

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

REGULATIONS ESTABLISHING SYSTEM  
OF RATEMAKING

Docket No. RM2007-1

SUPPLEMENTAL COMMENTS OF THE UNITED STATES POSTAL  
SERVICE ON THE CLASSIFICATION PROCESS  
(June 19, 2007)

In earlier filings in this docket, the Postal Service set forth its preliminary views regarding market-dominant classification procedures under the Postal Accountability and Enhancement Act (PAEA).<sup>1</sup> These views were summarized in the Postal Service's Reply Comments to the first Advance Notice of Proposed Rulemaking as follows:

The PAEA grants the Postal Service far greater authority over classification changes than did the PRA. With the removal of former § 3623 from Title 39, the Commission is no longer responsible for designing classifications (either on its own initiative or pursuant to a request by the Postal Service) based on enumerated statutory criteria. Instead, as noted above, the PAEA grants the Postal Service the ability to manage its product portfolio, with Commission oversight to ensure that the Postal Service does not violate the statute.

As the Postal Service noted in its Initial Comments, the PAEA is largely silent as to the procedures that should replace former § 3623. The Postal Service must petition the Commission to move, add, or delete products from the lists maintained pursuant to § 3642. Meanwhile, many classification changes below the level that implicates § 3642 are accompanied by price changes that will be part of the cap compliance review of § 3622(d)(1)(C). Beyond that, however, the statute is largely silent as to the specific procedural mechanisms for classification changes. The Postal Service, for its part, has not yet finalized its views in this regard, and plans on providing supplemental comments as soon as

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<sup>1</sup> Postal Service Initial Comments at 29-31; Postal Service Reply Comments at 9-10.

possible on this topic, which will build off of the classification discussion in its Initial Comments.<sup>2</sup>

These Supplemental Comments address the changed role of the Commission with respect to classifications, and present the procedural framework within which market-dominant classification changes should occur in the new pricing regime.<sup>3</sup> This framework will allow the Commission to exercise the oversight role contemplated by the Act, while giving the Postal Service the flexibility the Act affords to restructure its service offerings to meet customer and business needs.

## **I. Market-Dominant Products: General Considerations**

### **A. The Commission's role over classifications has been fundamentally changed**

The purpose of classification is to “identify[ ] groupings of mail for the purpose of setting rates.”<sup>4</sup> A price means nothing without specifying the mail matter to which the price is applied. The processes of pricing and classification thus do not operate independently of one another.<sup>5</sup> While the PAEA lays out the specific procedures that apply to price changes for market-dominant products,<sup>6</sup> it is largely silent with respect to the procedures applicable to classification changes, except for the addition, deletion, or transfer of a “product” (the proper definition of which will be discussed below). In developing a procedural framework for classification changes, the Commission must be guided by the provisions of § 3622 and the recognition that “pricing” and “classification” are essentially two sides to the same coin.

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<sup>2</sup> Postal Service Reply Comments at 9-10.

<sup>3</sup> The Postal Service also discusses the classification process for competitive products at the end of these Comments.

<sup>4</sup> See PRC Op., MC95-1, at ¶¶ 2059-2063.

<sup>5</sup> *Id.* at ¶ 2063 (noting the “interrelationship of the classification and ratemaking processes”).

<sup>6</sup> See 39 U.S.C. § 3622(d)(1)(C).

Several of the “objectives” of § 3622(b) are particularly relevant to the procedures to be used for classification changes. Consistent with the principles of “predictability” and “transparency,”<sup>7</sup> changes to classifications should be communicated in advance so that mailers have time to prepare for those changes. At the same time, the principle of “pricing flexibility” for the Postal Service implicitly calls for a corresponding level of “classification flexibility.”<sup>8</sup> As noted above, the process of defining products and services is intrinsically related to pricing, such that not according the Postal Service the ability to restructure its service offerings efficiently to meet market and operational conditions would render the “pricing flexibility” envisioned by the Act largely illusory.

