

**UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001**

**Regulations Establishing System
Of Ratemaking**

Docket No. RM2007-1

JOINT COMMENTS ON OCA POSITIONS

The Association for Postal Commerce, Advo, Inc., Alliance of Nonprofit Mailers, Direct Marketing Association, Magazine Publishers of America, Mail Order Association of America, National Postal Policy Council, Parcel Shippers Association and Time Warner, Inc. (hereafter "PostCom *et al.*") submit these joint comments to address the proposals set forth by the Office of Consumer Advocate ("OCA") in its comments filed on June 18, 2007 ("OCA Comments") in response to the Second Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking issued by the Commission on May 17, 2007 ("Second Advance Notice").

The proposals set forth by the Office of Consumer Advocate on a number of the key issues raised by the Commission in its Second Advance Notice of Proposed Rulemaking cannot be reconciled with the terms and the basic purposes of the Postal Accountability and Enforcement Act ("PAEA"). PostCom *et al.* submit these joint comments in order to facilitate the Commission's assessment of the proposals advanced by the OCA and thereby expedite the Commission's promulgation of regulations implementing the modern system of regulation called for by Congress and the President in the enactment of the PAEA.

PostCom *et al.* will show in these comments that a detailed exegesis by the Commission of the more controversial issues advanced by the OCA is not necessary: the

OCA's proposals proceed from a premise that is fatally defective, leading to certain regulatory proposals that either are flatly contradicted by the terms of the Act or do such violence to its unmistakable purposes that they are simply beyond the power of the Commission to entertain, much less to adopt. In support, the following is stated:

1. The wellspring of the specific proposals advanced by the OCA is clearly stated at the outset of the Office's comments. The OCA proceeds from the fundamental premise that the Commission

“will prescribe, in large measure, a system of regulation similar to the historic costing approaches used in previous omnibus rate cases with ... procedural modifications

OCA Comments at 1. There are at least two interrelated and fatal flaws with this governing premise. First, and foremost, the PAEA decidedly is not merely a “procedural modification” to the Postal Reorganization Act; as to rate setting, the PAEA completely overhauls the old law and constitutes a basic and profound change in policy. Second, it is certainly true that the Commission and the Postal Service can and should use – in certain cases with appropriate adaptation – the historic accounting systems (such as the CRA, RPW, and billing determinants reports), in the discharge of reporting and compliance determinations called for by the PAEA. It does not follow, as the OCA's comments assert, that the modern system of regulation is simply a reinvention or indeed an expansion of the cost of service ratemaking system that existed under the Postal Reorganization Act of 1970. The PAEA is substantive. It entirely replaces – both for market dominant and competitive products – the cost of service ratemaking system under former law.

PostCom *et al.* are convinced that this conclusion emerges unmistakably from a reading of the provisions of Section 201 and Section 202 of the Act. The former requires the

Commission to establish regulations implementing a price cap regime, based upon changes in the CPI, that is applicable to market dominant products; and neither of these concepts is to be found anywhere in former law. Section 202, applicable to competitive products, places the basic authority to establish rates and categories for competitive products in the hands of the Governors subject to certain specific and narrow safeguards to guard against cross-subsidization, predatory pricing and other forms of unfair competition. The OCA's position that the PAEA entails merely "procedural modifications" cannot be reconciled with the statute itself.

It is equally plain that any attempt to reintroduce, much less to expand, cost of service ratemaking by treating the PAEA as procedural would undermine its basic purposes.

Congress intended to do a great deal more than change the *procedures* for ratemaking:

The objective of the bill is to position the Postal Service to operate in a more business-like manner. To achieve this goal, the system must be responsive to market considerations and must provide clear incentives for postal management and the Postal Service as an institution. The Postal Service would no longer operate under a break-even mandate. By maximizing gains and minimizing costs, the Postal Service could generate earnings ... In the same way, losses could not be recovered by increasing rates beyond specific parameters without regulatory approval.

Report to Accompany H.R. 22 at 43 (April 28, 2005).

Thus, Congress intended to establish an "entirely new method of rate regulation" (to use the OCA's words) for market dominant and competitive products. Since the Commission's jurisdiction and its authority derive exclusively from the powers and the limitations imposed upon it by Congress (*U.S. v. Mead Corp.*, 533 U.S. 218, 226-27 (2001)), the Commission cannot simply treat the PAEA as a "procedural modification" to the Postal Reorganization Act. As a consequence, the governing premise from which the OCA's more radical proposals stem must be rejected.

