

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

Regulations Establishing a System of Ratemaking

)
)
)
Docket RM2007-1

Further Comments of
DFS Services LLC

July 16, 2007

Robert J. Brinkmann
Attorney at Law
1730 M St. N.W. Suite 200
Washington, D.C. 20036
robert.brinkmann@rjbrinkmann.com
202.331.3037; 202.331-3029 (f)

Counsel for DFS Services LLC

Table Of Contents

I. Preliminary	1
II. DFS Supports The Postal Service’s Position On Pricing And Classification.	2
III. The OCA Comments Of June 18, 2007 Are Based On A Patently Flawed Premise About The PAEA And Should Be Given Little Weight.	3
IV. Reviewing Worksharing Discounts For Compliance With § 3622(e) Twice A Year Is Unnecessary And Would Be A Significant Waste Of Limited Commission And Mailer Resources.	5
V. Construing §3622 As Limiting Discounts Only To “Workshare Discounts” Would Be Fundamentally Inconsistent With The Act Since The Postal Service Has The Pricing Power To Create Rates And Discounts Based On Market Factors As Well As Costs Not Associated With Worksharing.	7
VI. The PRC Should Not Adopt The ECP Recommendation Of NPPC And Pitney Bowes.	8
VII. DFS Supports The Postal Service Position That Market-Dominant “Products” Initially Be Defined As Subclasses, But That In The Future They Can Be Subordinate Units Of Subclasses That Have Either A Distinct Market Or Cost Characteristic.	10
VIII. The Issue Of Whether An NSA Is A Product Or Not Should Be Considered, When Necessary, On An Ad Hoc Basis.....	11
IX. DFS Supports The Position That Past Pension Expenses Should Be Considered Institutional Costs And Current Pension Expenses Should Be Attributed.	12
X. While The Moving Average Method For Computing The CPI-U Would Be Permissible Under The Act, The Commission Needs To Justify Its Decision Carefully.	13

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

Regulations Establishing a System of Ratemaking)
Docket RM2007-1)

Further Comments of
DFS Services LLC
July 16, 2007

I. Preliminary

DFS Services LLC, formerly known as Discover Financial Services LLC (“DFS”) submits these Further Comments in Docket RM2007-1 in response to the Postal Service Supplemental Comments on the Classification Process, as well as Comments and Reply Comments filed in response to the Commission’s Second Advance Notice of Proposed Rulemaking in this docket.

DFS is a financial services company that operates the Discover® Card and holds an NSA with the Postal Service. With more than 50 million Discover Cardholders, DFS is one of the larger mailers of First-Class and Standard Mail letters in the country.

DFS wishes to commend the Commission for separating the service standard issue from the rate issues in this proceeding, and opening a separate docket. The service standard issue is a very important issue, and the procedural posture of a separate proceeding should ensure that it receives the attention it deserves.

Moreover, DFS commends the Commission for its determination to promulgate a new regulatory scheme by mid-fall of this year, and urges the Commission to include its

new market-dominant NSA regulations in that release rather than delaying their implementation.

II. DFS Supports The Postal Service's Position On Pricing And Classification.

DFS concurs with the Postal Service's Supplemental Comments on the Classification Process, which point out that pricing and classification are essentially "two sides of the same coin." Thus, if the Postal Service is to have authority over pricing—which is the clear intent of the new Act—it must have authority over classification. The two must go together, and both are necessary in order for the Postal Service to have true control and responsibility for its own pricing.¹

DFS, in its Reply Comments filed on May 7, 2007 in this Docket, made the same point. In those Comments, DFS discussed the fundamentally changed roles of the Commission and the Postal Service under the Postal Accountability and Enhancement Act ("PAEA"), and pointed out that the Act places the responsibility for pricing and rate design within the purview of the Postal Service.² This is necessary, we pointed out, in order for the Postal Service to fulfill Congress' intent that it act more like a business³ and to ensure that it has more control and flexibility over pricing its products: "Without control over pricing, the Postal Service has no control over its marketing strategy. Without a good marketing strategy and control over that marketing strategy, the Postal Service cannot act like a business . . . and fulfill the mandate of the new Act."⁴

¹ See Postal Service Supplemental Comments on the Classification Process in RM2007-1 at p. 2-4 (June 19, 2007).

² See DFS Reply Comments in RM2007-1 at 2-4 (May 7, 2007).

³ See *e.g.*, 152 CONG. REC. H9182 (December 8, 2006) (Remarks of Vice Chair Christopher Shays).

