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POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Regulations Establishing a System
of Ratemaking

Docket No. RM2007-1

NOTICE OF RECEIPT OF DOCUMENT

(Issued August 9, 2007)

On August 6, 2007, the Postal Service General Counsel transmitted to the Postal Regulatory Commission General Counsel, for informational purposes, a document prepared by a Postal Service consultant containing an analysis of parts of the Postal Accountability and Enhancement Act. It has been explained that the document does not necessarily reflect the views of the Postal Service, but it is provided for informational purposes to further an open evaluation of that legislation.

Attachments: Transmittal letter

James I. Campbell, Jr., *An Analysis of Provisions of the Postal Accountability and Enhancement Act Relating to the Regulation of Postal Rates and Services*, August 3, 2007.

Steven W. Williams
Secretary

MARY ANNE GIBBONS
SENIOR VICE PRESIDENT, GENERAL COUNSEL



August 6, 2007

Stephen Sharfman
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901 New York Avenue
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Dear Mr. Sharfman:

The Postal Service retained James Campbell as a consultant to advise it on matters related to the Postal Accountability and Enhancement Act of 2006 (PAEA). Mr. Campbell prepared the attached analysis of parts of the PAEA and I have been asked to share a copy with you.

Sincerely,

A handwritten signature in cursive script that reads "Mary Anne Gibbons".

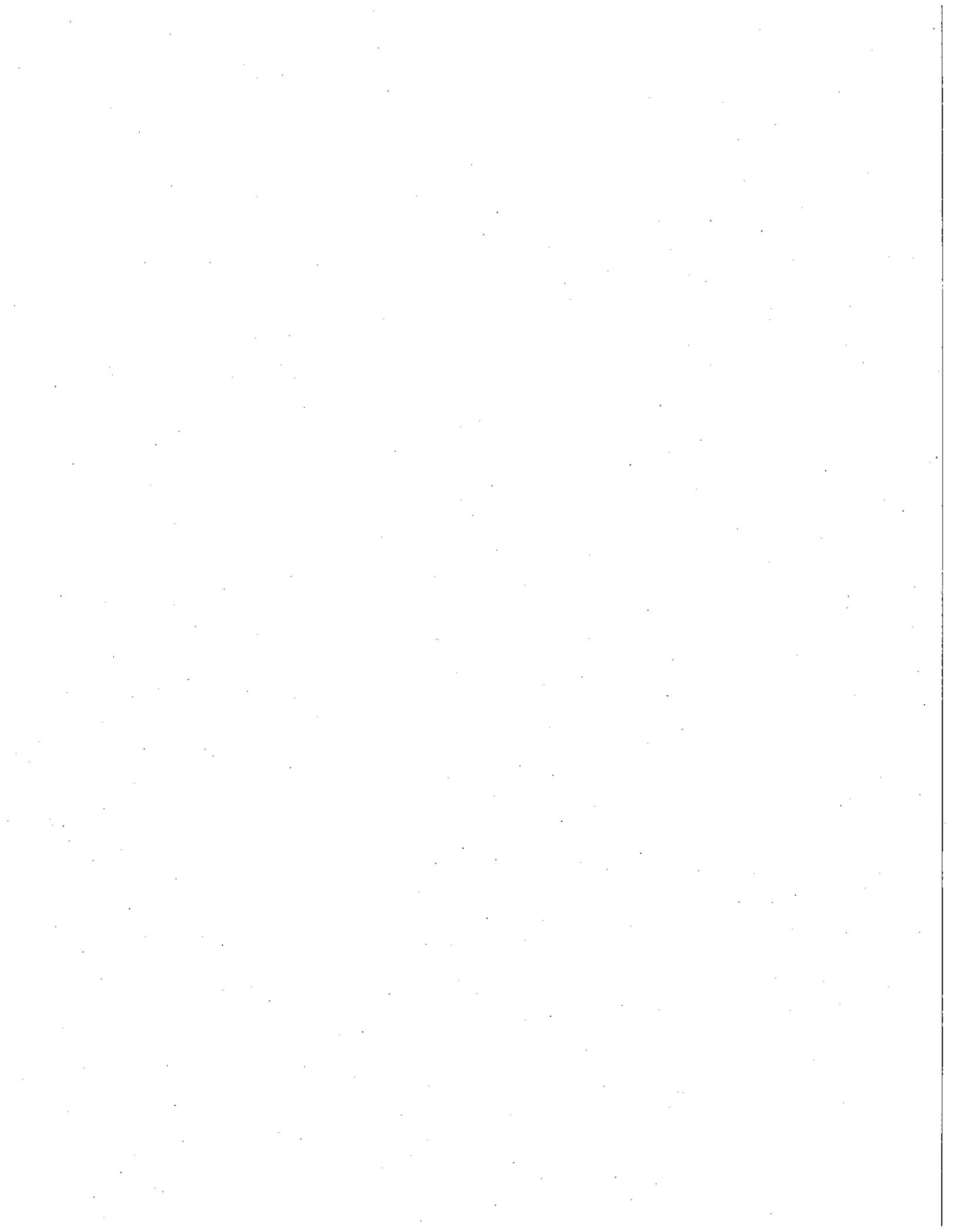
Mary Anne Gibbons

Attachment

**An Analysis of Provisions of the
Postal Accountability and Enhancement Act
Relating to the Regulation of
Postal Rates and Services**

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August 3, 2007



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1 Introductory Note and Disclaimer

The Postal Accountability and Enhancement Act of 2006 (PAEA) substantially amended elements of the postal law, title 39 of the United States Code, which relate to regulation of postal rates and services.¹ This paper attempts to provide an objective and coherent interpretation of these revised legal provisions. It is *not* a comprehensive analysis; it addresses only what seemed to me to be the most significant and pressing issues of interpretation. In preparing this analysis, I have tried to adhere to the statutory text and documented legislative history and to ignore other knowledge and beliefs acquired during the long Congressional consideration of the PAEA. While I have benefitted from the insights of others, the opinions expressed in this paper represent my personal views only.²

2 General Statutory Requirements

In the amended title 39, all postal services are assigned to one of two mutually exclusive categories, market dominant products and competitive products. Each category is subject to an appropriate regulatory regime. Most, but not all, of the new regulatory framework is to be established through regulations administered by the Postal Regulatory Commission.³ Certain statutory requirements, however, bear directly or indirectly on regulation of postal rates and services but fall outside this Commission-led regulatory framework. For purposes of exposition, they are mostly easily noted at the outset.

¹Title 39, United States Code, as amended by the Postal Accountability and Enhancement Act, Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). Unless otherwise indicated, all statutory references in this paper (e.g., “§ 401”) are to provisions of title 39 as compiled by Legislative Counsel, House of Representatives in March 2004 and amended by the PAEA. Unless otherwise indicated, use of *italicized text* in quoted statutory text and other quoted material indicates emphasis added by the author.

²This paper was prepared as a background study for the legal department of the Postal Service. Postal Service lawyers requested my best judgement and did not try to control the results in any respect. Although I have revised the paper in light of comments by Postal Service staff and some filings with the Postal Regulatory Commission in RM2007-1, this paper should not be interpreted as reflecting the position of the Postal Service or anyone else (in some cases, the Postal Service has adopted different positions in RM2007-1). Moreover, my own understanding of this complex statute will likely change with further study. Comments on this analysis would be welcome and may be addressed to jcampbell@brownrudnick.com.

³In this paper, the terms “Commission” and “PRC” refer to either the Postal Rate Commission or its post-PAEA successor, the Postal Regulatory Commission, as appropriate.

2.1 General policies

The postal law includes several policy declarations which bear on regulation of postal rates and services. Sections § 101 and § 403 set out the general postal policy of the United States. Section § 101 requires the Postal Service to operate as a universal public service, to apportion costs fairly, and to give particular attention to transmission of letter mail.

(a) The United States Postal Service shall be operated *as a basic and fundamental service* provided to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress, and supported by the people. The Postal Service shall have as its basic function the obligation *to provide postal services to bind the Nation* together through the personal, educational, literary, and business correspondence of the people. It shall provide *prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities*. The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people.

(d) Postal rates shall be established *to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis*;

(e) In determining all policies for postal services, the Postal Service shall give the *highest consideration to the requirement for the most expeditious collection, transportation, and delivery of important letter mail*.

Subsections § 403(a) and § 403(b) require the Postal Service to provide adequate and efficient postal services at fair and reasonable rates throughout the United States and between the United States and the rest of the world.

(a) The Postal Service shall plan, develop, promote, and provide *adequate and efficient postal services at fair and reasonable rates and fees*. The Postal Service shall receive, transmit, and deliver throughout the United States, its territories and possessions, and, pursuant to arrangements entered into under sections 406 and 411 of this title, throughout the world, written and printed matter, parcels, and like materials and provide such other services incidental thereto as it finds appropriate to its functions and in the public interest. The Postal Service shall *serve as nearly as practicable the entire population of the United States*.

(b) It shall be the responsibility of the Postal Service—

(1) to maintain an efficient system of collection, sorting, and delivery of the mail nationwide;

(2) to provide *types of mail service to meet the needs of different categories of mail and mail users*; and

(3) to establish and maintain postal facilities of such character and in such locations, that postal patrons throughout the Nation will, *consistent with reasonable economies* of postal operations, have ready access to

essential postal services.

Section § 407(a) declares that the international postal policy of the United States is to promote international communications while fostering undistorted competition outside the scope of the U.S. postal monopoly:

(a) It is the policy of the United States—

(1) to *promote and encourage communications between peoples* by efficient operation of international postal services and other international delivery services for cultural, social, and economic purposes;

(2) to *promote and encourage unrestricted and undistorted competition* in the provision of international postal services and other international delivery services, *except where provision of such services by private companies may be prohibited by law* of the United States;

...

(b)(1) The Secretary of State shall be responsible for formulation, coordination, and oversight of foreign policy related to international postal services and other international delivery services and shall have the power to conclude postal treaties, conventions, and amendments related to international postal services and other international delivery services, except that the Secretary *may not conclude any treaty, convention, or other international agreement (including those regulating international postal services) if such treaty, convention, or agreement would, with respect to any competitive product, grant an undue or unreasonable preference to the Postal Service, a private provider of international postal or delivery services, or any other person.*

Echoing the service standards of § 403(a), § 3661(a) broadly obliges the Postal Service to “develop and promote adequate and efficient postal services.”

2.2 Fairness and non-discrimination

Several statutory provisions relate to the proper relationships between rates charged different mailers. They generally require that the Postal Service, or the rates charged by the Postal Service, adhere to a standard of fairness and eschew unreasonable discrimination.

Fairness and equity are referenced in at least three provisions. As noted above, § 101(d) declares that, “Postal rates shall be established to apportion the costs of all postal operations to all users of the mail *on a fair and equitable basis.*” Subsection § 403(a) requires the Postal Service to maintain “*fair and reasonable rates and fees.*” Subsection § 404(b), the general ratemaking power granted the Governors, continues the phraseology of prior law by authorizing establishment of “*reasonable and equitable classes of mail and reasonable and equitable rates of*

postage and fees for postal services.”⁴

Section § 403(c) prohibits the Postal Service from engaging in undue or unreasonable discrimination among *mailers*, as follows:

(c) In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make *any undue or unreasonable discrimination among users* of the mails, nor shall it grant *any undue or unreasonable preferences to any such user*.

As noted above, § 407(b) similarly prohibits undue or unreasonable discrimination between *providers* of competitive international postal products.

It should be noted that these provisions, except for § 407(b), do not distinguish between market dominant and competitive products. This lack of distinction creates problems of interpretation. The overall design of the statute implies stricter regulation of market dominant products than competitive products, yet what is fair play in a competitive context could be considered unfair in a market dominant context. It could be argued that the terms “fair,” “equitable,” “due,” and “reasonable” must be interpreted more strictly when dealing with the regulation of market dominant products than when dealing with the regulation of competitive products. Alternatively, it could be argued that to accommodate the PAEA’s more laissez-faire approach towards regulation of competitive products, these terms must given a more laissez-faire interpretation in respect to all products, market dominant as well as competitive.

Likewise, it should be noted that these provisions generally do not distinguish between domestic and international mailers. Although on rare occasions the statutory prohibition against unjust discrimination was applied to users of international mail before the PAEA, extending Commission regulation to international mail could result in more active application of this prohibition to distinctions among international mailers and even to distinctions between domestic and international mailers.

2.3 Uniform rates

Two statutory provisions require that the Postal Service provide rates that are uniformly priced throughout the United States.

