

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

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**Regulations Establishing System  
of Ratemaking**

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**Docket No. RM2007-1**

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

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## **I. INTRODUCTION**

In its April 6, 2007, comments in response to PRC Order No. 2, the first Advance Notice of Proposed Rulemaking (ANPRM I), Pitney Bowes Inc. (Pitney Bowes) suggested that in developing the modern system of ratemaking the Postal Regulatory Commission (Commission) should adhere to the following guidelines: (1) embrace the letter and intent of the statute, (2) promote reduced costs and improved efficiency through rules and incentives, (3) enhance mail's value proposition, and (4) balance pricing flexibility with predictability and stability. Above all:

the Commission must further the congressional objective “to reduce costs and increase efficiency.” This will ensure a vibrant, growing mailing industry and continuing universal, affordable mail service . . . the Commission can do this by building upon its decisions recognizing the importance of Efficient Component Pricing. This will ensure that postal rates for market dominant products, to the maximum extent practical, reflect Postal Service costs and will minimize total costs for the postal sector.

Pitney Bowes Comments (ANPRM I) at 39.

Having had the benefit of numerous comments of others over several months, we continue to believe that these recommendations are central to the Commission's effort to resolving differences among the parties as to how it should proceed in establishing a new system of ratemaking.

The range of views is evidenced in the comments in response to the PRC Order No. 15, the Commission's Second Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking (ANPRM II). On one end of the spectrum there are those such as the Office of Consumer Advocate (OCA) who suggest the new system should largely be a continuation of the existing cost-of-service regime with some “procedural modifications.” OCA Comments at 1. On the other end are those

such as the Postal Service who argue for virtually unfettered pricing flexibility. The Commission must find a middle ground.

The modern rate system should not be a cost-of-service regime, but it *will* require a strong and active regulator to prescribe rules that ensure cost-based or “cost-reflective” rates. At the same time, the limitations, such as the annual limitation on rate increases (price cap) and the limitation on workshare discounts, imposed by the Postal Accountability and Enhancement Act (PAEA), *see* Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006), should be administered in a manner that minimally intrudes on the flexibility in pricing, product introduction, and operations that Congress intended to give the Postal Service under the PAEA.

This requires a delicate balance. In ANPRM II the Commission is asking parties how it should achieve that balance with respect to both market-dominant and competitive products. Pitney Bowes’ initial comments urged that:

the Commission fashion price cap rules that promote pricing flexibility, reduce administrative burden, and provide stability and predictability;

the statutory workshare limitations and reporting underscore the importance of an active Commission role in administering the PAEA to ensure cost-reflective rates;

the Commission require reporting under sections 3622(e) and 3652 that meets the statutory requirements while minimizing the administrative burden on the Postal Service; and

the Commission’s regulations promote pricing flexibility for competitive products.

*See* Pitney Bowes Comments at 1-4, 9-12.

Below we respond to the comments of others on the key issues raised in ANPRM II including application and administration of the price cap and statutory workshare requirements for market-dominant products, and the regulation of competitive products.

## **II. DISCUSSION**

### **A. Regulations Concerning Market-Dominant Products**

1. The Commenters are in Accord Regarding the Need for Price Cap Rules That Promote Flexibility, Reduce Administrative Burden, and Provide Stability and Predictability.

*a. The Commission Should Adopt the “12 Month Moving Average” Methodology.*

The majority of the commenters agree that the Commission’s “12-month moving average” methodology is the superior approach because it better reflects the letter and intent of section 3622(d)(1)(A), and because it furthers the statutory objective of achieving “predictability and stability in rates” by smoothing monthly variations and increasing transparency. *See* ADVO Comments at 2; GCA Comments at 2-4; MOAA Comments at 1; NAA Comments at 1-5; Pitney Bowes Comments at 2-3; PostCom Comments at 2-4. In fact, even those parties advocating in favor of the Postal Service’s proposed “point-to-point” method concede that it has the disadvantage of being more “volatile” and introduces the “risk of large, short term variations.” APWU Comments at 3; Postal Service Comments at 3. And the Postal Service concedes “that no long-term advantage or disadvantage to the Postal Service would result from either alternative, the objective that the new pricing system assure the Postal Service ‘adequate revenues’ does not appear to favor one method over the other.” Postal Service Comments at 3 (footnote omitted). Accordingly, the Commission should calculate the annual limitation under the “12 month moving average” methodology.

