the Postal Service.

c. The Commission Should Establish Rules That Encourage Pricing Flexibility Consistent with the Price Cap, as Proposed by the Postal Service.

The Commission should establish rules that encourage the Postal Service to pursue the pricing flexibility and product innovation contemplated by the PAEA. Part D of the appendix of the Postal Service’s reply comments addresses the important issue of “non-annual” price changes. To ensure that neither the annual limitation (price cap) nor the compliance review process stifles new product or pricing innovations such as customer-specific contract pricing (expanded negotiated service agreements), the Commission’s rules should exclude *bona fide* new products, special classifications, and contract prices from the compliance determination until the year after those new products, special classifications, or pricing arrangements are introduced. (To a certain extent, this also would be accomplished by the use of historical volume weights.) As discussed in earlier comments, a temporary exclusion from the cap calculation for *bona fide* new products and special classifications during their introductory year is consistent with the statutory treatment of new products introduced via market tests. *See* 39 U.S.C. § 3641; Pitney Bowes Comments at 8.

2. The Statutory Workshare Limitations and Reporting Obligations Underscore the Importance of an Active Commission Role in Administering the PAEA to Ensure Cost-Reflective Rates

Section 3622(e)(1) narrowly defines “workshare discount” as “rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail as further defined by

the Postal Regulatory Commission.” 39 U.S.C. § 3622(e)(1). This definition reflects the historical understanding of “worksharing activities” for which rate discounts have been traditionally afforded. Subject to certain enumerated exceptions, section 3622(e)(2) provides that these statutorily-defined workshare discounts cannot exceed the “cost that the Postal Service avoids as the result of workshare activity.” *See* 39 U.S.C. § 3622(e).² The limitation of section 3622(e)(2), coupled with the reporting requirements of section 3622(e)(4), require the Postal Service to collect and report to the Commission certain cost information for the statutorily-defined “workshare discounts.” These statutory directives require Commission involvement in ensuring cost-reflective rates and undercut the notion that the Postal Service should be afforded unfettered pricing flexibility. They also support adherence to Efficient Component Pricing (ECP) principles as urged by Pitney Bowes and others. As discussed in earlier comments of Pitney Bowes and Dr. John Panzar, cost-reflective rates (and the data required to ensure them) should be a key feature of the modern system of ratemaking.³ *See* Pitney Bowes Comments at 3-4, 18-19; Panzar Comments at 10-15; Pitney Bowes Reply Comments at 6-9.

The cost-based workshare limitations of section 3622(e)(2) support the Commission establishing rules to require the Postal Service to adopt, to the maximum extent practicable, rates that comport with the principles of ECP. As a practical matter, to ensure compliance with section 3622(e)(2), the Commission will need to have the same data that will be needed to ensure that the Postal Service implements ECP-compliant rates. Thus, there should be no significant additional data production burdens on the Postal Service if the Commission requires the Postal

² Because the specific exceptions and limitations under sections 3622(e)(2) and (3) are so context-dependent, the Commission should address those issues on a case-by-case basis.

³ For purposes of these comments, the term “cost-reflective rates” means rates in which cost differences are, to the fullest extent practicable, reflected in rate differences. These comments use the term efficient component pricing (ECP) in both its traditional sense to mean that workshare discounts should be set equal to the per unit avoided costs of the Postal Service, *see* PRC Op. R2006-1, ¶ 4016, and as extended by the Commission “beyond worksharing” as a pricing rule to “promote productive efficiency[,]” and “provide incentives to minimize costs in the case of shape and other mail characteristics.” PRC Op. R2006-1, ¶ 4024.

Service to adopt, to the maximum extent practicable, ECP-compliant rates. ECP-compliant rates would necessarily satisfy the statutory limitation on “workshare discounts” imposed by section 3622(e)(2).

Moreover, as Pitney Bowes and other parties have discussed in their prior comments, cost-reflective or ECP-compliant rates would serve important purposes under the new system of ratemaking. First, consistent with the statutory objectives of the PAEA, a cost-reflective system with rates that accurately and fully reflect cost differences will enhance productive efficiency and reduce total postal sector costs. Second, ECP is the most effective means for the Commission to safeguard upstream competition from potential abuses of the Postal Service’s market-dominant power. *See* Pitney Bowes Comments at 19-20; Panzar Comments at 13-16; Joint Comments of ANM, NAPM, NPPC at 18-19; Pitney Bowes Reply Comments at 3-4, 6-7.