Subsection § 404(c) requires the Postal Service to provide uniform rates for domestic letter services, necessarily market dominant products because of the

⁴This subsection replicates the first two sentences of former § 3621.

postal monopoly:

(c) The Postal Service shall maintain one or more classes of mail for the transmission of letters sealed against inspection. *The rate for each such class shall be uniform throughout the United States, its territories, and possessions.* One such class shall provide for the most expeditious handling and transportation afforded mail matter by the Postal Service. . . .

The Commission has interpreted “uniform” in § 404(c) to require that Postal Service must offer the same rate structure at all locations where the service is offered but not to require that the Postal Service must offer the same rate from any point in the United States to any other point in the United States.⁵

Section § 3683 requires uniform rates for domestic services for transmission of books, films, and certain other materials (with some exceptions listed in subsection (b)) even though these are competitive products.

(a) Notwithstanding any other provision of this title, the rates of postage established for mail matter enumerated in former section 4554 of this title shall be uniform for such mail of the same weight, and shall not vary with the distance transported.

2.4 Reduced rates

Section § 3626 requires that rates for certain types of mail— such as mail sent by nonprofit organizations, local newspapers, and classroom materials— should be set below what they otherwise would be. Some of these products are in the market dominant category, and some are in the competitive category. Section § 3629 requires reduced rates for certain mail used for voter registration purposes.

3 Market Dominant and Competitive Categories

3.1 Definition of categories: effective competition

After amendment by the PAEA, postal law divides all postal products—and therefore all postal services—into one of two categories: *market dominant* or *competitive*. The essential distinction is defined by § 3642(b)(1), which directs the Commission to transfer products from one category to the other according to the following standard:

⁵PRC Op. R-77 (1978) at 411-19. Although this interpretation seems to me highly questionable, it could be argued that it has been ratified by reenactment in the PAEA.

(1) The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises *sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products*. The competitive category of products shall consist of all other products.

Since the competitive category consists of “all other products,” by definition the two categories are mutually exclusive and include all products. The mutually exclusive nature of the two categories of mail is emphasized by § 3642(e), which provides:

(e) Prohibition.—Except as provided in section 3641, no product that involves the physical delivery of letters, printed matter, or packages may be offered by the Postal Service unless it has been assigned to the market-dominant or competitive category of mail (as appropriate) either—

- (1) under this subchapter; or
- (2) by or under any other provision of law.

An important issue posed by this definition of product categories is proper interpretation of “*other firms offering similar products*.” As a practical matter, the Postal Service faces increasing competition from communications services, such as broadcast media and the internet. In some cases, these competitors could be considered to offer similar “products” as that term is used in ordinary speech, even though they do not offer “products” as that term is defined in § 102(6), i.e. postal delivery services (see next section). In interpreting § 3642(b)(1), the Commission must decide whether “similar products” may be interpreted to include nonpostal products when referring to the services of companies other than the Postal Service. Clarification will be needed to allow the Postal Service to plan its business strategy.

3.2 Definition of “product”

The concept of “product” was introduced by the PAEA and is central to the new regulatory framework.⁶ Subsection § 102(6) defines “product” as “*a postal service with a distinct cost or market characteristic for which a rate or rates are,*

⁶Prior to the PAEA, the term “product” was used in the postal law to refer to merchandise as distinct from documentary communications. See, e.g., § 3626(m)(1). The only reference to “product” as a type or form of postal service was found in former § 3663(b), which required the Commission to prepare an annual report on costs and revenues for “for each international mail product or service.” This use of “product” is explained by the fact that this provision resulted from early adoption in 1998 of some of the international mail provisions of the bill that became the PAEA.

or may reasonably be, applied." A "postal service" is defined in § 102(5) as "the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto."

Paragraph § 3641(b)(1) sheds further light on the concept of a "product." It limits use of market test procedures to cases in which "the product is, *from the viewpoint of the mail users, significantly different* from all products offered by the Postal Service within the 2-year period preceding the start of the test." From this provision, it seems that the viewpoint of the user should be considered in determining whether one service constitutes a different "product" from another service.

3.2.1 Relation to "rate cell" and "subclass"

The possibility of applying different "rates" to a single "product" is significant. It seems likely that, for market dominant products, the Postal Service may not charge two different rates under precisely similar circumstances—i.e., when two mailers use similar postal services to ship similar items between similar points at similar times—because the Postal Service is barred from engaging in "any undue or unreasonable discrimination among users of the mails" or granting "undue or unreasonable preferences." § 403(c). Hence, a "product" must refer to a set of related services which may be appropriately described as a single "postal service . . . for which a rate or rates are, or may reasonably be, applied." Put another way, the fact that a single product may refer to a postal service with multiple rates implies that not every "rate cell" in a "rate schedule" can be considered a distinct "product."

On the other hand, a "product" cannot be so broad a grouping of services as a "subclass" as that term has been defined by the Commission. As discussed below,⁸ a "subclass" is defined by the Commission as a grouping of postal services distinguished by *both cost and demand characteristics*.⁹ In contrast, according to its statutory definition, a "product" is a set of postal services which differs from other postal services by virtue of *either* distinct cost characteristics *or* distinct market characteristics significant enough that the Postal Service charges different rates or may reasonably do so.

The conclusion that a "product" represents a narrower category of mail than a subclass is reinforced by § 3642(c), which says,

⁷Whether the Postal Service may charge reasonably different rates under similar conditions for competitive products is discussed below.

⁸See section 4.1, below.

⁹See the discussion of pre-PAEA classification in section 4.1, below.

(c) 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).

Since § 3642(c) is referring to the transfer of *products* (to the competitive category or market dominant category), it is evident that a “product” may refer a “subordinate unit” other than a subclass.¹⁰ Since any division of a “class” was called a “subclass” in the Commission’s pre-PAEA postal terminology, a “subordinate unit” can only refer to a division of a subclass, that is, to a “rate category” or smaller grouping of services.

Having said this, it should be noted—given the central importance of this issue to proper administration of the statute—that some commentators have pointed to other statutory provisions which, they suggest, imply that a “product” refers to grouping of services akin to the existing concept of “subclass.” To support this interpretation the provision most commonly cited is § 3642(a) which refers to the “list of market-dominant products under section 3621” and the “list of competitive products under section 3631.” As discussed below,¹¹ of the 15 items in these two lists, 3 refer to what are now classes of mail, 6 to subclasses, and 6 to other groupings of mail or other services. Since these lists are explicitly said to be lists of “products” and the items listed most often refer to classes or subclasses, it could be inferred from § 3642(a) that “product” most likely refers to a subclass or more highly aggregated grouping of mail.

This interpretation of § 3641(a) derives some plausibility from the fact that, in setting rates under prior law, the Commission concluded that it was statutorily obliged to apply what was essentially the same rate schedule to all services within a domestic mail subclass, i.e., a schedule of rates based on a single decision as to the appropriate cost coverage but with rate variations that allowed for different weights, discounts, surcharges, and other factors. For any commercial enterprise, of course, the art of pricing lies primarily in the assignment of cost coverage, not in a decision whether or not cover incremental costs. Thus, in a sense, under former law as administered by the Commission, the only rate schedules were those defined by subclass. Or, to use post-PAEA terminology, the only domestic mail “products” under the former statute were “subclasses.” Even if one

¹⁰This is the only use of the term “subordinate unit” in the PAEA. It is the only remnant of the more detailed definition of product found in the McHugh discussion draft of August 12, 1999.

¹¹See sections 3.6 and 3.7, below.

subscribes to this interpretation § 3641(a),¹² however, it does not change the fact that the revised statute defines and uses the term “product” in a fundamentally different manner than the Commission defined and used the term “subclass” in pre-PAEA days. Under the new statute, the Postal Service is given discretion to set rates for “products” even if, under the old law, the Commission felt obliged to set rates by “subclasses.”

3.2.2 Relation to “workshare discount”

Paragraph § 3622(e)(1) defines “workshare discount” for purposes of that subsection as “*rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail*” (and further defined by the Commission). According to § 3622(e)(2), the basis of a workshare discount should generally be the difference in the cost of providing a workshared postal service as opposed to unworkshared postal service. Yet the definition of “product” in § 102(6) indicates that a difference in cost may be the basis for defining a distinct product. What is the relationship between the terms “product” and “workshare discount,” if any?

The only other provision in the statute using the term “workshare discount”—and the only occasion in which “workshare discount” and “product” are used together—occurs in paragraph § 3652(b). This subsection refers to “*information with respect to each market-dominant product for which a workshare discount was in effect.*” Subsection § 3652(b) seems to imply that one of the rates associated with a “product” may be a workshare discount. Granting this as a possible interpretation, however, nothing in § 3652(b) or § 102(6) excludes the possibility that a product may also be defined based on “distinct cost characteristics” that can be regarded as arising from “workshare activity.” To exclude such a possibility would severely limit the definition of “product” since many of the cost distinctions associated with different types of postal service arise from differences in the cost of workshare-type activities, i.e., sorting, barcoding, handling, or transporting mail. Thus, if two rates have a workshare relationship to one another, then according to § 3622(e) the difference in rates should reflect the costs avoided by the Postal Service (with some exceptions), but it appears that the two rates could arise *either* within the same product (as implied by § 3652(b)) *or* in different products (as implied by § 102(6)).

¹²Alternatively, it seems to me, § 3641(a) could as easily, or more easily, be interpreted as implying that the lists in § 3621(a) and § 3631(a) refer to “products” or groups of “products.” In this manner one could conclude that in these lists, Congress referred to classes and subclasses as the most convenient and well-known groupings of products at the date of enactment and deviated from reference to subclasses when it sought to refer to a finer division of products.

3.2.3 Postal Service discretion to define its products

Under the statutory definition, whenever the Postal Service establishes a set of rates for providing a bundle of services (within the universe of "postal services"), it defines a "product," provided certain basic statutory criteria are met. For a "product" to be distinct from other products, the bundle of services must differ from those of other products in terms of cost characteristics or market characteristics, where "market characteristics" takes into account user perception among other things. Since the statutory definition says that a product is indicated when "a rate or rates are . . . applied," the fact that the Postal Service has established a rate or rate schedule for a bundle of services appears to be *prima facie* evidence of a different product.

As a practical matter, the Postal Service must have substantial discretion to decide when differences in costs and/or market characteristics should be reflected in different product definitions. The cost characteristics of postal services vary along an almost infinite spectrum. The cost of transmitting an envelope or parcel varies slightly by specific origin-destination pair, by routing, by shape and weight, by time of day and weather conditions, and by all sorts of other considerations. Likewise, market characteristics vary slightly from user to user. It probably could be shown that there are slight differences in costs or market characteristics between postal services provided to men and women or to left-handers and right-handers or to rich people and poor people or to banks and department stores. By defining products which respond to differences in cost and demand, the Postal Service can increase efficiency and improve customer satisfaction. At the same time, it is impossible to define a product for every difference in cost or market characteristic because the costs of administration would be prohibitive. Inevitably, therefore, the Postal Service must have discretion to decide when cost and market characteristics should be served on an average basis by a single product and when such differences are large enough to justify the administrative cost of defining separate products.

Under the revised statute, how finely can the Postal Service disaggregate its services into different products? As a legal matter, the limits seem to be established by such provisions as the prohibition against undue or unreasonable discrimination, § 403(c), and the statutory requirements for uniform letter rates, § 404(c). In other words, the Postal Service seems to have a large measure of discretion to disaggregate product definitions.

The Postal Service's new discretion to disaggregate product definitions should be emphasized, for it represents a "clean break with the past," much as the Postal Reorganization Act of 1970 made a clean break with its past by introducing

cost-based rates instead of politically negotiated rates.¹³ As the Commission itself has noted, in the 35 years prior to the PAEA, it was exceedingly cautious about accepting new subclasses.¹⁴

At the other end of the spectrum, how broadly can the Postal Service define products to include services with differing cost and/or market characteristics? This is a more difficult question. The definition of product says that a product is “a postal service with a distinct cost or market characteristic for which a rate or rates are, *or may reasonably be*, applied.” § 102(6). The italicized language appears to imply that, even though the Postal Service has established a rate or rates that treat a bundle of services as a single product, the Commission may regard the same of bundle of services as two or products if it would be “reasonable” to apply multiple rate schedules. Since, under § 3652(a), the Postal Service must report costs, revenues, rates, and service quality by product, whether or not a specific bundle of services is one product or multiple products is an important question.