*b. There is Broad Agreement with the Postal Service's Proposed Use of Historical Data for Purposes of Calculating Compliance with the Annual Limitation.*

Numerous commenters advocate the use of historical volume data for purposes of calculating compliance with the annual limitation. *See* ANM / MPA Comments at 1-2; APWU Comments at 3, ADVO Comments at 3; Pitney Bowes Comments at 3-4; Postal Service Comments at 4-9. The use of historical volume data allows for a predictable and transparent means of determining whether proposed rate changes comply with the annual limitation. The use of verifiable historical volume data would also facilitate pricing flexibility by providing the Postal Service increased confidence that proposed rate adjustments would be in compliance with the annual limitation.

In contrast, the complexity and practical difficulty of projected volume data is inherently inconsistent with the annual limitation and the PAEA's promotion of administratively economical regulation. *See* 39 U.S.C. § 3622(b)(6). ADVO's concern that because of "the complexity and judgmental nature of volume forecasting, projected volumes would be subject to both manipulation and litigation," is well founded. ADVO Comments at 3.

*c. In Those Circumstances Where There Is No Historical Data, The Commission Should Establish Rules That Encourage The Postal Service To Pursue the Pricing Flexibility And Product Innovation Contemplated by the PAEA.*

Assuming the use of historical volume data, the Commission specifically invited parties to address how the "method of calculating the annual change in rates" should "treat an altered rate design, for example, one for which billing determinants do not exist, such as the new rates to be applied to Periodicals." PRC Order 15 at 5. There are a number of circumstances under the PAEA in which historical data will not be available.

These include: (1) the introduction of experimental products through market tests under section 3641, (2) the introduction of a *bona fide* new product under section 3642, (3) the adoption of special classifications and contract rates (NSAs), and (4) a substantially altered rate design proposal. In each of these circumstances the Commission should fashion rules that encourage the Postal Service to pursue the pricing flexibility and product innovation contemplated by the PAEA.

i. Market Tests for Experimental Products

The PAEA expressly excludes experimental products from the compliance determination. Section 3641 provides, in pertinent part, that “[a] product shall not, while it is being tested under this section, be subject to the requirements of section[] 3622 . . . or regulations promulgated under [that] section[.]” 39 U.S.C. § 3641(a)(2).

ii. *Bona Fide* New Products

Numerous parties recommend that the Commission rules exclude *bona fide* new products from the compliance determination in the year those new products are introduced. *See* APWU Comments at 4; ADVO Comments at 4; OCA Comments at 18-19; Pitney Bowes Comments at 4; PostCom Comments at 5-6; USPS Comments at 6-10. Because the PAEA contemplates a more dynamic, market-responsive regulatory environment, the Commission’s rules should encourage the Postal Service to respond to changing market and technological developments by offering innovative new products and services. As discussed above, excluding *bona fide* new products from the cap calculation is also consistent with the statutory treatment of new products introduced via market tests.

### iii. Special Classifications / Contract Rates

Several commenters also urged the Commission to adopt rules to exclude special classifications and contract rates (NSAs) from the compliance determination. *See* ADVO Comments at 4; Pitney Bowes Comments at 4. As above, the Commission must exercise care to avoid implementing the annual limitation in a manner that discourages new product and pricing innovations.

Additionally, as ADVO correctly observes:

assuming that NSAs will almost always reduce the specific mailer's rates (and increase its volumes), any inclusion of NSA billing determinants in class average rates will tend to reduce the apparent level of the proposed class-wide increase and thereby allow the Postal Service to justify higher rate increases for other mailers in the class within the CPI cap. . . . Eliminating NSA volumes and rates from the class average rate will avoid this negative impact while permitting the Postal Service full flexibility to pursue beneficial NSAs, knowing that any losses on NSAs cannot be recovered from other mailers.