Reflective of the fact that pricing and classification are inherently interrelated, the Commission’s role over classification changes in the new regime should be commensurate with its role over pricing. This was the case under the Postal Reorganization Act (PRA), as former § 3623 tasked the Commission with designing specific classification language based on enumerated statutory criteria, just as it designed specific rates under former § 3622. Under the PAEA, however, the Commission’s role over pricing has changed from a body designing specific rates to a regulator practicing oversight to ensure that the prices designed by the Postal Service in the exercise of its business judgment fall within the constraints imposed by the Act.<sup>9</sup> As MOAA succinctly states in its Reply Comments to the first Advance Notice:

The new procedures under the PAEA represent a profound change. The PAEA is intended to permit the Postal Service, an enterprise consisting of multiple products and types of customers, to function as it must if it is to survive and prosper. Under the new regulatory approach, the role of the Commission is not to “second guess” pricing and other management

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<sup>7</sup> See 39 U.S.C. § 3622(b)(2), (6).

<sup>8</sup> See 39 U.S.C. § 3622(b)(4).

<sup>9</sup> See, e.g., S. REP. NO. 108-318, at 21 (2004).

decisions, but rather to ensure that the Postal Service has not exceeded its authority.<sup>10</sup>

In the same way, the Commission's role with respect to classifications should be one of oversight, ensuring that the classification schedule designed by the Postal Service in the exercise of its business judgment is consistent with the standards set forth in the Act, rather than actually designing the classification schedule itself. The primary standard set forth by the Act in this regard is the objective that the classification schedule be "just and reasonable."<sup>11</sup>

**B. The term "product" is best interpreted now as being equivalent to the "subclasses" of mail**

In applying the provisions of the PRA, the Commission established a classification framework based on the concept of "subclasses" and "rate categories." Subclasses were based on distinct cost and market characteristics, with the former necessary for the purpose of attributing costs, and the latter necessary for the purpose of applying the non-cost factors of former § 3622 to assign institutional costs.<sup>12</sup> Rate categories, meanwhile, were developed to reflect different services within the subclass, of which many were workshare discounts based on avoided costs. The Commission developed this structure based on the unique statutory criteria of the PRA.

The PAEA has eliminated former §§ 3622 and 3623 and has replaced cost-of-service ratemaking with a price cap regime that is designed to allow the Postal Service the flexibility to redefine and reshape its product structure in order to meet the

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<sup>10</sup> Reply Comments of Mail Order Association of America, at 2.

<sup>11</sup> Section 3622 also sets forth some "factors" dealing with general classification issues that must be "taken into account" under the new regime. See 39 U.S.C. § 3622(c)(8), (9). As the Postal Service noted in its Initial Comments, these factors are always relevant to the rational, business-like management of a product structure adapted to the postal needs of the United States. See Postal Service Initial Comments at 21-22. Thus, it can be safely presumed that the Postal Service will, in the exercise of its business judgment, take such considerations into account.

<sup>12</sup> See PRC Op., MC95-1, at ¶ 1007.

challenges of the marketplace. The Act still mentions the concept of a “subclass” at several points,<sup>13</sup> but replaces the rigid framework of the PRA with a more dynamic and market-responsive regulatory structure centered on the statutory concept of “just and reasonable,” with additional standards applicable to those prices that are “workshare discounts” within the meaning of § 3622(e), and to contract prices under § 3622(c)(10).

The PAEA sets forth certain terms that are now central to the operation of the new regime: the “classes” of mail, “product,” and “workshare discounts.” The classes of mail (which are relevant for purposes of applying the price cap) are defined by reference to the Domestic Mail Classification Schedule (DMCS) that existed at the time of the PAEA’s enactment.<sup>14</sup> “Workshare” discounts, meanwhile, are defined in § 3622(e) as discounts provided to customers for certain specified activities, such as presortation, that allow the Postal Service to avoid costs that it otherwise would have incurred. As noted above, such discounts are subject to special statutory standards not applicable to other prices or services.

The application of the term “product” is central to the operation of the new regime, including the classification process. “Product” is used throughout the statute with respect to the attribution of costs,<sup>15</sup> service performance,<sup>16</sup> and reporting requirements.<sup>17</sup> In addition, in § 3642, the PAEA sets forth a specific process for “chang[ing] the list of market-dominant products under section 3621 and the list of

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<sup>13</sup> See, e.g., 39 U.S.C. § 3622(e)(2)(C).