Given the changes in roles of the Postal Service and Commission in ratemaking and central role of pricing flexibility in the PAEA, it seems apparent that the Commission should generally defer to the Postal Service in the matter of product definition, that is when it is “reasonable” to apply multiple rates to specified bundle of services. However, one can imagine are cases in which a complainant might persuade the Commission that the Postal Service has combined services into a single product unreasonably. For example, if the Postal Service were to eliminate discounts for downstream entry of bulk Standard Mail, some mailers might successfully argue that the Commission should order the Postal Service to divide the single product, Standard Mail, into origin and downstream products to which multiple rates “may reasonably be applied.”¹⁵

Within these broad parameters, it seems useful to consider examples of cost and/or market characteristics that could plausibly be used to define products.

¹³PRC Op. MC95-1 (1996) ¶ 2071 (“In the Reorganization Act, however, Congress determined that rates should be based largely on costs of service. This was intended as a clean break with the past”).

¹⁴See, e.g., PRC Op. MC95-1 (1996) ¶ 2126 (“the Commission historically has been quite cautious in departing from the existing subclass structure”).

¹⁵Although § 102(6) seems to provide a basis for the Commission ordering establishment of a new product, it is less apparent what would be the basis for the Commission ordering the Postal Service to establish a new rate within a product.

(a) Item shape

As demonstrated in R2006-1, within First Class Mail, the costs of single-piece flat and parcel services differ from those of envelope service. Preparation by the mailer also differs, at least in respect to packaging. Demand for the two services may differ as well. It seems plausible, therefore, to regard single-piece flat service and single-piece parcel service as different "products" from single-piece letter service.

(b) Set of services

First Class Mail also contains several services for "automation letters." In order to simplify mail processing, the Postal Service requires automation mail to meet strict packaging and addressing requirements; hence, the cost of service is less than for single-piece letter mail. In addition, costs and mail preparation requirements vary by level of sortation, and these differences are reflected in different rate schedules. Since each level of sortation appears to be a "postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied," it seems that each of the sortation levels of automation mail (mixed AADC, AADC, 3-digit, and 5-digit) could be considered a separate product.

By the same token, it would seem possible for the Postal Service to consider upstream and downstream services as separate products. For almost a century, Post Office Department regarded city-to-city transportation service ("mail service") and local delivery service ("free city delivery," introduced in 1863) as distinct services. Indeed, the Post Office did not terminate its "drop letter" service—a delivery-only service for letters—until 1968. If provision of drop letter service for 189 years did not create an unjust or unreasonable mail classification, reinstitution of such a mail classification should not do so either.

(c) Downstream and upstream services

Rate schedules for Standard Mail and Package Services include rates that vary according to where the mail is tendered to the Postal Service and the number of sortations required. The rate schedule for Standard Mail includes "dropship" discounts that depend on how far "downstream" the mail is tendered, i.e., on how much of the Postal Service's transportation and distribution system is bypassed by the mailer. The mailer can either purchase upstream transportation and sorting services from the Postal Service by mailing at the origin post office or buy similar services from private companies and tender the mail to the Postal Service downstream. Upstream and downstream services are thus separable as matter of commercial reality; they involve activities with different costs and different

demands. Likewise, each level of downstream service provides a different bundle of services with different cost characteristics. It seems that each downstream dropship service and each upstream transportation and sorting service could be considered a different product.

A somewhat similar situation is provided by parcel post. Parcel post service is provided according to two rate schedules, one for intra-BMC service (conveyance within an area served by a single bulk mail center) and inter-BMC service. For each type of service, different rates are charged according to the increment of distance (the "rate zone") over which the parcel is to be conveyed. Like the different downstream services provided in Standard Mail, intra-BMC, on the one hand, and inter-BMC parcel post, on the other other, seem to qualify as different products because they are offering different bundles of services. Rate zones seem less fundamental a distinction. The same basic service is offered but the cost of transportation varies. On the other hand, the mailer can purchase separate transportation services to skip postal zones. Whether or not different parcel post services to different zones may be considered different "products" seems to a close question that could be answered either way.

(d) Expectations about market needs or developments.

In an international mail case, the court rejected a claim that a classification limited to mailers "capable" of tendering a certain minimum level of mail was "unjust or unreasonable" in violation of § 403(c).¹⁶ If mailers can lawfully be given different rates based on such a distinction, then necessarily the services could be considered different "products." Or, to give a different example, in light of the success of CityMail in Sweden, it does not seem implausible to create a product for computer-generated mail in anticipation of future developments.. Similarly, it may be appropriate to define a product based on the suitability for certain types of equipment that promise increased efficiency or mail security.

(e) Negotiated service agreements

A "Negotiated Service Agreement" (NSA) is a contract with an individual mailer. An NSA may be "cost-based," i.e., it may involve a unique set of services. Alternatively, it is possible imagine an NSA based upon the particular demand

¹⁶UPS Worldwide Forwarding, Inc. v. United States Postal Service, 66 F.3d 621, 634 (1995) ("That the Postal Service chose to offer the program to those 'capable' of tendering a certain minimum level of mail or dollars, instead of those that actually so deliver, reflects a reasonable business decision about the most effective means to solicit new customers. . . . Allowing a limited class—the relatively small percentage of large-volume mailers eligible to participate in the ICM program—to negotiate individual service plans at individual rates does not appear on its face to be "undue or unreasonable.").

characteristics of an individual mailer. Such NSAs would appear to fit the statutory definition of "product." On the other hand, an NSA might entail no more than volume-incentive discounts from existing rates. Such a NSA would not seem to fit the statutory definition of "product." In short, where or not a specific NSA is a "product" or not seems to depend on the precise nature of the NSA.

3.3 Size and weight limits for products

Section § 3682 provides for size and weight limits for postal products, as follows:

The Postal Service may establish size and weight limitations for mail matter in the market-dominant category of mail consistent with regulations the Postal Regulatory Commission may prescribe under section 3622. The Postal Service may establish size and weight limitations for mail matter in the competitive category of mail consistent with its authority under section 3632.

Under this provision, the Commission is required to set limits on the size and weight of market dominant products. In the competitive category, however, the Postal Service is authorized to collect and deliver packages of any size and weight. Hence, it appears that the Postal Service may expand the competitive product category to include at least some services for heavy-weight packages have traditionally fallen outside the scope of postal services.

3.4 Postal monopoly and definition of the market dominant category

Paragraph § 3642(b)(2) introduces the postal monopoly as a criterion for determining whether a product is in the market dominant category or the competitive category. While technically applicable only to categorization determinations made by the Commission after the date of enactment, it appears reasonable to use § 3642(b) as an aid in interpreting the lists of mail matter set out in § 3621(a) and § 3631(a).¹⁷ Paragraph § 3642(b)(2) provides as follows:

(2) Exclusion of products covered by postal monopoly.—A product covered by the postal monopoly shall not be subject to transfer under this section from the market-dominant category of mail. For purposes of the preceding sentence, the term "product covered by the postal monopoly" means any product the conveyance or transmission of which is reserved to the United States under section 1696 of title 18, subject to the same exception as set forth in the last sentence of section 409(e)(1).

This paragraph incorporates 18 U.S.C. § 1696 (2000) into the definition of

¹⁷See section 3.5, below.

“market dominant product.” Subsection § 1696(a) provides for a postal monopoly over the carriage of “letters and packets” across U.S. territory although there are some statutory exceptions.¹⁸ It was originally enacted in 1872. It has been amended only slightly since then. The precise scope of the 1872 postal monopoly law is far from clear.

The final phrase in § 3642(b)(2)—“subject to the same exception as set forth in the last sentence of § 409(e)(1)” —indicates that for purposes of defining the scope of the market dominant category, the definition of the monopoly includes exceptions to the monopoly set out in § 601.¹⁹ The scope of these exceptions depend, in turn, on two sets of Commission regulations. First, the Commission must issue regulations under § 3633(a) to implement pricing rules for competitive products. Revisions to § 601 made by the PAEA are not effective until the effective date of such regulations.²⁰ Second, under § 601(c) the Commission must issue such regulations as it considers necessary to carry out the provisions of the revised § 601. These regulations will likely include, but may not be limited to, a definition of services which are exempted from the monopoly by grandfathering Postal Service regulations which purport to suspend the monopoly under former § 601(b).²¹

In sum, the definition of the market dominant category depends upon a determination of the scope of the postal monopoly created by 18 U.S.C. 1696 and the revised § 601. The boundaries of the postal monopoly will need to be clarified by the Commission before the interplay between the postal monopoly and the definition of the market dominant category can be fully understood.

Definition of the postal monopoly may appear tangential to the definition of

¹⁸18 U.S.C. § 1696(a) states, “(a) Whoever establishes any private express for the conveyance of letters or packets, or in any manner causes or provides for the conveyance of the same by regular trips or at stated periods over any post route which is or may be established by law, or from any city, town, or place to any other city, town, or place, between which the mail is regularly carried, shall be fined not more than \$500 or imprisoned not more than six months, or both. This section shall not prohibit any person from receiving and delivering to the nearest post office, postal car, or other authorized depository for mail matter any mail matter properly stamped.”

¹⁹The final sentence of § 409(e)(1) says, “For purposes of the preceding sentence, any private carriage of mail allowable by virtue of section 601 shall not be considered a service reserved to the United States under section 1696 of title 18.”

²⁰PAEA § 503(b), 120 Stat. 3235, states: “(b) EFFECTIVE DATE.—This section [revising former § 601(a), striking former § 601(b), and adding § 601(b) and § 601(c)] shall take effect on the date as of which the regulations promulgated under section 3633 of title 39, United States Code (as amended by section 202) take effect.”

²¹See 39 CFR § 310(a)(1) n. 1 (2006); 39 CFR § 320 (2006).

the market dominant category, but it is not. Application of the postal monopoly to Standard Mail rests primarily on a determination by a single federal court of appeals to defer to Postal Service regulations claiming that the term "letters and packets" in 18 U.S.C. § 1696 includes printed advertisements.²² Since the PAEA repeals the authority of the Postal Service to adopt regulations defining the scope of the postal monopoly, the Commission will be not required to determine whether it should defer to Postal Service regulations (the question before the court) but rather to determine whether the postal monopoly does indeed include Standard Mail. While the Commission may come to the same reading of the postal monopoly law as the appellate court, the court's decision cannot necessarily be considered as definitive.²³

The scope of the postal monopoly also affects which international postal services are placed within the market dominant category. Although § 3631(a)(4) lists "bulk international mail" as within the competitive category, the postal monopoly applies to outbound and inbound international letters to same extent as to it does to domestic letters. There is no exception from the postal monopoly for bulk mail.²⁴ Hence, the Commission could find that at least some "bulk international mail" is covered by the postal monopoly. If so, the Commission may then conclude that it must transfer such mail from the competitive category to the market dominant category immediately.

3.5 Rule of construction

Subsections § 3621(a) and § 3631(a) list types of mail matter which are designated by statute to fall within the market dominant and competitive categories, respectively, as of the date of enactment of the PAEA. Subsections § 3621(b) and § 3631(c) provide a "rule of construction" that is to be used in interpreting the lists of mail matter set out in the two sections, respectively. The wording of each rule of construction is identical:

²²Associated Third Class Mail Users v. United States Postal Service, 600 F.2d, 824 (D.C. Cir. 1979), *cert. denied*, 444 U.S. 837 (1979).

²³Moreover, in its review of the case, the court of appeals apparently lacked critical historical information. In assessing the reasonableness of the Postal Service's regulations, the court relied heavily on brief, broadly worded opinions issued by the solicitor of the Post Office Department in 1916. The court was seemingly unaware of (i) a contrary interpretation of the scope of the postal monopoly adopted by the Attorney General prior to 1916 and subsequently relied upon by the Post Office Department and (ii) a clarification by the Post Office Department sent to Congress after 1916 that appears to recant the solicitor's opinions.

²⁴There is an administrative suspension, codified in § 601 by the PAEA, for outbound international *re-mail* that is not ultimately destined for a U.S. address. 39 CFR § 320.8. This suspension does not cover outbound international mail that is not remailed.

Rule of Construction.—Mail matter referred to in subsection (a) shall, for purposes of this subchapter, be considered to have the meaning given to such mail matter under the mail classification schedule.

Despite, and to a large extent because of, this “rule of construction,” interpretation of the lists of market dominant and competitive products is difficult. The rule of construction refers to “the mail classification schedule.” Other than in these rules of construction, this term is used only one other time in Title 39. Paragraph § 3622(d)(1)(A) defines certain requirements for the modern system of regulation to be established by the Commission by using the following phrase: “the annual limitations under paragraph (1)(A) shall apply to *a class of mail, as defined in the Domestic Mail Classification Schedule* as in effect on the date of enactment of the Postal Accountability and Enhancement Act.”²⁵ Clearly, this is a precise reference to a specific mail classification schedule. In this provision reference to the DMCS is for a somewhat different purpose than reference to the “mail classification schedule” in the rules of construction in § 3621(b) and § 3631(c). The purpose of paragraph § 3622(d)(1)(A) is to specify products subject to a statutory price cap; the purpose of the rules of construction is to illuminate the meanings of finer and more ambiguous divisions of mail matter.