⁴ DFS Reply Comments in RM2007-1 at 3 (May 7, 2007).

In this regard, the inference made by the Office of the Consumer Advocate (“OCA”) in its July 3 Comments that the Commission can and should create new postal products on its own initiative is fundamentally inconsistent with the Act.⁵ The Commission should be able to move a product from one list to another (which involves adding it to one and removing it from another) and in—rare—circumstances refuse to list a product or order the Postal Service to cease offering a product.⁶ In contrast, the Commission should never decide to create a postal product *sui sponte*. It should be up to the Postal Service, not the Commission, to create new products and meet its customers’ needs, not the PRC. To interpret the law otherwise would be inconsistent with the purpose and intent of Congress, for it could force the Postal Service to offer to the public a product that could be inconsistent with its marketing strategy and its approach to market pricing.

III. The OCA Comments Of June 18, 2007 Are Based On A Patently Flawed Premise About The PAEA And Should Be Given Little Weight.

Like The Association for Postal Commerce and others⁷ DFS believes that the OCA Comments of June 18 are predicated upon an assumption about the PAEA that is fundamentally incorrect.

The OCA assumes “a theory of regulation generally familiar to the Commission and participants in proceedings before the Commission in rate and classification cases” and concludes that the Commission therefore “will prescribe, in large measure, a

⁵ See OCA Comments in Response to Supplemental Comments of the Postal Service on Classification in RM2007-1 at 2-3 (July 3, 2007).

⁶ See 30 U.S.C §3642(a).

⁷ Joint Comments on OCA Comments in RM2007-1 (July 3, 2007).

system of regulation similar to the historical costing approaches used in previous omnibus rate cases with the procedural modifications commanded by the PAEA.”⁸

This assumption demonstrates a basic misconception about the nature of the recently-enacted legislation. Rather than embracing the complex, contentious and litigious system of regulation used in omnibus rate cases since 1970, the legislation plainly rejects that approach. The PAEA did not simply prescribe procedural changes in postal rate-making. Rather, the sponsors of the Act adopted “landmark legislation”⁹ that completely replaces the old approach. Moreover, this landmark legislation profoundly changes the roles of the Postal Service and the Commission in the rate-setting process.

The OCA’s Comments start from a flawed set of assumptions, and that flaw flows through to its analysis and to its recommendations. For instance, the OCA recommends that the Commission should cap subclass rate increases at 50 percent of the overall class increase. That recommendation is at odds with the legislation, which nowhere indicates that such a cap would be permissible. Indeed, notions that rates should be capped in any fashion other than at the class level were much debated in Congress and specifically rejected as not giving the Postal Service sufficient rate flexibility.

The OCA does seem to understand this point for it said that its “comments may not be precisely on point if the Commission wishes to establish an entirely new method of rate regulation.”¹⁰ The OCA is correct there. Its Comments are not on point. Given

⁸ OCA Comments to Second Advanced Notice in RM2007-1 at 1-2 (June 18, 2007).

⁹ *E. g.*, 152 CONG. REC. 9179 (December 8, 2006) (Remarks of Chair Tom Davis, Remarks of Rep Danny Davis); *see Id* at H9180-9181 (Remarks of John McHugh). *See also* 152 CONG. REC. S11674-77 (December 8, 2006) (Remarks of Senators Susan Collins and Thomas Carper).

¹⁰ OCA Comments to Second Advanced Notice in RM2007-1 at 1 (June 18, 2007).

the fundamentally flawed premise underlying the OCA's Reply Comments to the Second Notice, the Commission should give the Comments little weight .

IV. Reviewing Worksharing Discounts For Compliance With § 3622(e) Twice A Year Is Unnecessary And Would Be A Significant Waste Of Limited Commission And Mailer Resources.

A number of commentators have urged the Commission to perform a compliance review not only *every year* when it performs its general compliance review under §3653, but also *every time* the Postal Service files a Notice of Price Adjustment for market-dominant rates.¹¹ We disagree.

First, the Commission has ample authority to require the USPS to collect, maintain, and provide in its annual report whatever data is necessary to demonstrate that all worksharing discounts comply with §3622(e)(2).¹² It is also true, that collecting and maintaining accurate information about avoided costs is a formidable task, due to both the constantly changing nature of the network and the constantly changing nature of the way mailers handle mail.¹³

Second, the Postal Service must show in its report to the Commission each year that worksharing discounts comply, each year, with the mandate of §3622(e)(2) and the Commission must review that report in its annual compliance review.¹⁴ As the preceding paragraph points out, the Commission will have an ample data set, each year, with which to conduct this review.