<sup>14</sup> See 39 U.S.C. § 3622(d)(2)(A).

<sup>15</sup> See 39 U.S.C. § 3633(a)(2).

<sup>16</sup> See 39 U.S.C. § 3691.

<sup>17</sup> See 39 U.S.C. § 3652.

competitive products under section 3631 by adding new products to the lists, removing products from the lists, or transferring products between the lists.”<sup>18</sup>

The PAEA defines “product” as “a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied.”<sup>19</sup> Read solely in isolation, this definition could be interpreted as stating that individual rate categories are individual “products.”<sup>20</sup> Determining what constitutes an individual “product” under the PAEA requires, however, a practical consideration of the statutory definition read in conjunction with the statute as a whole.<sup>21</sup> There are a number of aspects of the PAEA that, when read as a whole, support an understanding that “product” should be interpreted at a high level of aggregation. At this time, it is most practical and legally supportable to interpret “product” as being generally equivalent to the current “subclasses” under the PRA. Going forward, meanwhile, the use of the disjunctive “cost or market” in the definition of “product” allows the Postal Service and Commission greater ability to group postal services into distinct “products” based on customer and business needs, regardless of how those postal services were grouped under the old PRA law.<sup>22</sup> In other words, when read in conjunction with the statute as a whole, the definition of “product” does not demonstrate that the term equals “rate category,” but that under the new system the standard for treating mail matter as distinct “subclasses” (i.e., “products”) has been made more flexible. The exercise of this

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<sup>18</sup> 39 U.S.C. § 3642(a).

<sup>19</sup> 39 U.S.C. § 102(6).

<sup>20</sup> The Commission has historically employed the conjunctive “cost and market” when defining “subclasses” under the PRA. See PRC Op., MC95-1, at ¶ 3025.

<sup>21</sup> See 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 46.05 (6<sup>th</sup> ed. 2002) (stating that “[e]ach part or section [of a statute] should be construed in connection with every other part or section so as to produce a harmonious whole,” consistent with the general purpose and intent of Congress).

<sup>22</sup> This is consistent with the creation of a dynamic regulatory structure that is less rigid than the PRA framework.

flexibility, in turn, must be practiced with care, based on changing business and market needs, and should be considered gradually over time.

The attribution of costs under the new regime supports an interpretation that “product” should be applied at a high level of aggregation. Congress has endorsed the Commission’s attribution standards under the PRA in both §§ 3622(c)(2) and 3631(b), which tie attribution to “reliably identified casual relationships.”<sup>23</sup> Such attribution has occurred at the subclass level, as discussed by the Senate Committee Report which seems to equate “subclass” with “product”:

Identifying costs which can reliably be found to have been caused by each specific subclass and service is essential to maintaining economically efficient rates and avoiding cross-subsidization, which occurs when rates from one product are used to pay costs associated with another.<sup>24</sup>

With respect to market-dominant products, the PAEA sets forth at § 3622(c)(2) the “requirement” that “each class of mail or type of mail service” cover its attributable costs. That section is in all relevant respects a restatement of former § 3622(b)(3) of the PRA, which the Commission held to mean that subclasses of mail were required to cover their attributable costs.<sup>25</sup> With respect to competitive products, meanwhile, the attribution requirement is expressly linked to “each competitive product.”<sup>26</sup> Given the uniformity between the attribution standard of those provisions, it is clear that they should be applied at the same level. In sum, there is nothing to suggest that attribution be done differently under the PAEA than it was done under the PRA: at the subclass level.

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<sup>23</sup> See also S. REP. NO. 108-318 at 9-10.

<sup>24</sup> *Id.* at 9.

<sup>25</sup> See, e.g., PRC Op., MC95-1, at ¶ 2073.

<sup>26</sup> 39 U.S.C. § 3633(a)(2).