Do the rules of construction in § 3621(b) and § 3631(c) refer specifically to the DMCS or more generally to the schedule of mail categories used by the Postal Service as of the date of enactment? The contrast between the precise reference to the DMCS in § 3622(d)(1)(A) and the more general references to “mail classification schedule” in the rules of construction suggests that Congress meant something different in the latter cases. But this implication is negated to some degree by legislative history. In a report dealing with a predecessor bill, the House committee explained this provision by stating, “The products listed have the *same meaning given them in the Mail Classification Schedule* (39 CFR pt. 3001, Subpt. C, App. A) as of the date of enactment.”²⁶ Report language, however, does not alter the fact that the “rule of construction” in § 3621(b) and § 3631(c) uses the general phrase “mail classification schedule” and not the more specific phrase “Domestic Mail Classification Schedule” (DMCS).

In fact, the rules of construction in § 3621(b) and § 3631(c) cannot mean that the lists of market dominant and competitive products are to be interpreted exclusively by reliance on the DMCS. Some terms in the lists of mail matter set

²⁵Paragraph § 3622(d)(1)(A) apparently refers to the Domestic Mail Classification Schedule (Sep., 13, 2006). In this paper, all references to the DMCS will be this edition unless otherwise indicated.

²⁶H.R. Rept. No. 109-66 (2005) at 46-47. See generally my “Legislative History of the Postal Accountability and Enhancement Act, Public Law 109-435” (Version 1.0, Apr. 2007).

out in § 3621(a) and § 3631(a) do not correspond to a subclass or rate category listed in the DMCS (e.g., “single-piece parcel post”). Moreover, the DMCS pertains only to domestic mail while the lists of mail matter in both § 3621(a) and § 3631(a) include international mail products.

For terms in § 3621(a) and § 3631(a) that are not defined in the DMCS, there are three readily apparent aids to interpretation. First, the DMCS can be consulted for similar terms. For example, although the DMCS does not use the term “single-piece parcel post,” it does use the terms “single-piece” and “parcel post” separately, so the meaning of “single-piece parcel post” can be plausibly derived. Second, the International Mail Manual (IMM)²⁷ provides a classification scheme for international mail that is generally equivalent to the classification scheme provided for domestic mail in the DMCS. Third, the definitions of the market dominant category and competitive category provided in § 3642(b) may be consulted. Since the Commission is required to follow these definitions in revising the lists provided in § 3621(a) and § 3631(a), it is logical to surmise that Congress intended the statutory lists to be initially consistent with the criteria for revision as of the date of enactment; otherwise, the Commission would be obliged to revisit the lists immediately after enactment.²⁸

3.6 Products in the market dominant category listed in § 3621(a)

The list of market dominant products in § 3621(a) is as follows:

- (a) Applicability.—This subchapter shall apply with respect to—
- (1) first-class mail letters and sealed parcels;
 - (2) first-class mail cards;
 - (3) periodicals;
 - (4) standard mail;
 - (5) single-piece parcel post;
 - (6) media mail;
 - (7) bound printed matter;
 - (8) library mail;
 - (9) special services; and

²⁷In this paper, all references to the International Mail Manual refer to Issue 33 (March 2006) as updated to March 1, 2007, currently available on the Postal Service’s internet site. As the “update notice” in this edition indicates, changes since December 20, 2006, have been minor and do not affect the correctness of references in this paper.

²⁸Although the lists of market dominant and competitive products set out in § 3621(a) and § 3631(a) were likely intended to include all of the products of the Postal Service, this not literally the case. Some products may be considered to have been overlooked. The fact that a specific product is not listed as belonging one category does not logically imply that it belongs in the other category. As a matter of drafting, it would have been clearer to have specified the set of products in one category and defined the other category as including all other products.

(10) single-piece international mail,
subject to any changes the Postal Regulatory Commission may make under
section 3642.

In this list, two terms refer to *classes* of domestic mail: (3) periodicals and (4) standard mail. Five terms refer to *subclasses* of domestic mail: first-class mail letters and sealed parcels, first-class mail cards, media mail, bound printed matter, and library mail. One term, special services, refers to fees for services ancillary to carriage of domestic mail. This leaves one term for which the DMCS fails to offer definitive guidance insofar as domestic mail is concerned: (5) single-piece parcel post. Although the DMCS uses the term "single-piece" and the term "parcel post," it does not use the terms in conjunction.²⁹ The most plausible interpretation is to construct a meaning based on the way these terms are used in the DMCS.

With respect to international mail, interpretation of this list is less straightforward. Although item (10), single-piece international mail, refers to international mail, there is no mention of international mail in the DMCS. As noted above, it seems plausible to refer to the International Mail Manual (IMM) as the official "mail classification schedule" available for international mail. The Postal Service has incorporated the IMM into the Code of Federal Regulations. 39 CFR § 20.1 (2006).

Item (10) appears to refer to both outbound and inbound international mail since it makes no distinction between the two services. Both services are described in the IMM. If single-piece inbound international mail is not placed in either the market dominant category or the competitive category, then the Postal Service would be prohibited from providing the service. § 3642(e). Inbound single-piece international mail must be considered to be in the market dominant category if it is not to be placed in the competitive category.

As a practical matter, it makes sense to apply the same legal treatment to inbound and outbound mail because they are two sides of the same coin. Since the Postal Service does not conduct operations outside the United States, both services are provided by the Postal Service acting in partnership with foreign postal administrations and/or private delivery services. Outbound services are sold by the Postal Service but largely performed by foreign posts. Inbound services are sold by foreign partners but are largely performed by the Postal Service. International mail products are thus necessarily created by international agreement. These may be intergovernmental agreements negotiated by the Secretary of State under § 407(b) or they may be commercial agreements between the Postal Service and foreign delivery services negotiated by the Postal Service.

²⁹See DMCS § 521.

under § 407(d). For outbound international mail services, the Postal Service groups the joint international products into "categories" and assigns rates. For inbound international mail services, the Postal Service seems to provide transportation and delivery services for international mail products by aggregating them with the nearest equivalent domestic mail classes or subclasses. Since outbound and inbound international mail services are essentially the same products, there appears to be no basis for not interpreting item (10) to refer to both outbound and inbound services.

The applicability of the modern system of regulation to international mail arranged by intergovernmental agreement is underscored by § 407(c). This provision addresses the Commission's responsibilities in respect to "any treaty, convention, or amendment that establishes a rate or classification" for a market dominant product, as follows:

(c)(1) Before concluding any treaty, convention, or amendment that establishes a rate or classification for a product subject to subchapter I of chapter 36, the Secretary of State shall request the Postal Regulatory Commission to submit its views on whether such rate or classification is consistent with the standards and criteria established by the Commission under section 3622.

(2) The Secretary shall ensure that each treaty, convention, or amendment concluded under subsection (b) is consistent with the views submitted by the Commission pursuant to paragraph (1), except if, or to the extent, the Secretary determines, in writing, that it is not in the foreign policy or national security interest of the United States to ensure consistency with the Commission's views. Such written determination shall be provided to the Commission together with a full explanation of the reasons thereof, provided that the Secretary may designate which portions of the determination or explanation shall be kept confidential for reasons of foreign policy or national security.

Since no treaty, etc., establishes a rate or classification for postal services conveyed in one direction only, the Commission must address both outbound and inbound services in giving its views on "whether such rate or classification is consistent with the standards and criteria established by the Commission under section 3622." The "standards and criteria" can only refer to Commission regulations dealing with rates and classifications.

Although the IMM does not use the term "single-piece international mail," it does use the term "bulk international mail" (see next section). Thus, single-piece could be considered non-bulk. Or "single-piece international mail" could be interpreted by applying the concept of "single-piece" as used in the DMCS to international mail as defined in the IMM. In making this determination, the Commission may wish to consider the extent of effective competition for specific

international mail products under the test of § 3642(b)(1).

In addition, two other terms in § 3621(a) could be interpreted to refer to international as well as domestic mail. The reference to periodicals in § 3621(a)(3) could plausibly include what the IMM calls “Publishers Periodicals.”³⁰ On the other hand, periodicals would seem to be a bulk service by its nature, and § 3631(a) designates “bulk international mail” as part of the competitive category. Likewise, the IMM refers to “Special Services” so § 3621(a)(9) might plausibly be interpreted to include international as well as domestic special services.³¹ These interpretative issues, too, will have to be resolved by the Commission.

3.7 Products in the competitive category listed in § 3631(a)

Interpreting the list of competitive products set out in § 3631(a) presents similar difficulties. This subsection provides the following list of postal services subject to regulation as competitive products:

- (a) Applicability.—This subchapter shall apply with respect to—
- (1) priority mail;
 - (2) expedited mail;
 - (3) bulk parcel post;
 - (4) bulk international mail; and
 - (5) mailgrams;

subject to subsection (d) and any changes the Postal Regulatory Commission may make under section 3642.³²

Subsection § 3631(c) provides the same rule of “rule of construction” as found in § 3621(b).

In respect to domestic postal services, only (1) priority mail and (2) expedited mail are terms appearing in the DMCS, as a subclass and class, respectively.³³ While “parcel post” appears in the DMCS, there is no definition of (3) bulk parcel post. Hence, it will presumably be necessary for Commission to construct a meaning for “bulk parcel post” from the way these words are used in different parts of the DMCS. The DMCS does not include (5) mailgrams at all because mailgram service is no longer provided by the Postal Service and was, in

³⁰IMM § 294 (“Publishers’ periodicals are domestically approved publications that include magazines, newspapers, journals, and other types of periodical publications. See DMM 707.”).

³¹IMM Chapter 3.

³²There is no subsection (d) in § 3631. This is an error in drafting.

³³DMCS § 223 (priority mail); § 110 (expedited mail).

any case, never considered a postal service.³⁴

In respect to international postal service, the proper interpretation of § 3631(a) is still less clear. Three terms in § 3631(a) could refer to international as well as domestic products: priority mail, expedited mail, and parcel post. As for the first, the IMM lists "Global Priority Mail" as one of five principle categories of international mail³⁵ and "International Priority Airmail" as a subdivision of a second principal category, "Airmail." Similarly, while the IMM does not use the term "expedited mail" to define any type of international mail service, it describes two of its international services as "expedited": Global Express Mail Guaranteed and Global Express Mail.³⁶ Both domestic "Expedited Mail" and these international express products are marketed as "express mail." Indeed, Global Express Mail Guaranteed is a joint product of the Postal Service and a private express company. "Parcel post" is a long-established international mail service; it is available both as an airmail service and an economy service.³⁷ In the IMM, as in the DMCS, there is no specific service called "bulk parcel post." In deciding whether § 3631(a) should be interpreted to include any of these three international mail services, it would appear reasonable to look to the definition of the competitive category found in § 3642(b)(1). If the Postal Service has a market dominant position in a service, should be considered a market dominant product. Otherwise, it should be considered a competitive product.

Interpreting the fourth item, "bulk international mail," presents the same problem as interpreting "single-piece international mail" in § 3621. While there is no international mail service specifically called "bulk international mail," the word "bulk" is used in the IMM in sufficient contexts to identify a basis for interpretation. For example, the IMM indicates that "bulk business products" include at least two specific services: International Priority Airmail and International Surface Air Lift.³⁸ At another point, the IMM refers to any mailing of

³⁴See PRC Op. MC76-1, MC76-2, MC76-3, and MC76-4 (1977) (Mail Classification Schedule, 1976).

³⁵IMM 141.1 ("There are five principal categories of international mail that are primarily differentiated from one another by speed of service. They are Global Express Guaranteed (GXG) service, Global Express Mail (EMS) service, Global Priority Mail (GPM) service, airmail service, and economy mail service.").

³⁶IMM §§ 141.2-1.3.

³⁷IMM § 280.

³⁸IMM § 123.61 n. 2 ("Bulk business products, including International Surface Air Lift (ISAL) and International Priority Airmail (IPA), require customs forms based on package contents and weight as specified above and as required by the country of destination.").

more than 200 pieces as a bulk mailing.³⁹ Thus, it appears that the Commission may interpret “bulk international mail” by the use of the individual term “bulk” in the IMM.

4 Regulation of Rates Before the PAEA

Since the modern system of regulation represents a departure from the pre-PAEA system of regulation, and since the list of factors requires the Commission to take into account most of the norms of the prior system, it is useful to review briefly the salient features of prior regulatory regime.