Accordingly, as urged by Pitney Bowes and others, the Commission should establish by regulation that ECP-compliant rates are presumptively valid under the Act. Such a presumption will encourage cost-reflective rates, promote the efficiency and predictability objectives of the PAEA, and promote upstream access and protect against abuse of the Postal Service’s monopsony power. *See* Pitney Bowes Reply Comments at 3-6.

3. The Commission Should Require Reporting Under Sections 3622(e) and 3652 that Meet the Statutory Requirements while Minimizing the Administrative Burden on the Postal Service.

The PAEA also imposes reporting requirements with respect to statutorily-defined workshare discounts. Section 3652(b) requires annual reporting, as part of the annual compliance process, for all statutorily-defined workshare discounts – new, unchanged, and changed. In contrast, section 3622(e)(4) provides that, “[w]henver the Postal Service *establishes* a workshare discount rate, the Postal Service shall at the time it publishes the workshare discount

rate, submit to the Postal Regulatory Commission a detailed report” 39 U.S.C. § 3622(e)(4). Accordingly, section 3622(e) distinguishes between newly “establish[ed]” workshare discounts and existing discounts for purposes of both the nature of the information and data required and when that data and information must be provided. Likewise, the Commission’s advance notice appropriately differentiates between “new” workshare discounts and existing (“unchanged” or “changed”) workshare discounts.⁴

With respect to *what* information is necessary for the Postal Service to comply with the reporting requirements, neither section 3622(e)(4) nor section 3652(b) should be read to require the Postal Service to undertake more onerous data production than what historically has been found sufficient in connection with a request for rate and classification changes for mature or existing workshare discounts. Rather, for new or existing (changed or unchanged) workshare discounts, the information and data necessary to allow the Commission to evaluate compliance with section 3622(e) is the same data that the Postal Service has traditionally provided, such as library references 110 and 48, in past omnibus postal rate proceedings. *See e.g.*, Docket No R2006-1, USPS-LR_L48 and L110.

However, section 3622(e)(4) requires the Postal Service to submit additional information when it establishes a new statutorily-defined “workshare discount.” In that case the Postal Service must submit a “detailed report” setting forth the “reasons for establishing the rate,” “the data, economic analysis, and other information relied on by the Postal Service to justify the rate,” and a certification “that the discount will not adversely affect rates or services provided to users of postal services who do not take advantage of the discount rate.” 39 U.S.C. § 3622(e)(4)(A)-(C).

⁴ *See also* Postal Service Reply Comments at 7-8.

Finally, the Commission’s regulations should provide that determinations as to compliance with the PAEA’s workshare discount limitations under sections 3622(e)(2) and (4) will be based on historical avoided cost information rather than forecasts or future estimates. This approach would be consistent with the use of historical data for purposes of determining the annual limitation under section 3622(d)(1)(A), discussed above, and will minimize the administrative burden on the Postal Service.

With respect to *when* the information must be provided, it is clear, as discussed above, that the information required for newly established workshare discounts must be submitted by the Postal Service “at the time it publishes the workshare discount rate.” 39 U.S.C. § 3622(e)(4). This should occur in connection with the required notice of rate adjustment for the particular class of mail. *See* 39 U.S.C. § 3622(d)(1)(C)(i).

The PAEA is silent, however, with respect to when the Postal Service must provide the avoided cost information necessary to satisfy the general limitation of section 3622(e)(2). As a means of promoting the statutory objectives of pricing flexibility and reduced administrative burden, the Commission should only require workshare data production for existing workshare discounts in the context of the annual compliance report filing under section 3652, not in connection with the notice of rate adjustment under 3622(d)(1)(C)(i). To maximize pricing flexibility and minimize administrative burden, the Commission’s review upon the notice of rate adjustment ought to be focused on price cap compliance issues, and must be completed 45 days prior to the implementation of new rates. It should not be an opportunity for a “mini” rate case. Except in the case of *new* statutorily-defined workshare discounts, compliance determinations should be reserved for the annual determination of compliance under section 3653, not the “quick look” process contemplated under section 3622(d).