Another aspect of the PAEA that supports this interpretation is § 3652(b). That provision requires the Postal Service to report certain information “with respect to each market-dominant product for which a workshare discount was in effect” during the previous fiscal year. The phrasing of this section suggests that a “market-dominant product” is not equivalent to “workshare discount,” such that an individual workshare discount (which is a rate category) is not itself an individual “product.” Rather, it seems that a “market-dominant product” may contain multiple rate categories, some of which are workshare discounts and some of which are not. Since there is no classification level between the subclasses and the rate categories at which to consistently apply the term “product,” it is proper at this time to interpret “product” as generally equivalent to “subclass,” as discussed above.

Finally, several textual aspects of § 3642 support such an interpretation of the term “product.” First, by referencing the “list of market-dominant products under section 3621” and the “list of competitive products under section 3631” as a benchmark, § 3642(a) defines the level of aggregation at which the term should be applied, and, by extension, when a proceeding under § 3642 is necessary. The § 3621 “list of market-dominant products” and the § 3631 “list of competitive products” generally correspond to the subclasses and classes of the current DMCS. The lone exception (on the domestic side)<sup>27</sup> is the special case in which Congress decided, for policy reasons, to separate the Parcel Post subclass into a market-dominant portion (“single-piece parcel post”) and a competitive portion (“bulk parcel post”).<sup>28</sup> Thus, when § 3642 speaks of the

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<sup>27</sup> Because international mail was not subject to Commission jurisdiction under the PRA, it was not separated into distinct classes, subclasses, and rate categories in the way that domestic services were.

<sup>28</sup> For a discussion of why this split occurred, see S. REP. NO. 108-318 at 7. It is noteworthy that, even had the PAEA not mandated this separation of Parcel Post, there were already indications that these two

Commission changing the lists of market-dominant products under § 3621 and competitive products under § 3631, it is speaking in almost all circumstances of changing a list of products defined at a high level of aggregation (*i.e.*, the subclass level and above).

Second, § 3642(c) states:

Transfers of Subclasses and Other Subordinate Units Allowable—Nothing in this title shall be considered to prevent transfers under this section from being made by reason of the fact that they would involve only some (but not all) of the subclasses or other subordinate units of the class of mail or type of postal service involved (without regard to satisfaction of minimum quantity requirements standing alone).

If the term “product” was equivalent to, say, the rate category level, this subsection would appear to be completely extraneous: the power to transfer such subordinate units would be implicit in the Commission’s authority under § 3642(a) to transfer a “product” between the market-dominant and competitive lists. Congress is presumed, however, not to have enacted extraneous provisions.<sup>29</sup> This section only seems necessary if it is understood that “product” is a term to be applied at a highly aggregated level,<sup>30</sup> such that it is necessary to explicitly clarify that the Commission has the authority to “break up” an existing product in the situation where it is appropriate to move a portion of that product from one side of the business to another.

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portions of Parcel Post were more properly separate subclasses under PRA law. See PRC Op., R2006-1, at ¶ 5013-14; see *also* Docket No. R2006-1, Rebuttal Testimony of Sander Glick, PSA-RT-1 at 3-7.

<sup>29</sup> See SUTHERLAND STATUTORY CONSTRUCTION § 46.06 (“A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant....No clause sentence or word shall be construed as superfluous, void, or insignificant if the construction can be found which will give force to and preserve all the words of the statute.”).

<sup>30</sup> Indeed, one could read this section as implying that “product” is equivalent to the classes of mail. However, the best reading, based on the entirety of the statute as discussed herein, is that “product” is generally equivalent to the subclasses of mail, as discussed *supra* at page 6.