4.1 Classification regulation

Regulation of classification is the regulation of price discrimination. Classification defines when it is permissible to give mailers in group A a different rate or service than mailers in group B. Historically, postal services in the United States were divided into content-based categories called *classes*. The four traditional classes of postal service were established by the postal act of 1879 which refined the three classes introduced in the postal act of 1863. These classes were defined as: *first class*: letters, cards, and other matter in writing; *second class*: newspapers and other periodic publications; *third class*: books, circulars, and miscellaneous printed matter; and *fourth class*: merchandise and other matter.⁴⁰ These classes were originally derived from the practice in earlier postal laws of pricing letters at or above (what we today call) standalone costs and pricing other items as byproducts or social services. International mail was not part of this classification system. Congress maintained these four classes of postal services until 1970.

In the Postal Reorganization Act of 1970, Congress delegated authority to decide mail classification to the Commission acting either on request of the Postal Service or at its own discretion. The 1970 act did not define the term “class” nor require the Commission to follow the traditional scheme for mail classification. It merely directed the Commission to establish a “mail classification schedule” that is “in accordance with the policies of this title and the following [six] factors.” Former § 3623. After 1970, however, the Postal Service and Commission continued the traditional division of domestic postal services into four classes. Only one new class was added, what is now Expedited Mail, in 1977. The

³⁹IMM § 122.2 (“For the purpose of this section, a “bulk mailing” is 200 or more pieces mailed at the same time by the sender.”).

⁴⁰Act of March 3, 1879, ch. 180, §§ 8-21, 20 Stat. 355, 358-60. See generally the summary of the history of mail classification in PRC Op. MC95-1 (1996) ¶¶ 2001-2049.

Commission acquiesced in the Postal Service's claim that international mail was outside its jurisdiction.

The only time the Commission conducted a comprehensive review of mail classification was the MC95-1 case.⁴¹ In this case, the mail classification system was revised to be somewhat more oriented towards priority as the basis for defining classes. Nonetheless, with the exception of Expedited Mail, the primary classes remained largely defined by the content of the items conveyed. In MC95-1, the Commission rejected proposals by the Postal Service to create several new "subclasses," i.e., classification divisions within the primary classes. The Commission held that a subclass may be created only after a showing of differences in both *cost* and *demand* characteristics between two groupings of mail.

A showing of cost *and* demand differences has been important for concluding that independent application of all of the § 3622(b) ratemaking criteria is warranted. . . . The cost characteristics test reflects the need to classify mail for purposes of attributing costs. The market-demand characteristics test reflects the need to classify mail for purposes of assigning institutional costs, particularly to take into account "the value of mail service actually provided each class or type of mail service to both the sender and the recipient" 39 U.S.C. § 3622(b)(2).⁴²

This standard for creation of subclasses was recently reiterated in R2006-1. The Commission declared that "It is essential that subclasses contain rational groupings of mail *with similar cost and demand characteristics*."⁴³

The MC95-1 case makes clear the uniqueness of the Commission's position on product classification. To justify its concept of "subclass," the Commission

⁴¹PRC Op. MC95-1 (1996) ¶ 1001 ("the first comprehensive reclassification proposal the Postal Service has submitted under the Postal Reorganization Act").

⁴²PRC Op. MC95-1 (1996) at ¶ 1007. *See also* Id. ¶ 1009 (Whether or not cost differences exist, subclass status may be accorded a grouping of mail when necessary for proper application of the noncost (pricing) factors of the Act. Typically, the test applied is whether the grouping exhibits different demand characteristics, which indicate it consists of distinct products which serve a separate market. As the Commission has recognized, 'the critical factors to be considered are whether the cost characteristics and demand characteristics . . . are sufficiently different to warrant independent evaluation under § 3622(b) factors.' PRC Op. R80-1, para. 0686.").

⁴³PRC Op. R2006-1 (2007) at ¶ 4033.

cites no legal source but its own precedents and the text of former § 3623.⁴⁴ The Commission rejected a determined argument by the Postal Service and mailers that mail classification divisions should be permitted if based on a showing of cost differences alone. The Commission held that such an approach would reduce “economic efficiency” and could lead to “unwarranted discrimination.”⁴⁵ When some mailers pointed out that regulators of other sectors recognized classification divisions based on the wholesale or retail status of customers, the Commission responded that regulatory precedents in other sectors were irrelevant. It concluded that postal classification presented unique legal issues because postal classification is controlled by the full range of factors set out in former § 3623. Quoting an earlier opinion with approval, the Commission emphasized that its approach to mail classification was longstanding and unique:

The wholesale/retail dichotomy was rejected by the Commission on both factual and legal grounds. The Commission found *public utility standards* “not . . . particularly instructive in defining classes of mail.” PRC Op. R80-1, para. 0683. Unlike utilities, which provide an essentially homogeneous product for which differences in demand may be the major defining characteristic, *separate classification of mail triggers all the ratemaking criteria of § 3622(b)*. This was said to be a legal consequence “unique to mail classification,” and one which requires the Commission to look mainly to the Act itself for its classification criteria. *Id.*, paras. 0683-84.⁴⁶

In addition to the uniqueness of the Commission’s approach towards product classification, two other factors stand out in reviewing MC95-1. First, the Commission’s approach towards classification was substantially, but not wholly, influenced by the requirement in former § 3623 to maintain a “fair and equitable mail classification schedule.”⁴⁷ As noted above, however, the PAEA expressly

⁴⁴See in particular PRC Op. MC95-1 ¶¶ 2050-2086 (classification under the Postal Reorganization Act); ¶¶ 3019-3054 (the distinctions among classes, subclasses, and rate categories). Although the Commission cites some judicial interpretations of the mail classification provisions of the act [e.g., ¶ 2072], none of these judicial opinions appear to address the basic issue of appropriate criteria for establishing product classifications in the postal sector.

⁴⁵PRC Op. MC95-1 (1996) ¶ 3031 (“The Commission finds that adopting a “cost-only” test would seriously compromise its ability to prevent unwarranted discrimination, as well as protecting the interests of individual mailers. Where the distinctions between categories are mainly cost differences, which are the result of varying degrees of worksharing, rate discounts encourage productive efficiency, while separate subclass pricing can impair economic efficiency.”).

⁴⁶PRC Op. MC95-1 (1996) ¶ 3039 .

⁴⁷See, e.g., ¶ 3045 (“Foremost was maintaining a fair and equitable schedule”); ¶3046 (“splitting subclasses between large and small users could ultimately violate the requirement of fairness of § 3623(c)(1)”).

drops this factor from the list of factors which the Commission is to take into account in regulation of mail classification after the PAEA. Second, the Commission insisted that the proponent of a change in mail classification must overcome a substantial burden-of-proof requirement.⁴⁸ Hence, there was a strong administrative bias against creation of new subclasses.

This relatively restrictive approach towards product classification was not ameliorated by the possibility of creating "rate categories" within a "subclass." A rate category is *not* a separate classification because it is not a separate category of mail for the purpose of setting rates. In essence, all products in a rate category are required to bear the same rate but for an allowance for clearly identifiable differences in direct costs.

In sum, prior to the PAEA, the Commission adopted a more restrictive approach towards product classification than adopted in other regulated sectors. Guided by its interpretation of former § 3623, the Commission concluded that a new classification division could be created only if justified by *persuasive* evidence demonstrating differences in *both* cost and demand characteristics.

4.2 Rate regulation

Under the pre-PAEA law, the key to the Commission's approach to ratesetting was its concept of a "subclass." The Commission summarized its approach in R2006-1 as follows:

The first step in recommending rates is to determine *the attributable cost for each subclass*. The second step is *to assign an institutional cost burden to each subclass* based on the pricing factors of the Act. The third step is *to design rates for each subclass* that will cover the attributable cost and assigned institutional cost burden.⁴⁹

Within each subclass, there could be several "rate categories." A rate category is essentially a type of postal service which has different costs from other postal services in the same subclass but which cannot be shown, with persuasive evidence, to pass the Commission's test for subclass status, i.e., differences in

⁴⁸See, e.g., PRC Op. MC95-1 (1996) ¶ [3054] ("To qualify for separate class or subclass treatment, with independent application of all the policy criteria of the Act, a proponent must demonstrate, with persuasive evidence of record, that its product possesses intrinsically different characteristics which warrant separate application of one or more of the other statutory ratemaking standards.").

⁴⁹PRC Op. R2006-1 (2007) ¶ 4013 .

both cost and demand characteristics.

Originally, the idea of a rate category was introduced to describe "workshared mail," that is, mail which was in some manner prepared by the mailer so that Postal Service did not incur the cost of work that it would otherwise perform. The Commission considered that the mailer should receive a discount for such mail, and hence the discounted rate constituted a "rate category." In R77-1, its first extended discussion of a rate category for workshared mail, the Commission focused on the *purpose* of the rate category in order to develop the appropriate rate:

Upon reviewing the purpose for which this presort discount was established and the factors relied upon to support that decision, we conclude that this mail category was *primarily intended to bring about a structural reform within first-class mail in order to align rates with costs rather than to give recognition to unique characteristics of presorted first-class mail* which would warrant an independent application of all of the § 3622(b) ratemaking criteria to this category.

In MC73-1 we found that *the purpose of the presort discount was to provide to the mailer who presorts equitable compensation for the costs avoided by the Service, to encourage such worksharing, and, as a consequence, improve service.* The factors that we considered in approving the discount were primarily the cost avoidance characteristics of presorting and the conditions of mailing and rate structure which would best reflect these cost characteristics. . . .

Perhaps the best indication that presorted first-class mail, at the time of its adoption, *was not intended to have the legal status of an independent subclass, is the determination made there to relate the discount to the cost coverage of first-class mail as a whole, rather than of presorted first-class mail itself.* For these reasons we conclude that the presorted first-class discount established in MC73-1 is not a discrete "class of mail or type of service" for purposes of § 3622(b). *Accordingly, we conclude that it is the policies of the Act to offer a discount for presorted first-class mail in the amount of the costs avoided by such mail in order to maintain the per piece and overall residual cost contribution of first-class mail.*⁵⁰

In brief, in R77-1, the Commission held that if the purpose of the rate

⁵⁰PRC Op. R77-1 (1978) at 247-49.

category is to induce the mailer to do some of the mail preparation that the Postal Service would otherwise do, then the appropriate rate is established by the cost of the work avoided by the Postal Service. Indeed, to ascertain the purpose of the discount the Commission relied in part on the Postal Service's determination to "to relate the discount to the cost coverage of first-class mail as a whole, rather than of presorted first-class mail itself."

In subsequent cases, the Commission developed the idea of rate categories well beyond its origin as a discount intended to induce worksharing. The rationale for pricing workshared mail based upon avoided costs was generalized into the more formal economic concept of "efficient component pricing" (ECP). ECP was extended to all "workshared" mail, regardless of the purpose of the rate differential. The label "workshared" was also extended to mail for which the mailer did essentially no preparatory work and the Postal Service avoided no costs that it would have otherwise incurred. For example, computer-generated letters are produced in the order of delivery; they are not sorted by the mailer and would have never been sorted by the Postal Service. Nonetheless, such mail was deemed workshared and priced using ECP. In R2006-1 the Commission concluded that, contrary to previous decisions, ECP should be the "starting point" for all rate differentials within a subclass, including differences based on shape and weight which have no relation to the concept of worksharing.⁵¹

In R2006-1, the Commission explained that it relies upon ECP to determine the rates for rate categories in order to promote fairness and increase efficiency.

Witness Panzar has provided the insight that if cost differences equal rate differences then *mailers can make informed choices which minimize net end-to-end mailing costs*. Moreover, *it seems to be fundamentally fair that mailers pay the costs they impose upon the Postal Service plus the same contribution per piece that all the mailers make within the same subclass*. This is the definition of an ECP price. For all these reasons, and contrary to what the Commission articulated in R2000-1 about the neutral starting position for rate design, the Commission now believes, and with good evidence, that the neutral starting position should equal the per-piece contribution because *this promotes productive*

⁵¹PRC Op. R2006-1 (2007) ¶¶ 4029, 4038. The Commission declares, "the Commission now believes, and with good evidence, that the neutral starting position should equal the per-piece contribution because this promotes productive efficiency. [¶ 4032] . . . Although the Act provides pricing factors and policies, it does not prescribe a rate setting methodology. That is left to the judgment of the Commission. . . . The Commission finds in this case that ECP is a sound starting point from which to make adjustments to satisfy the pricing factors and policies of the Act. [¶ 4036]."