2. Perhaps as the result of the OCA's fatally flawed policy predicate, but in any event, many of the specific proposed rules or policy advanced in the comments cannot be credited. *PostCom et al.* will not burden the Commission with a detailed refutation of each of these proposals advanced in the OCA comments. A brief explanation of why several of the key propositions advanced by the OCA collide with the statute will, we believe, suffice.

The OCA's approach to the provisions of the Act governing workshare discounts is at odds with the statute and its basic purposes. The OCA begins its discussion by truncating Section 3622(e). OCA Comments at 21. It is absolutely true that the first sentence of that section sets forth the general rule that workshare discounts should not "exceed the cost that the Postal Service avoids as a result of workshare activity." However, the OCA completely ignores the remainder of the subsection which is dismissed as constituting exceptions "under explicit circumstances." OCA Comments at 21. The Commission does not have the authority, in developing its implementing regulations, to truncate the statute in this fashion. The rules which it promulgates must reflect each of the exceptions enumerated in Section 3622(e).

This is required not merely as a matter of basic statutory construction, but also because the failure to fully reflect all of the "explicit circumstances" embodied in the statute would defeat the overarching objectives that Congress and the President sought to realize. Of particular importance to the proper implementation of subsection (e) is the exception to the basic rule articulated at Subsection (e)(2)(D) which specifically provides that a workshare discount shall not be reduced or eliminated if to do so would "impede the efficient operation of the Postal Service." The Administration's basic principles for postal reform specifically decreed that the legislation must "ensure that the Postal Service's governing body and

management have the authority to reduce costs, set rates, and adjust key aspects of its business” in order to meet its obligations to customers in “a dynamic marketplace.” *Report to Accompany H.R. 22* at 43. The worksharing activities that the Postal Service’s rate structure encourages form a key part – if not the core – of the means by which the Postal Service can achieve that goal. The Commission must, therefore, fully implement Section 3622(e) through its regulations.

The OCA’s misreading of the workshare provisions leads it to a procedural conclusion which equally falls well outside the scope of the statute. The OCA insists that the basic workshare principle concerning avoided costs applies “without limitation as to time of day or day of the year” and that, therefore, the Commission must prescribe monthly data updates, at least with respect to the workshare provision. OCA Comments at 21. The OCA provides no authority for the proposition that the basic rule concerning avoided costs must be applied anew at every minute or any minute of every day of Postal Service operations. In fact, there is utterly no authority for that proposition in the statute.¹ As a consequence, the proposal for monthly data updates is equally unsupported. Indeed, it is insupportable: it collides with the explicit provision of the statute that spells out exactly what the Postal Service is to provide in the way of data concerning workshare discounts and when that information is to be provided. See Section 3652(b). There is simply no rational way to read monthly updates into a provision of the statute which specifically and unmistakably contemplates an annual report. The OCA’s position, therefore, cannot be credited.

The OCA’s proposals to establish a cap on increases at the subclass level clearly also cannot be accepted. The statute unmistakably specifies that the price cap mechanism, based

¹ Even if the basic avoided cost principle did apply on a real time basis, it would necessarily follow that all of the exceptions equally apply without temporal limitations.

upon CPI-U, is to be applied at the “class level.” See Section 3622(d). The OCA does not contend otherwise. Nonetheless, setting forth some purely hypothetical examples of rate increases in a “Rate Category,” the OCA arrives at the conclusion that “some level of subclass protection appears to be appropriate.” OCA Comments at 15. This proposition flies in the face of the terms of the statute. Early versions of the bills that became the PAEA considered approaches analogous to that advanced by the OCA. H.R. 22 would have allowed the Commission the discretion to decide how and at what level to apply the cap. H.R. 22 at 3622(d). But, none of the earlier bills or H.R. 22 became law. The law unmistakably specifies that the system of rules for modern rate of regulation is to be based upon the CPI and is to be applied at the class level. Where the law is unambiguous, as it is here, the Commission has no authority to consider what some might consider “appropriate” as a legal matter; and, in fact, the existence of the cap at the class level will limit the ability of the Postal Service to price subclasses under the fixed weight method of analysis that is widely endorsed by the commenting parties. Thus, the Commission’s task is to apply the statute in accordance with its terms. *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004).