ADVO Comments at 5.

### iv. Substantially Altered Rate Design

The method of calculating the annual change in rates for altered rate design should turn on the nature and significance of the "altered rate design." ANM / MPA draws a distinction between "structural" changes in rate design (e.g., Periodicals) and non-structural changes in rate design. *See* ANM / MPA Comments at 2. With respect to "structural" changes to a rate design, ANM / MPA urges the Commission to require the Postal Service to provide a volume forecast estimate and a mail characteristics study at the time the "structural" change in the rate design is proposed. *See id.* In contrast, compliance determinations with respect to non-structural rate design changes should be addressed retrospectively after billing determinants are available. *See e.g.,* PostCom

Comments at 5. This is a sensible approach. The Commission’s rules should establish a discretionary determination to be made on a case-by-case basis as to whether a proposed rate change is “structural” and if so, what additional data or information is required from the Postal Service. Any such rule must be narrowly tailored to appropriately balance the PAEA’s competing objectives of pricing flexibility and reduced administrative burden with the predictability and stability intended from the annual limitation.

2. The Commission Should Assess Compliance with the Annual Limitation on the Basis of Average Revenue Per Piece, Not on the Basis of “Actual Current Rates” as Proposed by the Postal Service.

Citing administrative difficulties with calculating average revenue per piece and the complexity of applying the annual limitation to a base period with overlapping rate regimes, the Postal Service proposes that the annual limitation be applied to “actual current rates” in effect at the time of the next rate increase. *See* Postal Service Comments at 5-6, 6 n.3 and 4. This proposal is inconsistent with the PAEA. The annual limitation is intended to provide mailers the assurance that from year to year postage rates within any given class of mail, on average, will not increase at a rate greater than inflation. The Postal Service’s proposal to use “actual current rates” would undermine this defining feature of the PAEA.

A variation of the example set out in the Postal Service’s comments illustrates why using “actual current rates” is inappropriate. The Postal Service sets out a hypothetical in which there is a class with a single product with a rate of 20 cents and a five percent increase in the CPI-U from year to year. *See* Postal Service Comments at 6 (footnote 3). Now assume further that the rate for the first half of Year 0 was 15 cents and the rate for the second half of Year 0 was 25 cents. Extending the Postal Service’s

hypothetical in this way would still ensure that, on average, the 20 cent rate complies with the annual limitation. But if the same five percent increase in the succeeding year, Year 1, were applied to the “actual current rate” in effect at the time of the rate change (25 cents) the result would be a Year 1 rate of 26.25 cents. This is an effective year-to-year rate increase of 31 percent. In contrast, if the five percent increase for Year 1 were applied to the “average revenue per piece” of 20 cents, the result would be a Year 1 rate of 21 cents. This is an effective year-to-year increase of 5 percent. Accordingly, the Commission should require the Postal Service to use average revenue per piece as the appropriate measure for purposes of determining compliance with the annual limitation.

To address, in part, the complexity associated with overlapping rate regimes identified by the Postal Service, the Commission should also require that the twelve month period used for purposes of calculating average revenue per piece is the same twelve month period that is used for purposes of establishing the relative volume weights.

For purposes of transparency and administrative efficiency, the Commission should require the Postal Service to use its fiscal year as the twelve month period for purposes of measuring both the average revenue per piece within each class and the relative volume weights for the base rates. Pursuant to Section 3622(d)(1)(A), the applicable CPI-U percentage change would be based on the most recent available twelve month period preceding the date the Postal Service filed its notice of intention to increase rates.

Use of the fiscal year would have the added benefit of tying the base rate and volume weight calculations to the same data and information that will be used for purposes of the Postal Service’s annual report to the Commission under section 3652.