*efficiency.*⁵²

In sum, the Commission's basic approach towards setting rates under the pre-PAEA law was as follows: attribute costs to each subclass as far as possible; assign to each subclass an appropriate contribution to institutional costs; and then price rate categories within each subclass according to ECP. In any given rate structure, however, variations from this basic approach may be introduced due to lack of data, concern for rate shock, consideration for other ratemaking factors, and other factors.

5 Modern System of Regulation for Rates of Market Dominant Products

In the wake of the PAEA, the Commission is required to establish, by regulation, "*a modern system for regulating rates and classes for market-dominant products.*" § 3622(a). The modern system shall include a definition of "workshare discounts." § 3622(e)(1). The modern system shall also prescribe size and weight limitations for market dominant products. § 3682.

5.1 New relationship between Governors and Commission

The Governors are authorized to establish rates and classifications for all postal products, including market dominant products, by § 404(b), which provides:

(b) Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rate of postage and fees for postal services in accordance with the provisions of chapter 36. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

In turn, the Commission is required to establish a modern system of regulation for these classes and rates that is "designed to achieve" nine statutory objectives listed in § 3622(b).

This approach appears to alter substantially the respective roles of the Postal Service and the Commission in the setting of rates and classifications. Although

⁵²PRC Op. R2006-1 (2007) ¶ 4032 .

former Title 39 also declared that the Governors were authorized "to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services" (former § 3621), this authority was severely circumscribed by the active role given the Commission. Former § 3622(a) declared that "Postal Service may submit *such suggestions for rate adjustments* as it deems suitable." After submission of suggestions by the Postal Service, the statute required the Commission to make a "recommended decision" in accordance with the policies of Title 39 and specific statutory factors. Postal Service "requests" for a change in classification were addressed by the Commission in similar fashion (former § 3623). With respect to each Postal Service proposal, the Commission was obliged to exercise *its* best judgement as to which among of a spectrum of lawful rates or classifications was the outcome most consistent with the statutory criteria. A "recommended decision" by the Commission was recommended in name only. In almost all cases, the Commission's decision was a final determination because the statute provided little scope for change by the Governors. As the Supreme Court explained,

Although the Postal Reorganization Act divides ratemaking responsibility between two agencies, *the legislative history demonstrates 'that ratemaking . . . authority [was] vested primarily in [the] Postal Rate Commission.'* . . . *The structure of the Act supports this view.*⁵³

In contrast, in the revised statute, the authority to establish reasonable and equitable classes of mail and rates of postage is vested primarily in the Postal Service. The legislative history and structure of the act support this revised view. While the contours of a modern system of regulation must be determined by the Commission, it would be inappropriate for the Commission to assume its former role of selecting from among of a spectrum of lawful rates and classifications the set of rates which is, in its judgement, most consistent with statutory criteria. In its new role of regulator rather than ratemaker, the function of the Commission is to define the spectrum of lawful rates. Within this spectrum, the Postal Service is responsible for selecting the set of rates which, in its judgement, is most consistent with its statutory mission. The Commission may *reject* a given rate or classification as unlawful, but it should no longer *recommend* rates and classifications except in the most extraordinary cases.⁵⁴

⁵³National Association of Greeting Card Publishers v. United States Postal Service, 462 U.S. 810, 820 (1983) (footnotes omitted).

⁵⁴For example, the Commission is explicitly authorized to order "unlawful rates to be adjusted to lawful levels" if it finds a complaint justified. § 3662(c).

5.2 Statutory standards

5.2.1 Objectives of modern system of regulation

The nine objectives established for the modern system of regulation are set out in § 3622(b) as follows:

(b) Objectives.—Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:

- (1) To maximize incentives to reduce costs and increase efficiency.
- (2) To create predictability and stability in rates.
- (3) To maintain high quality service standards established under section 3691.
- (4) To allow the Postal Service pricing flexibility.
- (5) To assure adequate revenues, including retained earnings, to maintain financial stability.
- (6) To reduce the administrative burden and increase the transparency of the ratemaking process.
- (7) To enhance mail security and deter terrorism.
- (8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.
- (9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

The nine objectives set for the modern system of regulation “shall be applied in conjunction with the others.” § 3622(b). This phrase seems to mean that the Commission may not rely on one or more objectives to the exclusion of others. Where satisfaction of one objective may tend to thwart satisfaction of another objective, the Commission must weigh one against the other in a reasoned manner. Similarly, one objective may be consulted to shed light on second.

The list of objectives seems to be *exclusive*. The Commission is not authorized to include in the modern system any provision that does not plausibly advance an objective in the list. The list of objectives is multi-faceted but not open-ended. It conspicuously fails to grant the Commission catchall authority to use the modern system to pursue any other objective embraced by Title 39 or such objectives as the Commission determines appropriate.⁵⁵ Where other statutory

⁵⁵Absence of such language is especially notable because it represents a rejection of the approach in the corresponding provisions of the former statute. For example, former § 3622(b) provided, “Upon receiving a request, the Commission shall make a recommended decision on the request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors: . . . (9) such other factors as the Commission deems

purposes are to be pursued, they are included by cross reference. Objective (3), service standards, explicitly refers to § 3691. Objective (9), allocation of institutional costs, clearly, if implicitly, links regulation of market dominant products with regulation of institutional contribution by competitive products in § 3633(a)(3). Thus some statutory objectives may lie outside the modern system of regulation (although they may be enforceable through the complaint process of § 3662 or some other procedures).⁵⁶

In the revised postal law, the "objectives" occupy the legal role played by the "factors" in prior law. In prior law, the Commission was directed to recommend rates and classifications "in accordance with" factors listed in former § 3622(b) and former § 3623(c). The change from the "factors" of the pre-PAEA statute to the "objectives" of the post-PAEA law is a change in the norms for rate and classification regulation. The Commission is directed to reorient regulation to achieve the new list of objectives. Of course, the new list of objectives has in many respects grown out of the old lists of factors, but in the PAEA Congress has struck a decidedly different balance as to the purpose of rate regulation.

5.2.2 Factors to be taken into account

Subsection § 3622(c) declares that in establishing a modern system of regulation, the Commission is also directed to "take into account" fourteen "factors." Eleven of these factors duplicate, with relatively minor changes, factors listed in the pre-PAEA provisions dealing with regulation of rates and classification. Three new factors—(7) pricing flexibility, (12) increased efficiency, and (13) intelligent mail—all point towards increased consideration for benefits of flexibility, efficiency, and technology. One important factor from former law has been dropped, the "fair and equitable" standard.

The fourteen factors are as follows, with new or revised text shown in italics and the corresponding provision in former law, if any, indicated in brackets.

(c)(1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery [former § 3622(b)(2)];

(2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service *through reliably identified causal relationships* plus that portion of

appropriate." See also former § 3623(c).

⁵⁶For example, the statutory policy in § 101(d) of encouraging apportionment of the costs of all postal operations to all users of the mail on a fair and equitable basis. See section 9.1.1, below.

all other costs of the Postal Service reasonably assignable to such class or type [former § 3622(b)(3)];

(3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters [former § 3622(b)(4)];

(4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs [former § 3622(b)(5)];

(5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service [former § 3622(b)(6)];

(6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services [former § 3622(b)(7)];

(7) *the importance of pricing flexibility to encourage increased mail volume and operational efficiency;*

(8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail [former § 3623(c)(2)];

(9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery *and of providing those that do not require high degrees of reliability and speed of delivery* [former § 3623(c)(3); [former § 3623(c)(4)];];

(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, *including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—*

(A) *either—*

(i) *improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or*

(ii) *enhance the performance of mail preparation, processing, transportation, or other functions; and*

(B) *do not cause unreasonable harm to the marketplace* [former § 3623(c)(5)];

(11) the educational, cultural, scientific, and informational value to the recipient of mail matter [former § 3622(b)(8)];

(12) *the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;*

(13) *the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail; and*

(14) *the policies of this title as well as such other factors as the Commission determines appropriate* [former § 3622(b)(9); [former § 3623(c)(6)].

(a) Deletion of fair and equitable factor

One important pre-PAEA factor has been conspicuously omitted, the requirement that rates and classifications should be “fair and equitable.” In the Senate debate over the bill leading to the PAEA, a proposal to delete the “fair and equitable” factor prompted sustained opposition led by Senator Kit Bond of Missouri.⁵⁷ It was resolved by deleting the first factor in the Senate bill—“the establishment and maintenance of a fair and equitable schedule for rates and classification system”—and adding Objective (8)—“to establish and maintain a just and reasonable schedule for rates and classifications.” The deleted factor echoed the “fair and equitable” requirement found in both the rate and classification provisions of the pre-PAEA law.⁵⁸ This deliberate deletion of the “fair and equitable” factor implies that in the future the Commission should *not* take into account the pre-PAEA regulatory approach insofar as it depended upon considerations of fairness and equity.

Despite deletion of “fair and equitable” from the criteria of the modern system of regulation, it must be recalled that, as noted above, several general statutory requirements continue to require some level of fairness and equity.⁵⁹ The Commission is obliged to enforce one of these, § 101(d), through the complaint procedure of § 3662. Hence, fairness and equity cannot be ignored entirely. Nonetheless, in designing the modern system of regulation, the explicit repeal of the “fair and equitable” provisions of prior law from the lists of objectives to be achieved and the factors to be taken into account must be respected and given substantial weight.⁶⁰

⁵⁷Objective (8) was the result of an amendment to the Senate version of the bill, S. 662, that was offered by Senator Susan Collins, chief sponsor of the bill, and Senator Kit Bond. SA 2750, 153 Cong. Rec. S926 (Feb. 9, 2006); 153 Cong. Rec. S1033 (Feb. 9, 2006). Overall, the amendment changed five provisions of the bill: (i) the objectives and factors dealing with establishment of a modern system of regulation for market dominant products (as explained in the text); (ii) the banking provision in the price cap; (iii) the provision dealing with the transition from the pre-PAEA ratemaking procedures to the modern system of regulation; (iv) the complaint procedure; and (v) the modern system of service standards. The only legislative history explaining this amendment is a stylized “colloquy” entered into the Congressional Record two days before Senate consideration of the bill. 153 Cong. Rec. S767 (Feb. 7, 2006). The colloquy dealt only with changes to the complaint procedure.

⁵⁸See former § 3622(b)(1) (“the establishment and maintenance of a *fair and equitable* schedule”) and former § 3623(c)(1) (“the establishment and maintenance of a *fair and equitable* classification system for all mail”).

⁵⁹See section 2.2, above.

⁶⁰A possible resolution of these statutory provisions is discussed below in the context of the complaint procedure. See section 9.1.1, below.

(b) Requirement to cover attributable costs

One factor, factor § 3622(c)(2), appears to be mandatory because, as in prior law, it is denominated a “requirement”: “(2) *the requirement* that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.” In administering prior law, the Commission considered the predecessor of factor (2) to be a mandatory requirement of all rates, an approach the Supreme Court noted with approval.⁶¹

Factor § 3622(c)(2) does not explicitly require that each market dominant *product* cover its attributable costs, only that each “class or mail or type of mail service” do so. It seems plausible, however, to suggest that under the revised statute, the different “types” of mail service are called “products.” This interpretation is also implied by the explicit requirement in § 3633(a)(2) that each competitive product must cover its attributable costs. It seems unlikely that Congress intended to apply a different or more lenient cost coverage rule to market dominant products than to competitive products.

Demotion of the minimum cost coverage requirement to “factor” may have one important legal effect, however. It is possible that setting rates to cover attributable costs could one day result in rates which would exceed the statutory price cap specified in § 3622(d)(2)(A). If the minimum cost coverage requirement and the statutory price cap were expressed in statutory language of equal force (so to speak), it would be difficult to resolve this conflict. However, demotion of the minimum cost coverage requirement to factor status seems to imply that the statutory price cap must be given primacy.

During reenactment by the PAEA, the phrase, “through reliably identified causal relationships,” was added by the Senate committee in the version of S. 662 reported in early 2006.⁶² There is no explanation of this addition in the legislative history. The new language appears to be consistent with the way this provision was interpreted by the Commission and the courts prior to the PAEA.

⁶¹ National Association of Greeting Card Publishers v. United States Postal Service, 462 U.S. 810, 820 (1983) (“Of the factors set forth in § 3622(b), only subsection (b)(3) is styled a ‘requirement.’ With the approval of both Courts of Appeals, the Rate Commission has concluded that notwithstanding its placement as the third of nine factors, this distinction dictates that ‘attribution’ and ‘assignment’ define the framework for ratesetting. In addition, the Rate Commission takes the view that ‘causation is both the statutory and the logical basis for attribution.’ PRC Op. R74-1, p. 110. The parties do not dispute these premises, and we see no reason to question them.”).