¹¹ E.g., Comments of the Newspaper Association of America to Second Advanced Notice in RM2007-1 at 5-9 (June 18, 2007).

¹² See Time Warner Comments to Second Advanced Notice in RM2007-1 at 4 (June 18, 2007) ; see 30 U.S.C §3652(b).

¹³ Id. at 3.

¹⁴ See 30 U.S.C. §§3652, 3653, 3654.

Third, when the Postal Service introduces a worksharing discount for the first time, there is no question that it must produce the data that show that the new discount complies with the mandate of 3622(e)(2).¹⁵ Indeed, the Postal Service must also explain why it is establishing a new discount and certify 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.¹⁶

Consequently, it follows that not only will there be an examination of each new workshare discount when it is established, but also that there will be a review—*each and every year*—of whether every workshare discount complies with the dictates of §3622(e)(2). As noted above, the Commission will have adequate data to undertake all these reviews, no matter what is filed with or reviewed by the Commission concerning existing workshare discounts during the 45 days after the Postal Service submits a Notice of Price Adjustment.

If the Commission undertakes, in addition to its annual compliance review, another compliance review each year when the Postal Service files its annual Notice of Price Adjustment,¹⁷ the PRC will conduct *two compliance reviews a year*. That is neither required by nor consistent with the PAEA, which is supposed to make the rate-setting processes simpler, not more complex.

Instead, the Commission should review the compliance of existing discounts with §3622(e) once a year when it undertakes its annual compliance review process, and not

¹⁵ See 39 U.S.C. §3622(e)(4).

¹⁶ *Id.*

¹⁷ This assumes only one Notice of Price Adjustment for market dominant products each year.

again when the Postal Service submits a Notice of Price Adjustment for market-dominant rates. Such an interpretation of the PAEA would be flexible, simple, reasonable, and in concert with both the spirit and the letter of the law. It would also be interpreting §3622(e)(2) in conjunction with the rest of the Act so as to produce a harmonious whole.¹⁸ Finally, such an interpretation would be consistent with the views of the Senate sponsors of the PAEA who have stated that the “45-day period that the Act gives the Commission to review rate filings is largely intended to be used to determine whether or not a rate filing is within the rate cap.”¹⁹

V. Construing §3622 As Limiting Discounts Only To “Workshare Discounts” Would Be Fundamentally Inconsistent With The Act Since The Postal Service Has The Pricing Power To Create Rates And Discounts Based On Market Factors As Well As Costs Not Associated With Worksharing.

In its Supplemental Comments on the Classification Process, the Postal Service points out that within any market-dominant product there may be a number of different prices, including “workshare discounts” within the meaning of §3622(e), as well as other discounts predicated on market considerations or on costs that are not associated with worksharing.²⁰ Giving the Postal Service the pricing freedom and flexibility to create such market-based pricing is essential to the purpose of the Act.

The OCA, however, has argued that *only* workshare discounts are allowed under the Act, and that “no discounts in excess of avoided costs” can be permitted.²¹ While

¹⁸ See 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION §46:05, at 154-167 (6th Edition, 2000 Revision) and cases cited therein (“if doubt or uncertainty exist as to the meaning or application of a statute’s provisions, the court should analyze the act in its entirety and harmonize its provisions in accordance with legislative intent and purpose.”)

¹⁹ Comments of Senators Collins and Carper in Docket RM 2007-1, at 2 (April 6, 2007).

²⁰ USPS Supplemental Comments on the Classification Process at 13.

²¹ See USPS Reply Comments to the Second Notice in RM2007-1 at 9, (discussing OCA Comments on the Second Advanced Notice in RM2007-1 at 20-21).

the Act does generally prohibit the Postal Service from creating workshare discounts in excess of avoided costs (although there are a number of exceptions), nothing in the Act prohibits the Postal Service from creating other discounts.

So long as (1) rates in a class cover costs on a class basis, (2) rate increases are below the CPI-U, and (3) *workshare* discounts are not greater than avoided costs (and even then there are exceptions), the Postal Service has the latitude to price as it wishes, including creating other discounts that are not based on avoided costs. Such discounts could be based on market conditions or on intrinsic costs that are not associated with worksharing. For example, the Postal Service could, as it hypothetically suggests, create a flat box rate for First Class mail.²²

This was a point developed by the American Bankers Association and supported by DFS in the last rate case.²³ This is a very important point, and it is one that is central to the notion of effective pricing flexibility for the Postal Service.