3. There is Broad Agreement that the Workshare Regulations Should Promote Efficiency and Minimize the Administrative Burden on the Postal Service.
  - a. *Numerous Parties Recognize the Continuing Importance of Worksharing and the Efficient Component Pricing Rule in Promoting Efficiencies and Reducing Total Postal Sector Costs.*

ADVO, MOAA, NAPM, NPPC and Pitney Bowes all discuss the continuing importance of worksharing under the PAEA as a means to enhance productive efficiency, reduce total postal sector costs, and stimulate future mail volume growth. *See* ADVO Comments at 6; MOAA Comments at 2; NAPM Comments at 2, 4; NPPC Comments at 3-10; Pitney Bowes Comments at 4-6. ADVO specifically cautions, as Pitney Bowes has in previous comments, that the Commission must “take care that the rules implementing [the workshare provisions] not freeze, or perhaps even reverse, some of the long-term progress that has been made to worksharing programs.” ADVO at 6; *see also* Pitney Bowes Reply Comments (ANPRM I) at 4.

NAPM, NPPC, and Pitney Bowes also advocate for the Commission’s continued adherence to the “bedrock principle” of Efficient Component Pricing (ECP) under the modern rate system to promote efficiencies and safeguard competitive access to the postal network. *See* NAPM Comments at 4, NPPC Comments at 4-6; Pitney Bowes Comments at 4-6. NPPC accurately observes that:

Unbundling and ECPR pricing promote competition and economic efficiency by encouraging “the competitive segment of the service [to] be performed only by efficient suppliers – that is, by those suppliers whose incremental costs incurred to supply the service are the lowest available.” ECPR-compliant rates “reflect cost differences fully,” and thus “send proper price signals,” thereby resulting in “more efficient processing and transportation practices, which in turn reduce costs, thereby allowing smaller rate increases, and less volume losses.”

NPPC Comments at 5 (quoting and citing R2006-1 PRC Op. & Rec. Decis. (Feb. 26, 2007) at ii).

As set forth in ADVO's and NPPC's comments, the Commission must exercise care to avoid establishing inflexible or administratively burdensome rules which could dissuade the Postal Service from offering workshare discounts that approach a 100 percent pass through. *See* ADVO Comments at 7-8; NPPC at 8. Pitney Bowes agrees. Consistent with ECP the Commission's implementing regulations should establish a presumption in favor of a 100 percent pass through, construing the general limitation as both a "ceiling" and a "floor."

*b. Consistent with the Limited Nature of the Commission's Compliance Review, Workshare Reporting Obligations in Connection with the Notice of Rate Adjustment Should be Minimal.*

The scope of the Commission's review upon the notice of rate adjustment is limited to a determination of whether the noticed rate adjustment complies with the annual limitation under section 3622(d)(1)(A). *See* Time Warner Comments at 8; Pitney Bowes Comments at 8. It is a "quick look." Therefore, workshare data reporting obligations under section 3622(e) in connection with the notice of rate adjustment should also be limited. Compliance determinations with respect to workshare discounts are properly reserved for the annual determination of compliance under section 3653. *See id.* The Commission's regulations must take care not to create an opportunity for parties to wage a "mini" rate case during the time of the focused compliance review under section 3622(d)(1)(C)(i).

*c. The Commission's Workshare Regulations Must Give Full Effect to the Statutory Exceptions to the General Workshare Limitation.*

ADVO, NAPM, and NPPC all appropriately recognize that the statutory limitation on “workshare discounts” is narrowly defined and subject to important statutory exceptions. *See* ADVO Comments at 8-9; NAPM Comments at 2-3; NPPC Comments at 7-10. The statutory exceptions identify circumstances in which the postal system may benefit from a workshare discount that exceeds avoided costs. As noted in NAPM’s Comments, the “enumerated exceptions are as much a part of the modern rate system contemplated by the PAEA as is the general limitation.” NAPM Comments at 3.