⁶²See 153 Cong. Rec. S913 (Feb. 9, 2006).

(c) Weight to be given other factors

Overall, however, the PAEA decisively downgraded that legal role of the other factors listed in § 3622(c). In the pre-PAEA statute, the Commission was directed to make determinations on rates or classification “*in accordance with the policies of this title and the following factors.*” Now the Commission is directed merely to “*take into account*” these factors while pursuing the objectives listed in subsection (b). With the exception of factor (2), the factors have been downgraded from norms that must be met to norms that should be considered in fulfilling a new set of norms, the “objectives.”

In effect, in developing the modern system of regulation, the Commission is directed to take into account, on a continuing basis, the factors that guided the prior regulatory approach while giving added consideration to the benefits of efficiency and flexibility and less weight to the prior emphasis on fairness and equity. While it will be up to the Commission to decide precisely what weight to give to these factors, it would do violence to the structure and purpose of the PAEA to raise them to the status of an objective by, for example, interpreting the just and reasonable standard of objective (2) as “incorporating” the demoted factors.

5.2.3 Additional statutory requirements

In addition to the list of objectives for modern system of regulation, the regulation of rates and classification is constrained by specific statutory requirements. These are included in § 3622 and directly limit the discretion of the Commission in designing the modern system of regulation:

- a rule limiting price increases for product in existing mail classes (§ 3622(d)(1)(A));
- a rule requiring regular and predictable rate changes (§ 3622(d)(1)(B));
- a procedural timetable for review of changes in rates (§ 3622(d)(1)(C));
- and
- a rule limiting workshare discounts (§ 3622(e)).

These statutory requirements must be incorporated into the modern system of regulation.

5.3 Regulation of rate levels - objectives

Four objectives for a modern system of regulation appear to relate specifically to the *level* of rates that should be permitted for market dominant rates:

- (1) To maximize incentives to reduce costs and increase efficiency.
- (5) To assure adequate revenues, including retained earnings, to maintain financial stability.
- (8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.
- (9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

In addition, the overall level of rates of market dominant rates is substantially affected by a statutory requirement, the statutory price cap.

5.3.1 Just and reasonable schedule

(a) Maximum rates

Objective (8), a just and reasonable schedule for rates, appears to impose an overall limit on the profits that can be earned by the Postal Service. The modern system of regulation should not permit the Postal Service to set rates so high that they are “unjust” or “unreasonable.” However, the only way that rate levels (as opposed to rate relationships, discussed below⁶³) could be deemed unjustly or unreasonably high is by comparison to costs. Hence, this objective creates an implicit limit on profits. Since increases in overall prices are limited by the statutory price cap, the Postal Service would have to reduce unit costs dramatically in order to generate unjust or unreasonable profits. While theoretically possible, it seems improbable that overall rate levels will be considered unjustly or unreasonably high before the Commission’s review of the modern system of regulation in 2016. § 3622(d)(3).

It is also true that an *individual* rate could be considered so high in relation to cost as to be considered inherently unjust or unreasonable. However, exactly how high is too high is difficult to answer in an absolute sense. It seems likely that a questionably high rate would be more easily attacked as unjustly or unreasonably high compared to other rates than as unjustly or unreasonably high in the abstract. Thus, with respect to individual rates, the just and reasonable standard appears to relate more to the relationships between rates than to the absolute level of rates.

(b) Minimum rates - attributable cost rule

As discussed above, factor § 3622(c)(2) seems to require that revenues from

⁶³See section 5.6, below.

each market dominant product must cover its attributable costs.⁶⁴ In any case, such a requirement seems implied by the objective of just and reasonable schedule for rates and classifications, § 3622(b)(8). It would generally be considered neither just nor reasonable for the Postal Service to a mailer purchasing product A costs directly attributable to product B. Application of an “attributable cost rule” to competitive products is discussed below,⁶⁵ and application of the rule to market dominant products should be similar.

5.3.2 Other objectives

Objectives § 3622(b)(1) (“maximize incentives to reduce costs and increase efficiency”) and § 3622(b)(5) (“assure adequate revenues, including retained earnings, to maintain financial stability”) pull against each other to some extent. An obvious regulatory strategy for reducing costs and raising efficiency would be to introduce administrative price caps that require productivity improvements. At the same time, any such price cap must permit the Postal Service not only to recover all costs but also to have a reasonable prospect of generating “retained earnings,” a phrase that presumably refers to an excess of annual revenues over annual costs.⁶⁶ Since more revenue can only contribute to the “financial stability” of the Postal Service, it seems that a price cap can be employed as a productivity incentive only in cases in which the Postal Service is expected to garner an extraordinary profit, i.e., a profit that will generate an unjust or unreasonable level of retained earnings and financial stability.⁶⁷

Objective (9), § 3622(b)(9), relates to the allocation of institutional costs between market dominant and competitive products. It appears to be achieved automatically by adopting appropriate regulations under § 3633(a). Thus, this

⁶⁴See section 5.2.2(b), above.

⁶⁵See section 6.3.2, below.

⁶⁶“Retained earnings” normally refer to profits which the owners of an enterprise elect to retain in the enterprise rather than distribute to themselves. Retained earnings are reported in the accounts of the enterprise as shareholders' equity. Since the Postal Service does not have active owners, the phrase as used in objective (5) cannot be interpreted according to normal usage. Rather, it must be interpreted more loosely and figuratively.

⁶⁷The Senate committee envisioned the relationship between a price cap and retained earnings as follows, “the Committee’s determination that a rate cap mechanism is the appropriate regulatory structure is based on a determination that a rate cap can result in downward pressure on costs through restrictions on price changes. If retained earnings are not permitted, that is if revenues must equal costs, the incentive to control costs and thus generate funds for long-term capital investments, network growth or other needs will not exist.” S. Rept. No. 108-318 (2004) at 8-9. If, however, “retained earnings” are ultimately expended on capital goods or bonuses (or other forms of wages), the result is an increase in the costs of the Postal Service. Hence, it is unclear to me how this provision creates an incentive to control costs.

provision seems only to emphasize the need to allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

5.4 Regulation of rate levels - statutory price cap

In addition to the limits implied by the objectives, the overall level of market dominant rates is constrained by a statutory price cap. The annual limitation on price increases is set out in two separate provisions, paragraphs § 3622(d)(1)(A) and § 3622(d)(2)(A). In addition, paragraph § 3622(d)(1)(B) declares that rounding of rates will be permitted under the cap, a seeming meaningless declaration since nothing prohibits such rounding of rates in the first place. Paragraph § 3622(d)(2)(C) gives the Postal Service the right to “bank” unused rate increases.⁶⁸

(d) Requirements.—

(1) In general.—The system for regulating rates and classes for market-dominant products shall—

(A) include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;

...

(2) Limitations.—

(A) Classes of mail.—Except as provided under subparagraph (C), the annual limitations under paragraph (1)(A) shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.

(B) Rounding of rates and fees.—Nothing in this subsection shall preclude the Postal Service from rounding rates and fees to the nearest whole integer, if the effect of such rounding does not cause the overall rate increase for any class to exceed the Consumer Price Index for All Urban Consumers.

(C) Use of unused rate authority.—

(i) Definition.—In this subparagraph, the term “unused rate adjustment authority” means the difference between—

(I) the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year subject to the annual limitation under paragraph (1); and

⁶⁸ Paragraph § 3622(d)(1)(E) sets out an exception to the cap in case of “extraordinary or exceptional circumstances.” It is not discussed in this analysis.

(II) the amount of the rate adjustment the Postal Service actually makes in that year.

(ii) Authority.—Subject to clause (iii), the Postal Service may use any unused rate adjustment authority for any of the 5 years following the year such authority occurred.

(iii) Limitations.—In exercising the authority under clause (ii) in any year, the Postal Service—

(I) may use unused rate adjustment authority from more than 1 year;

(II) may use any part of the unused rate adjustment authority from any year;

(III) shall use the unused rate adjustment authority from the earliest year such authority first occurred and then each following year; and

(IV) for any class or service, may not exceed the annual limitation under paragraph (1) by more than 2 percentage points.

The statutory price cap raises a number of questions.

5.4.1 Separating “notice of intention” from “notice of adjustment”

The price cap is expressed as an “annual limitation” on rate changes. The “annual limitation” is equal to the change in the CPI-U index for “*the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates.*” This formula of words presents several questions that can be explained with examples.

Suppose (i) USPS files a “notice of its intention to increase rates” on May 1, 2008, and (ii) the change in the CPI-U index for the most recently available 12-month period is for the year ending March 31, 2008 and indicates a change equal to 2 percent. Then, it seems that any rate increase is subject to an “annual limitation” of 2 percent. If USPS actually raises rates 2 percent on July 1, 2008, it would seem that the year to which the “annual limitation” applies begins July 1, 2008. If so, USPS has used up its entire “annual limitation” and cannot raise rates again until July 1, 2009. But suppose USPS has the right to raise rates on July 1, 2008, but does not actually does so until July 15, 2008. Can USPS still raise rates again on July 1, 2009 while complying with the “annual limitation”?

Suppose USPS raises rates for domestic mail on July 1, 2008, and international mail on September 1, 2008? It appears that different annual limitations apply to each category of mail. Such a situation could be confusing.

Suppose USPS files a “notice of its intention to increase rates” for domestic rates on May 1, 2008, but does not give notice to increase international rates. Can

USPS bank the unused rate increase for international rates? The amount of the price cap that is banked is defined as “the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year *subject to the annual limitation under paragraph (1).*” According to paragraph (1), however, there is no way to determine “the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year” until the Postal Service actually files a “notice of its intention to increase rates” since until that filing, there is no way to determine the applicable CPI-U index. Apparently, filing for an increase in rates for one product does not create a bankable amount for a second product. More generally, if USPS does not file a “notice of its intention to increase rates” for any product, it does not create a bankable amount for any product. It seems USPS can only create a bankable amount by actually raising rates less than the full amount calculated from the “notice of its intention to increase rates.”

Then, too, it is unclear what the term “year” refers to in the banking provision. The banked amount is “(I) the maximum amount of a rate adjustment that the Postal Service is authorized to make *in any year* subject to the annual limitation under paragraph (1); and (II) the amount of the rate adjustment the Postal Service actually makes *in that year.*” What year? The “annual limitation” for a product appears to apply to the year-long period following the date on which the rate for that product is actually increased. Does this provision refer to that year, which could differ from year to year and product to product? Or to a fiscal year⁶⁹? Or to a calendar year?

Suppose, after raising rates on July 1, 2008, USPS raises rates later in the year in 2009. That is, it files a “notice of its intention to increase rates” on June 1, 2008, using CPI-U index is for the 12-month period ending April 30, 2009, then actually raises rates September 1, 2009. When does the “annual limitation” begin? Apparently on September 1, 2009. Can USPS bank the unused increase in CPI-U during July and August 2009? Apparently not, since there was no “notice of its intention to increase rates” for that period and, therefore, there is no way to determine what CPI-U to use.

On its face, this is a very convoluted system. It will make it difficult, and potentially very costly, for the Postal Service to introduce rate changes later in one year than in the preceding year. It will also impede the Postal Service’s ability to raise rates for different products at different times of the year. At the same time, the basic goal of Congress seem manifests: to limit overall rate increases to increases in the CPI-U index while allowing pricing flexibility and reducing

⁶⁹§ 102(10) defines “year” as follows: “‘year’, as used in chapter 36 (*other than subchapters I and VI thereof*), means a fiscal year .” The statutory price cap is in subchapter I of chapter 36 and therefore the definition of “year” in § 102(10) does not apply.

administrative burden.

To resolve these apparent difficulties, the simplest solution way seems to be to interpret the "notice of intention" to raise rates as distinct from the "notice of adjustment" that would specify actual rate increases. The Postal Service could file a purely formal "notice of intention to increase rates" for all products soon after the end of each fiscal year, i.e., as soon as the CPI-U index for the fiscal year is available. Following the statute, this "notice of intention" would be interpreted as triggering the right to raise rates during the next calendar year by the percentage change in CPU-I during the preceding fiscal year. In this formal "notice of intention" the Postal Service would not be required to provide any details of new rates.