VI. The PRC Should Not Adopt The ECP Recommendation Of NPPC And Pitney Bowes.

Both the National Postal Policy Council (“NPPC”) and Pitney Bowes have argued that the Commission should craft a rule that says that all worksharing discounts must be set at 100% of avoided costs, in order to set into regulation the principles of Efficient Component Pricing (“ECP”).²⁴ DFS does not support that suggestion.

²² See USPS Supplemental Comments on the Classification Process in RM2007-1 at 13, n. 37.

²³ See ABA Brief in R2006-1 at 10-12, 16-17; *accord* DFS Brief in R2006-1.

²⁴ See NPPC Comments in Response to Further Advanced Notice in RM2007-1 at 4-10 (June 18, 2007); Pitney Bowes Comments on Second Advanced Notice in RM2007-1 at 5-6 (June 18, 2007).

While DFS agrees with the ECP principle that workshare discounts should be set at 100% of avoided costs, setting that principal into law would be a mistake. Not only would it open up, on an annual basis, the question of whether the Postal Service's measurement of avoided costs is *precisely* correct, but debating the issue in a world of pricing flexibility is not necessary. If the Postal Service wants to give a discount of ten cents where there is only eight cents of avoided costs, it can do so by creating a workshare discount of 8 cents and a market-based discount of 2 cents. Or, it can create a workshare discount of 7.5 cents, and another market-based discount of 2.5 cents. The result is the same, and it is not necessary to debate the issue of whether the measure of "avoided costs" is 7.5 or 8 cents, or whether 100% of the avoided costs are passed through. The Commission should not create a rule that locks in the principles of Efficient Component Pricing. Such action would create expensive, complicated, inefficient, and unnecessary litigation.

The Mail Order Association of American ("MOAA") made a similar point, in another context, in its Reply Comments to the Second Notice:

MOAA is concerned about the prospect of ever more extensive costing studies compared to the more easily demonstrated reality that First Class presort mail is overpriced relative to the balance of First Class mail. MOAA contends that the better approach is to take the market into account rather than continue to press for the ephemeral goal of "perfect" costing. Costs must be one element of pricing but the more important element is the market. The Service is given the responsibility to price. The Commission's role is to ensure that those prices comply with the cost and other constraints of the PAEA in its Annual Compliance Report.²⁵

²⁵ MOAA Reply Comments to the Second Advanced Notice in RM2007-1 at 5 (July 3, 2007).

VII. DFS Supports The Postal Service Position That Market-Dominant “Products” Initially Be Defined As Subclasses, But That In The Future They Can Be Subordinate Units Of Subclasses That Have Either A Distinct Market Or Cost Characteristic.

The question of what should be considered a market-dominant product under the PAEA is admittedly a difficult issue. On the one hand, since the test for a subclass is having distinct cost *and* market characteristics, at minimum, all subclasses should be considered products since a product need only have either a distinct market or cost characteristic²⁶ and all subclasses have both.

On the other hand, the language of §3642(c) plainly indicates that when it comes to transferring products between the market-dominant and the competitive product lists, nothing should be construed to prevent the transfer of “some (but not all) of the subclasses or other subordinate units of the class of mail or type of postal service.” That language implies that the drafters intended that a product could be a unit smaller than a subclass. Further, the fact that some mail undoubtedly has separate cost characteristics, but not necessarily separate demand characteristics (and *vice versa*) also suggests that the notion of a product should be smaller than a subclass.

Indeed, one could technically argue that each rate cell should be considered a product since each rate cell has a price different than any other rate cell. That would give the Postal Service thousands of products, if every possible combination of rate elements were to be considered a separate product. That result would not be in accord with the language of §3652(b), however, which creates a distinction between products

²⁶ 30 U.S.C. §102(6)

and workshare discounts, and which suggests that a product is a larger aggregation than a rate cell.²⁷

The Postal Service seems to have come up with a reasonable solution.²⁸ The Postal Service has proposed that initially a product be considered a subclass, but that as mail services evolve, individual products that are smaller than a subclass will arise: “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’ bases on customer and business needs, regardless of how those postal services were grouped under old PRA law.”²⁹

DFS supports that interpretation. It is a reasonable solution to a difficult interpretative problem.