*d. Most Exceptions to the Workshare Limitation Should Be Addressed on a Case by-Case Basis. One Exception, However, Is Particularly Important.*

NAPM and NPPC urge the Commission to address the statutory exceptions under section 3622(e)(2) on a case-by-case basis, “rather than through the establishment of rules in the abstract.” NPPC Comments at 8; *see also* NAPM Comments at 3. Pitney Bowes agrees this is a sensible approach. The exceptions in paragraphs (A) through (C) of section 3622(e)(2) apply to a specific situation such as a new or changed product, *see* 39 U.S.C. § 3622(e)(2)(A), or for a limited period of time. *See* 39 U.S.C. § 3622(e)(2)(A) and (B). Another exception, however, applies in all cases without time limitation. It provides that the general limitation on workshare discounts does not apply if the “reduction or elimination of the discount would impede the efficient operation of the Postal Service.” 39 U.S.C. § 3622(e)(2)(D). This general exception is further evidence of the importance Congress placed on efficiency in the PAEA. It would be an odd result, indeed, if the workshare reporting requirements and review requirements

discussed above were so onerous that they resulted in inefficient operation of the Postal Service.

## **B. Regulations Concerning Competitive Products**

1. Advo, MOAA, and PSA Properly Caution that the Commission Must Fashion Competitive Product Rules that Permit the Postal Service to Compete in Competitive Product Markets.

In response to the Commission's request for comment on how it should administer various PAEA provisions related to competitive products, Pitney Bowes urged the Commission to prescribe regulations that permit and promote pricing flexibility for competitive products and urged it to adopt a broad definition for competitive "products" as a means to promote flexibility. *See* Pitney Bowes Comments at 9, 11.

In this latest round of comments, some have suggested cost attribution or allocation methods which would appear to substantially increase the institutional cost burden borne by Postal Service competitive products. *See* UPS Comments at 7-16. This would be a mistake and is not required by the PAEA. Others have pointed out that "[t]he Postal Service's position in the package delivery market is fragile." PSA Comments (ANPRM I) at 3.

The Mail Order Association of America correctly describes the situation:

MOAA is concerned primarily with the market-dominant products, but competitive products have been, and must continue to be, a vital part of the mail. . . . The institutional costs contribution must be set at a level low enough to enable the Postal Service to actually compete. As discussed in MOAA's earlier comments, the Postal Service has been given no increased control over its labor costs and it is essential that the competitive products not be burdened with a share of institutional costs that will prevent competition. The danger to the market-dominant products is not setting the share of institutional costs for competitive products too low, but rather driving competitive products out of the system by setting a share that is too high.

MOAA Comments at 2-3.

It is imperative that the Commission's regulations balance the allocation of institutional costs as matter of fairness to other market participants. At the same time, the Commission must ensure that the viability of the Postal Service competitive product offerings is not threatened by overburdening them with institutional costs.

2. OCA Incorrectly Suggests That Pitney Bowes Supports Monthly Reporting of Data on Competitive Products.

OCA's comments incorrectly suggest that Pitney Bowes supports the OCA's call for *monthly* reporting of data on competitive products. *See* OCA Comments at 29, 30 (quoting Pitney Bowes Reply Comments (ANPRM I) at 19). That is not Pitney Bowes' position. OCA is correct that Pitney Bowes has expressed concern that a lack of "contemporaneous" data could hinder the ability of parties to challenge unlawful rates through the statutory complaint process. *See* Pitney Bowes Reply Comments (ANPRM I) at 17-19. Pitney Bowes has also stated that the Commission should establish routine data production requirements for *market-dominant products* to facilitate the annual compliance process, ensure transparency and permit meaningful review of rate changes. *See id.* But this should not be taken as support for required monthly data reporting for *competitive products*. Consistent with the fundamental structure of the PAEA, Pitney Bowes is on record in support of maximum flexibility for competitive products.

**III. CONCLUSION**

Pitney Bowes appreciates the Commission's consideration of these comments as it prepares to implement the modern system of ratemaking contemplated under the PAEA. Pitney Bowes urges the Commission to provide advance, comprehensive

guidance as to the requirements and boundaries of the new system of ratemaking. As before, 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.

Respectfully submitted:

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/s/

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