The OCA’s approach to certain of the issues raised in the Second Advance Notice concerning the competitive classes equally go beyond the bounds of the statute and its purposes. The OCA’s responses to Questions 6(a) and 6(b) are illustrative. Those questions asked what data should be filed with the Commission to enable it to assess the Postal Service’s compliance with the requirements of Section 3633. In response, the OCA seemingly assumes that the Commission’s rules will require that changes in rates for competitive products occur at the same time as the annual adjustment of rates for market products. See OCA Comment at 29. However, under Section 3632, the establishment of

rates and classes for products in the competitive category rests entirely with the Governors of the Postal Service; and there is nothing in that provision that empowers the Commission to dictate to the Governors the timing of changes in rates for competitive categories. *See* Section 3632(b)(2). Although it has been the Governors' practice under former law to institute rate changes for International Services at the same time a rate changes are made effective for domestic rates, the Commission cannot, under the PAEA, bind the Governors to any fixed rate change cycle.

It follows that the OCA's insistence upon monthly reports under Section 3633 (OCA Comments at 30) are beyond the new statute. Such a demand would be "appropriate" if the statute contemplated monthly reviews of the extent to which the rates and revenues from the competitive categories are compliant with the safeguards of Section 3633. Section 3633 does not establish a fixed time for the review and evaluation of rates for the competitive categories. Nonetheless, a core premise of the statute is that precisely because they are subjected to competitive pressures, the rates for competitive services are to be less closely scrutinized than the market dominant rates, and are to be evaluated only against the need for safeguards prohibiting cross-subsidization, predatory pricing and anti-competitive conduct. It is thus clear that Congress did not intend the competitive rates to be subject to compliance reviews more frequently than those reviews take place with respect to market dominant services.² The only rational reading of the Act is that the annual compliance determination mandated by Section 3653 embraces both market dominant and competitive products. Thus, the sound exercise of the discretion conferred upon the Commission under Section 3633 compels the conclusion that any evaluation of the competitive rates under Section 3633

² Indeed, Subsection 3653(b)(1) specifically refers to a compliance determination "for products individually or collectively," thus encompassing all products, including competitive products.

should take place at the same time as the annual compliance audit mandated by Section 3652. The OCA's attempt to re-regulate the competitive categories must be rejected.

Lastly, there is the matter of the OCA's response to question 6(h). The Commission asks: if a return on investment approach to measuring compliance with Section 3633 were to be used for purposes of analyzing potential cross-subsidization of competitive products by market dominant products, how should the capital structure of the Postal Service be evaluated? The OCA makes no attempt to assess whether such an approach to the application of the safeguards embodied in Section 3633 comports with or is required by the PAEA. Instead, the OCA puts forth a proposal for what is the equivalent of a comparable earnings test – under which the business operations of the Postal Service serving competitive products would be analyzed as if these operations constituted a stand-alone company and the capital structure and return on investment of the hypothetical stand-alone enterprise would be measured by comparing the Postal Service's revenues and returns from competitive business operations with a selected set of “comparable companies.” OCA Comments at 41.

It is far from clear that the language of Section 3633 would allow a return on investment approach as the means of assessing compliance with the safeguards against cross-subsidies and predatory pricing. This is so because the Postal Service remains a unitary governmental undertaking with universal service obligations as to both market dominant and competitive products, making the creation of a capital structure for the competitive categories purely hypothetical. At all events, the OCA's approach to a return on investment analysis cannot be accepted. While the OCA invokes Section 482 of the Internal Revenue Code, OCA Comments at 41, fn. 28, the task of the IRS bears no resemblance to the task of this Commission under Section 3633 of the PAEA. The Tax Code permits the IRS to reallocate net

income among separate but affiliated entities in order to prevent “tax evasion.” 26 U.S.C. 482. The Commission’s task under Section 3633 has nothing to do with the reallocation of net income from separate enterprises. Rather, the Commission’s task is to guard against predatory behavior by a single enterprise offering two legally discrete product lines that share joint and common costs. The comparative earnings test advocated by the OCA was historically used by utility regulators in cost-of-service regulation of monopoly services as a surrogate for the operations of a competitive marketplace. *See, e.g., FPC v. Hope Natural Gas*, 320 U.S. 591, 603 (1944); *Bluefield Waterworks v. W. Va.* 262 U.S. 679, 682 (1923). Under the PAEA, however, postal products in the competitive category are by definition offered in a competitive marketplace. As a result, a comparative earnings analysis has absolutely no meaning and its adoption would eviscerate Section 202 of the new Act.

CONCLUSION

For these reasons, PostCom *et al.* urge the Commission to reject both the premise and the key proposals advanced by the OCA in its comments and to proceed with dispatch to the issuance of final proposed regulations for implementation of the modern system of ratemaking in accordance with the terms and clearly defined purposes of the PAEA.

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