Workshare discounts as well as other rates may be subject to complaint under section 3662. The Commission's regulations must be sensitive to the potential for a significant passage of time between the implementation of new rates and the eventual availability of underlying data supporting those rates which will occur in connection with the annual compliance process under sections 3652 and 3653. Similarly, as noted in the previous comments of Pitney Bowes and other parties, the Commission's regulations must address the interplay of the complaint provisions of section 3662 and the annual compliance determination under section 3653. *See e.g., Pitney Bowes Comments at 15-16.*

The Commission should establish rules governing the periodic production of routine financial and operational data on costs, revenues, and volumes. This need not be burdensome, but rather an extension of current reporting (e.g. Revenue, Piece, and Weight reports; monthly financial statements). Only the Commission can determine what data and information it needs and how frequently it needs it. But reasonable periodic reporting requirements could provide the transparency envisioned by the PAEA, facilitate timely and meaningful review of rate changes by interested parties, and assist the Commission in meeting its annual compliance responsibilities. It does not appear necessary, however, to require a full-blown Cost and Revenue Analysis more frequently than annually.

B. Regulations Concerning Competitive Products

1. The Commission's Regulations Should Permit and Promote Pricing Flexibility for Competitive Products.

The division of postal services into market-dominant and competitive product lines and financially recognizable separate operations, and the substantial pricing flexibility afforded to the Postal Service with respect to its competitive product offerings, is one of the defining features of the PAEA. The authority to establish rates and classes for competitive products is vested solely

in the Postal Service Governors. *See* 39 U.S.C. § 3632. The Commission’s responsibilities run to preventing cross subsidy and ensuring that products are categorized correctly as either market dominant or competitive. *See* 39 U.S.C. §§ 3633, 3634, and 3642. The PAEA dramatically expands procedural pricing flexibility for competitive products, permitting the Postal Service to implement rates for competitive products of “general applicability” with 30 days notice, and rates for competitive products “not of general applicability” (which typically may be negotiated or contract rates) with only 15 days notice. The notice for rates of “general applicability” must be published in the Federal Register. In contrast, the notice of rates “not of general applicability” is only filed with the Commission, reflecting the fact that these contract rates may involve commercially sensitive considerations. There is no statutory requirement for disclosure of information pertaining to these rates.

To give effect to these provisions, the Commission must adopt rules that permit and promote the exercise of the pricing flexibility the Act gives the Governors. For example, with respect to the Postal Service’s expanded authority to enter into contract rates the Commission must adopt rules to protect and minimize the disclosure of commercially sensitive information and to reduce administrative burden and transaction costs for the Postal Service and its customers. Rules promoting pricing flexibility for competitive products will stimulate innovation and investment in the postal sector. On the other hand, required disclosure or even production of commercially sensitive information or burdensome procedural or transaction requirements or conditions will place the Postal Service at a competitive disadvantage in the marketplace and will have a chilling effect on the willingness of mailers to pursue negotiated deals.

For both competitive and market-dominant products the PAEA promises streamlined introduction of new rates, products, and classifications. With respect to rate changes or adjustments for existing products the procedural requirements are few and relate to price cap compliance, workshare limitations, and cost-reflective rates discussed above. New product introduction is governed by section 3642, which provides only limited guidance including the provision that at the request of the Postal Service, interested parties or upon its own initiative, the Commission may change the list of market-dominant or competitive products by adding new products, removing products, or transferring products from one category to another, subject to certain exceptions. *See* 39 U.S.C. § 3642. Consistent with the PAEA’s various statutory commands for flexibility, efficiency, and reduced burden, the Commission should administer section 3642 to facilitate the introduction of new products.

2. The Commission Should Adopt a Broad Definition for Competitive “Products.”

The PAEA offers a generic definition of 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). This definition is a variant of the Commission’s historical conception of a postal “subclass” under the existing ratemaking system. A plain reading of the Act further confirms that a “product” may have multiple rates associated with it. Therefore, a “product” under the PAEA is generally synonymous with a “subclass” under existing postal terminology.