Third, § 3642 is one of the few provisions of the PAEA that does not set forth a specified notice period or a specified period of regulatory review.<sup>31</sup> These notice or regulatory review provisions seem designed to ensure that the Postal Service has greater flexibility than it did under prior law. The lack of such specificity in § 3642 seems to indicate an expectation that proceedings under that section would be relatively infrequent and of significant scale, and would not be used with respect to small-scale classification changes such as the addition of new services or rate categories within an existing “subclass.” For example, the statute permits the Postal Service to change all of its market-dominant prices following a 45-day Commission review. It would be counterintuitive to believe that Congress intended that intra-subclass classification changes, with a vastly smaller financial effect, would be subject to an indeterminate, and possibly longer, period of prior regulatory review than the annual general price change under the CPI-U cap.<sup>32</sup>

**C. The law still requires a “mail classification schedule” distinct from operational documents like the DMM**

The DMCS was promulgated by the Commission pursuant to its authority under former § 3623 to establish a “mail classification schedule.” While former § 3623 has been eliminated by the PAEA, a “mail classification schedule” at a level of detail

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<sup>31</sup> See, e.g., 39 U.S.C. § 3622(d)(1)(C) (45-day prior review of market-dominant price adjustments); §3632(b)(2)-(3) (30 or 15 day notice of competitive price or classification decisions); § 3653(b) (90 day review of Postal Service annual compliance report).

<sup>32</sup> Applying § 3642 to low-level classification changes like the introduction of a new service or rate category would seem to undercut the flexibility and incentives for innovation intended by Congress under the PAEA. Under former § 3623 of the PRA, the Postal Service was required to seek a recommended decision before implementing any change to the DMCS. Requiring the Postal Service to seek prior Commission approval, through a proceeding of indeterminate length, every time it wishes to add a new service or rate category to an existing subclass, would seem to be just as, if not more, restrictive than the classification procedures of prior law.

analogous to the current DMCS is still contemplated by the Act.<sup>33</sup> For example, § 3621(c) states that the products listed in § 3621(a) are to be defined by reference to the “meaning given to such mail matter under the mail classification schedule.” A similar provision also appears with respect to the competitive side, in § 3631(c).

Therefore, it is still appropriate to maintain a “mail classification schedule” for regulatory purposes, separate and distinct from customer-focused operational documents such as the Domestic Mail Manual (DMM). However, reflective of the different regulatory regimes applicable to market-dominant and competitive products, there should be two classification schedules, one for each side of the business. Both schedules would, as an initial matter, be based on the language currently in the DMCS, separated appropriately, and with classification language pertaining to international mail added.<sup>34</sup>

## **II. Market-Dominant Products: Procedural Framework for Classification Changes**

Whenever the Postal Service proposes to create a new “product,” it would follow the procedures of § 3642 by petitioning the Commission to assign the new product to either the list of market-dominant products, or to the list of competitive products. For other classification changes, the Postal Service has endeavored to come up with a proposed classification framework that best comports with the intent of the PAEA, by

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<sup>33</sup> The DMCS is a “definitional” document, which “describe[s] and differentiate[s] the characteristics of mail embraced within the various [mail] classes.” See PRC Op., MC88-2 at 9; see also PRC Op., MC95-1, at ¶ 2055. It thus generally describes the postal services, and sets forth the rates and fees associated with those services.

<sup>34</sup> The Postal Service stands prepared, if the Commission agrees with this interpretation of the Act, to set forth specifically what the “Market-Dominant Products Classification Schedule” and the “Competitive Products Classification Schedule” should contain, by reference to the provisions of the current DMCS.

ensuring that mailers have transparency and predictability, while the Postal Service has increased flexibility. That framework is described below:

To provide transparency and predictability, the Postal Service is committed to working with the mailing community to communicate classification changes (and associated mail preparation changes through proposed revisions to the DMM) in advance of the formal notice to the Commission. A healthy Postal Service requires a healthy mailing community that clearly understands the direction and purposes behind any proposed classification change.<sup>35</sup> For substantive changes to the “Market-Dominant Products Mail Classification Schedule,” the Postal Service will engage affected customers, including through notices in the *Federal Register* and an opportunity for formal customer comment. This will ensure that interested parties are able to fully engage with the Postal Service prior to the classification change being noticed to the Commission. Final changes to the mail classification schedule would then be published in the *Federal Register*.

Most classification changes are accompanied by a price change, which are subject to the 45-day review provision of § 3622.<sup>36</sup> Within any market-dominant product, there may be a number of different prices, including “workshare discounts” within the meaning of § 3622(e) and other services that are predicated on market

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<sup>35</sup> In addition, as noted in its Initial Comments, the Postal Service will publicize long-term plans for product and pricing changes that could require substantial restructuring or business process redesign, and work with customers to ensure a smooth implementation of those changes. Postal Service Initial Comments at 30-31.