VIII. The Issue Of Whether An NSA Is A Product Or Not Should Be Considered, When Necessary, On An Ad Hoc Basis.

On the issue of products, DFS agrees with the Postal Service and the Newspaper Association of America (“NAA”) that the Commission should not promulgate a regulation stating that all market-dominant NSAs are products. Indeed, DFS respectively suggests that none of the market-dominant NSAs to date should be considered products because all involve the provision of a collection of existing products

²⁷ See 39 U.S.C. §3652(b): “with respect to each market-dominant product for which a workshare discount was in effect.”

²⁸ USPS Supplemental Comments on The Classification Process in RM2007-1 at 6-10

²⁹ Id at 6-7; See also USPS Reply Comments to the Second Advanced Notice in RM2007-1 at 37 (July 3, 2007).

with mailer-specific terms.³⁰ That is not to say, however, a future NSA could not be a separate product. One easily could be.

Hence, the Postal Service and NAA are correct when they suggest that the Commission need not answer this question now, but leave it to be decided upon a case by case basis, *if necessary*. The “if necessary” is important, and DFS urges the Commission not to include a specific provision in its NSA rules which states that the issue of whether a market-dominant NSA is a product or not must be decided. Since this could easily be a debatable issue, and since there seems to be little consequence as to whether a market-dominant NSA is a product or not, placing such a provision in the NSA rules would simply be an invitation for parties to engage in needless litigation. It would provide parties who oppose NSAs in principle another opportunity to litigate over an ancillary issue and thereby increase the transaction costs of obtaining NSAs.

IX. DFS Supports The Position That Past Pension Expenses Should Be Considered Institutional Costs And Current Pension Expenses Should Be Attributed.

Questions have arisen as to whether the Postal Service’s pension costs should be considered an institutional cost. The Alliance of Nonprofit Mailers (“ANM”) and the Magazine Publishers Association (“MPA”) have argued that past pension costs are “sunk” costs and should not be attributed.³¹ The Postal Service agrees with that position.³² So does DFS.

³⁰ See *generally* USPS Initial Comments on the Second Advanced Notice in RM2007-1 at 33 (June 18, 2007).

³¹ See *e.g.*, ANM and MPA Comments in RM2007-1 at 9-10 (May 5, 2007); ANM and MPA Comments to the Second Reply Notice in RM2007-1 at 5-6 (July 3, 2007).

³² USPS Comments on the Second Advanced Notice in RM2007-1 at 28 (June 18, 2007).

In terms of current year pension costs, DFS agrees that those costs should be attributed in the current year through some reasonable means. The Greeting Card Association (“GCA”) has suggested attributing them by the weighted average attributable cost of all labor, citing the Commission R 2005-1 Decision at ¶4027.³³ That seems to be a reasonable solution. To do otherwise would be to place the burden of pension costs disproportionately on First Class.

X. While The Moving Average Method For Computing The CPI-U Would Be Permissible Under The Act, The Commission Needs To Justify Its Decision Carefully.

DFS agrees with the majority of the parties submitting comments on this issue and believes the moving average method of calculating the CPI would be permissible under the PAEA, and DFS would support that approach. However, DFS submits that the question of the method’s legality under the PAEA is a delicate question. Consequently, DFS urges the Commission to carefully justify any decision to use the moving average method.

Moreover, while the argument that the moving average method could provide a result that is more predictable and more stable than the point-to-point method is a reasonable argument, DFS submits that since both methods should produce the same result over the long run, it does make a great deal of difference which method is used.

Indeed, one could argue that the inherent simplicity of the point-to-point method would provide a good reason, in and of itself, to use that method. It has long been thought on Capitol Hill that the level of complexity in postal rate making has been needlessly too great, and that the marginal benefit in the greater exactness that is

³³ GCA Reply Comments to Second Advanced Notice at 5 (July 3, 2007)

gained by increasing complexity does not necessarily outweigh the benefits of greater credibility to the PRC and the system in general that is gained by having a simple, straightforward but less complex approach to many issues.

Thank you for considering our views.

Respectfully submitted,

/s/ Robert J. Brinkmann
Robert J. Brinkmann
Counsel for DFS Services LLC

Law Offices of Robert J. Brinkmann LLC
1730 M St. N.W. Suite 200
Washington, D.C. 20036
robert.brinkmann@rjbrinkmann.com
202.331.3037; 202.331-3029 (f)

July 16, 2007