With respect to competitive products, the PAEA further requires that each competitive product must cover its attributable costs, so that the costs of competitive products are not subsidized by revenues from market-dominant products. *See* 39 U.S.C. § 3633(a). “Costs attributable” is a defined term for competitive products meaning “the direct and indirect postal

costs attributable to such product through reliably identified causal relationships.” 39 U.S.C. § 3631(b).

The test to determine whether a competitive product is covering its “costs attributable,” as defined in section 3631(b) must be applied individually at the “product” level which, as discussed above, is generally analogous to the “subclass” level. *See* 39 U.S.C. § 3631(a). As noted in the initial comments of the Parcel Shippers Association in response to the previous advance notice, there are several advantages to applying the test at the “subclass” level. *See* PSA Comments at 7-8. First, applying the test at the “subclass” level is consistent with the Commission’s longstanding practice under the existing ratemaking system. Second, application of the test at this level is also consistent with the manner in which the Postal Service measures costs. Nothing in the PAEA requires the Commission to deviate from its historical practice of measuring cost at the “subclass” level, nor does there appear to be any practical advantage to doing so.

Because a competitive “product” under the PAEA is generally analogous to a “subclass” under the existing system, individual International Customized Agreements, Negotiated Service Agreements, and other special classifications or rates not of general applicability should not be construed as distinct “products” under the PAEA.

3. The Commission Should Adopt the Postal Service’s Categorization of “Bulk International Mail.”

Section 3631 provides that “bulk international mail” will be subject to the provisions relating to competitive products under subchapter II of chapter 36. *See* 39 U.S.C. § 3631(a). Section 3631(c) establishes a rule of construction that provides that the mail matter “referred to in subsection [3631(a)] shall, for purposes of this subchapter, be considered to have the meaning given to such mail matter under the mail classification schedule.” 39 U.S.C. § 3631(c).

However, neither the Postal Service's International Mail Manual, Domestic Mail Manual, nor the Commission's Domestic Mail Classification Schedule provides a comprehensive definition for "bulk international mail."

Several parties including the Postal Service, the Parcel Shippers Association, and the International Mailers Advisory Group offered comments in response to the previous advanced notice regarding the proposed definition of "bulk international mail." *See* Postal Service Comments at 32-33; PSA Comments at 8 n.8; IMAG Comments at 1. The Postal Service proposed an initial categorization of its international product offerings that distinguishes between multi-item international mailings tendered for bulk entry and single-piece items other than those entered in the highly competitive international parcel and express market. The Postal Service's proposal presents a logical delineation of its existing international product offerings. The Commission should adopt the Postal Service's proposed categorization of "bulk international mail" for purposes of the initial classification under section 3631(a).

III. CONCLUSION

Pitney Bowes appreciates the consideration of the Commission in once again soliciting the views of interested parties on issues related to the implementation of a system of ratemaking. In its initial and reply comments Pitney Bowes urged the Commission, in the regulations that eventually result from these proceedings, to provide advance, comprehensive guidance as to the requirements and boundaries of the system of ratemaking. Once again Pitney Bowes urges the Commission to promulgate regulations that will promote and sustain a vibrant, growing mailing industry, enhance the value of the mailstream for senders and recipients, and ensure universal, affordable postal service.

We look forward to having another round of contributions from others and the opportunity to continue to be involved in the development of the system of ratemaking.

Respectfully submitted:

/s/

James Pierce Myers
Attorney at Law
1211 Connecticut Avenue, NW
Suite 620
Washington, DC 20036
Telephone: (202) 331-8315
Facsimile: (202) 331-8318
E-Mail: jpm@piercemyers.com

Michael F. Scanlon
KIRKPATRICK & LOCKHART
PRESTON GATES ELLIS LLP
1601 K Street, NW
Washington, DC 20006
Telephone: (202) 778-9000
Facsimile: (202) 778-9100
E-Mail: michael.scanlon@klgates.com

Counsel to PITNEY BOWES INC.