<sup>36</sup> Certain changes to the mail classification schedule may not be accompanied by a price change. Recently, for example, such a “pure classification change” was made when, pursuant to Postal Service Request, the Commission recommended a change to the definition of “nominal rate” for purposes of Periodicals eligibility. See Docket No. MC2006-5. If such a change is made outside of the annual price change process, the Postal Service would also provide at least 45-days notice.

considerations or on costs that are not associated with worksharing.<sup>37</sup> When the Postal Service establishes a new workshare discount (by, for example, de-averaging an existing workshare discount),<sup>38</sup> or establishes a new service, it will provide a Notice of Price Adjustment pursuant to § 3622(d)(1)(C).<sup>39</sup> At the same time, the Postal Service would formally notice to the Commission the mail classification schedule language, developed through the customer engagement process discussed above, describing the application of the new price.<sup>40</sup> In the 45-day prior review, the Commission would review the price for compliance with the cap. A specific review of the classification language published by the Postal Service would only be needed if a party challenges its lawfulness through a complaint.

This framework is premised on principles grounded in the fundamental change in the relationship between the Postal Service and the Commission contemplated by the PAEA. The Commission's role is not to design classifications, but to ensure that the classifications designed by the Postal Service are consistent with the Act. Thus, it is fundamentally the role of the Postal Service to work with customers in developing the classification schedule. The Commission, meanwhile, should defer to the business

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<sup>37</sup> The latter refers to a new service that falls squarely within the type and characteristics of mail that are defined within the existing "subclasses," such as, hypothetically, a flat-rate box for First-Class Mail.

<sup>38</sup> The de-averaging of existing rate categories serves to create two separate prices where one price previously existed. From a customer perspective, this is a pure price change and would fall within the requirements for demonstrating compliance with the price cap. Frequently, this type of de-averaging affects workshare discounts. For example, in the past the Postal Service proposed de-averaging basic presorted automation First-Class Mail letters into mixed-AADC and AADC presorted automation letters. These proposals did not change the required sortation schemes—AADC sortation was always required if possible—but the proposals did apply different prices based on the level of sortation.

<sup>39</sup> See Postal Service Reply Comments, Appendix C at 12. In the Postal Service's response to Question 3 of the Second Advance Notice, it discusses the additional data it will provide with respect to workshare discounts, due to the special standards applicable to them.

<sup>40</sup> Thus, if the new service is offered as part of the annual price change, mailers would be given approximately 90 days advance notice of the classification change, consistent with the illustrative regulatory schedule set forth in the Postal Service's Reply Comments. For new service offerings made at other times of the year, at least 45 days notice would be given.

judgment of the Postal Service when it comes to classification language that is developed, and should review that language only when it is asserted that it violates the statute.

With respect to customized agreements, meanwhile, § 3622(d)(1)(C) explicitly states that they are subject to a 45-day prior review by the Commission. At the time the Postal Service files its Notice of the new, customized prices with the Commission, it would also file information demonstrating that the NSA satisfies the criteria of § 3622(c)(10).

### **III. Competitive Products**

With respect to competitive products, the PAEA clearly vests classification authority with the Governors, and establishes certain requirements applicable to the Governors' classification decisions.<sup>41</sup> The Commission's role, meanwhile, is to determine which products are to be assigned to the competitive side (which it will exercise pursuant to § 3642), to establish "criteria for determining when a rate or class...is or is not of general applicability" (which will determine how much notice is required prior to any classification change), and to ensure that the prices and classifications set forth by the Governors meet the cost floor requirements of § 3633. Under § 3632, therefore, the Governors will maintain the "Competitive Products Classification Schedule," and will notice changes to it pursuant to the provisions of § 3632(b). Please see the Postal Service's initial response to Question 5 of the Second

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<sup>41</sup> 39 USC § 3632.

Advanced Notice for a discussion of related issues.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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