The Postal Service would then be entitled to file a "notice of adjustment" to increase rates of all products covered by the statutory price cap on January 1 of the following year.⁷⁰ However, once this right to new revenue is determined, there is no need to penalize the Postal Service if it actually raises rates later than January 1. As an example, suppose the statutory price cap turns out to be 2 percent for a given year, and the Postal Service decides to raise rates on April 1. Since a rate increase of 2.67 percent on April 1 will yield the same additional revenue over the full calendar year as a 2 percent increase on January 1, then Postal Service could permitted to increase rates by 2.67 percent. If the Postal Service only raises rates by 2 percent on April 1, it could bank 0.67 percent for that calendar year. In this manner, the modern system of regulation would limit the average increase in rates to changes in the CPI-U index while still allowing the Postal Service flexibility to raise rates whenever it deems appropriate. This interpretation of the statutory price cap mechanism is obviously similar in spirit to the banking provision although it is not quite the same issue. It seems the best way, or at least a plausible way, to reconcile the various provisions relevant to the statutory price cap.

5.4.2 Calculating the statutory price cap

The *statutory price cap* is one of four statutory rate rules that the Commission is directed to incorporate in its regulation of postal products. The other three are: the *attributable cost rule* (market dominant and competitive products), the *workshare discount rule* (certain market dominant products), the *collective contribution rule* (competitive products). In general, the most plausible procedure for implementing these rate rules simply, flexibly, and effectively appears to be (i) to adopt guidelines based on data from the previous fiscal year and then (ii) to adjust the guidelines for the subsequent year to account for any

⁷⁰For the procedures for raising rates, see section 5.9, below.

shortfall or overshoot. This section describes application of this approach to the statutory price cap.⁷¹

Paragraph § 3622(d)(1)(A) declares that “The system for regulating rates and classes for market-dominant products shall . . . include *an annual limitation on the percentage changes in rates.*” The meaning of this phrase is not entirely evident. Use of the plural word “changes” seems to indicate that this phrase refers to a limit on the annual percentage change in *each* rate. However, paragraph § 3622(d)(2)(A) declares “the annual limitations under paragraph (1)(A) shall *apply to a class of mail.*” This last phrase implies that the annual percentage limitation is to apply to the changes in the rates in each class *collectively.*⁷² In other words, rates in each class must be aggregated in some manner, and the change in the aggregated rate may not exceed the annual limitation. On balance, interpreting § 3622(d)(1)(A) as referring to an aggregated measure of the rates within a class appears to be the most plausible approach.

If so, how should rates for the different products in a class be aggregated to determine an annual percentage limitation for the entire class? The simplest solution seems to be to start with the total revenues earned the previous year⁷³ from all price-capped products within a class. As an example, assume this total is \$ 10 billion. If the statutory price cap is, say, 2 percent, then the annual limitation implies that rates can be increased so that these products earn an additional \$ 200 million in the 12 months following the first day on which rates can be raised, let us say, January 1. The Postal Service could then increase all rates 2 percent on January 1.

This approach is obvious enough if the rates for all priced-capped products are raised on the first day on which rates can be raised. But suppose the Postal Service increases rates of different products by different amounts at different

⁷¹See also discussion of the calculation of the attributable cost rule for market dominant products (section 5.5) and competitive products (section 6.3.2), the workshare discount rule (section 5.7.1(c)), and the collective contribution rule (section 6.3.3).

⁷²Otherwise, there would be no need to refer to “each class.” Paragraph § 3622(d)(2)(A) could simply declare that the annual limitations under paragraph (1)(A) shall apply to each product in the DMCS. This more flexible interpretation of the statutory price cap appears to be consistent with a Senate committee report on a similar provision in a predecessor bill: “In implementing this [statutory price cap] authority, the Postal Regulatory Commission should develop regulations that will give the Postal Service the maximum pricing flexibility possible consistent with the overarching financial and policy goals set forth in this legislation. Replacing one inflexible system with another will not address the needs of the postal community or ensure long term survival of the American public’s postal system.” S. Rept. No. 108-318 (2004) at 11.

⁷³That is, the 12-month period for which the change in the CPI-U index is calculated. This would be the previous fiscal year using the suggestions in the previous section are adopted.

times of the year? If so, the calculation is still uncomplicated. If the Postal Service raises the rate of a product by X amount⁷⁴ on day Y , then the Postal Service will earn new revenue equal to X times the volume of product X conveyed after day Y of the previous year. The statutory price cap would be exceeded only when the sum of the new revenues earned from the various rate increases for various products exceeds \$ 200 million. When that point comes, there can be no more rate increases until next year.

Use of prior year volumes to determine the effect of current year rate increases will, however, introduce a systematic bias in periods of rapidly rising or falling volumes. Suppose, for example, in fiscal 2008, that the revenue for a class is \$10 billion on a volume 10 billion pieces, an average rate of \$1.00. Suppose the CPI-U index allows a rate increase of 2 percent in calendar 2009, and the volume of mail jumps 10 percent to \$11 billion. Using the fiscal 2008 volumes to weight rate increases would limit the Postal Service to \$200 million in additional revenues. By the end of calendar 2009, the Postal Service would find that it had earned total revenues of \$10.2 billion on a volume of 11 billion pieces, an average rate of \$ 0.927. The average rate in calendar 2009 would amount to a *decrease* of 7.3 percent from 2008 instead of the allowable 2 percent. If the Postal Service had in fact raised average rates in calendar 2009 by the 2 percent allowed, i.e., from \$1.00 to \$1.02, it would have earned \$11.22 billion, quite a difference from \$10.2 billion. To correct for this, it appears that Postal Service will need to provide an estimate of the expected increase or decrease in the overall volume of a class of mail in the upcoming year.⁷⁵ This estimate should be provided at the same time as the "notice of intention" suggested above.

In sum, it appears that calculation and administration of the statutory price cap can be simple and straightforward. if the statutory price cap is expressed as a *limit on the additional revenues* which may be may be generated from a class of products. The limit should be derived from the product volumes of the prior fiscal year and an estimate of the overall change in volume expected in the year for which rates are being set. This system gives the Postal Service maximum pricing flexibility while limiting average price increases to the rate of increase in the CPI-U index.

⁷⁴Actually, for each product, the "rate increase" would be the average rate increase calculated by taking a volume-weighted average of the increases per billing determinant.

⁷⁵Although this approach would be based on the volumes of price-capped products from the previous year, the PAEA seems to allow the Postal Service flexibility to change rates substantially within a class. Substantial changes in rates may imply substantial changes in volumes. In such cases, use of the prior-year volumes for price-capped products might be artificially restrictive for the Postal Service. Regulations might therefore permit the Postal Service the option of using projected volumes to justify some rate adjustments. In such case, the regulations might also require the Postal Service to give the Commission additional time to review the "notice of adjustment."

What about shortfalls and overshoots? Since the statutory price cap must be calculated as a weighted average of rates for different products, there is no way that the Commission can guarantee compliance with the cap by *ex ante* review of rate adjustments. Inevitably, volumes of individual products will turn out to be different than prior year volumes, even if adjusted by a Postal Service estimate of expected overall volume growth (or decline) for the class. Therefore, at the end of the year the actual average rate for each class of mail will be less or more than foreseen when rate adjustments are announced by the Postal Service.

This flaw can be remedied by using the shortfall or overshoot from one year to adjust the statutory price cap for the next year. For example, suppose the Postal Service is permitted to increase price-capped First Class Mail rates by 2 percent in 2008. And suppose at the end of the year, the actual increase in the average rate of price-capped products turns out to be only 1.9 percent. Then, it appears sensible to add 0.1 percent to whatever is the statutory price cap for 2009. Similarly, an overshoot of 0.1 percent would be subtracted from the statutory price cap for 2009. In this manner, the effect of the statutory price cap will track more closely annual change in the prior year's CPI-U index over a period of a few years.

Such an annual adjustment mechanism implies two additional benefits. First, it creates a disincentive for the Postal Service to "game" the system in any manner. Even if the Postal Service were able to disguise volumes and rates in some way (say, by changing definitions of rate cells), raising rates by more than the appropriate amount one year would only decrease the ability of the Postal Service to raise rates the next year.⁷⁶ By the same token, the Postal Service will have no incentive to overestimate annual mail growth. In addition, a year-end adjustment implies that extensive Commission review of a rate adjustment at the time of the adjustment is not critical since any inaccuracy will be corrected at the end of the year. In particular, Commission scrutiny of a Postal Service estimate of annual volume growth appears unnecessary.⁷⁷

⁷⁶Technically, in this example, the Postal Service would be slightly better off because it would get the additional revenues a year earlier. However, such effects can be eliminated by adjusting the shortfall and overshoot amounts to allow for interest.

⁷⁷It should be noted that the statutory price cap is a year out of synchronization. In general, if one says that the price of a product has risen by less than the pace of inflation, the usual notion is that the increase in the price of the product in, say, 2008 was less than the increase of a measure of inflation in 2008. The statutory price cap, however, limits the increase in postage rates in 2008 to a increase in a measure of inflation for 2007. In a period of increasing inflation, the Postal Service will be forced to keep rate increases a bit below the real pace of inflation. Conversely, in a period of deflation, the effect will be the opposite.

5.4.3 Defining the baskets of rate-capped products

Paragraph § 3622(d)(2)(A) defines the baskets to which the statutory price cap applies as follows:

Except as provided under subparagraph (C) [relating to banking], the annual limitations under paragraph (1)(A) shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.

The reference to the Domestic Mail Classification Schedule appears to apply to the edition of September 13, 2006.

(a) Successor products and new products

Suppose the Postal Service replaces one price-capped product with other products defined in a slightly different manner—what is the effect on the statutory price cap? For example, suppose the Postal Service replaces the product *letters and sealed packages* with three products, *envelopes, flats, and sealed parcels*. If the former was in the pool of products subject to the first class mail price cap should the successor products also be included this same pool of products? The common sense answer would be affirmative. Otherwise, the Postal Service could escape the statutory price cap by relative slight changes in product definitions.

Suppose, however, that the Postal Service introduces a truly new product for which there was no previous successor. Such would be the case for any product qualifying for market test procedures under § 3641(b)(1). In such case, if the Commission assigns the new product to the market dominant category, should the Commission also assign the new product to one of the traditional domestic mail classes which define the pools of products subject to the statutory price cap (after expiration the market test period, if applicable)?

I believe the answer to this question is “no.” Nothing in statute requires the Commission to assign a truly new market dominant product to a domestic “class.” Indeed, reading § 3622(d)(2)(A) would seem to preclude such assignment since the new product was not part of “a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.” Moreover, such assignment could have the effect of discouraging the Postal Service from introducing new higher-priced, value-added domestic services. Such a disincentive would be inconsistent with the market test provisions, § 3641, which appear designed to encourage new

products.⁷⁸

On balance, therefore, the statutory price cap should be interpreted as applying to the specific *products* listed in the DMCS at date of enactment and to those products which the Commission regards as their direct successors. Truly new products should *not* be included in the statutory price cap even if arguably within the compass of one of the traditional mail classes. Nonetheless, the Commission may, as part of the modern system of regulation, regulate rates for new market dominant products, using price caps or some other means.

(b) Products transferred to the competitive category

The act contemplated that some products may be transferred from the market dominant category to the competitive category. Since there is no limit on price increases for competitive products generally, it would be inconsistent to continue the price cap limitation on products transferred to the competitive category. Hence, if a market dominant product is part of a basket of products to which the statutory price cap applies and that product is moved to the competitive category, then the revenues and volumes associated with that product should be taken out of the basket.

(c) International mail products

The statutory price cap clearly refers to "a class of mail, as defined in the Domestic Mail Classification Schedule." Since the DMCS does not refer to any class of international mail, no international mail product is included in the statutory price cap. Nonetheless, the Commission may, as part of the modern system of regulation, regulate rates for market dominant international products, using price caps or some other means.

5.5 Regulation of rate levels - calculation of attributable cost rule

As noted above,⁷⁹ factor (2), § 3622(c)(2), appears to be a mandate that rates for market dominant products cover attributable costs: "(2) *the requirement that*

⁷⁸Compare a Senate committee report on the market test provisions of a predecessor bill, "The Committee recognizes that, to remain financially viable and to continue to meet the evolving needs of its customers, the Postal Service must innovate and develop new products and services. . . . In fact, developing an organizational culture of innovation and market responsiveness, can help the Postal Service to address its financial difficulties by increasing the attractiveness of mail to both new and existing customers. Therefore, this legislation sets out procedures under which the Postal Service can offer experimental and new postal products." S. Rept. No. 108-381 (2004) at 16.

⁷⁹See section 5.2.2(b), above.

each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.” Under current regulations, when the Postal Service proposes rate changes, the Commission requires the Postal Service to submit detailed information about past and projected costs, revenues, and volumes of mail.⁸⁰ All data must be presented in a full evidentiary hearing where it may be cross-examined by affected parties. How much of this procedure must be retained to ensure that rates for market dominant products cover attributable costs after the PAEA?

The attributable cost rule is one of four statutory rate rules.⁸¹ The appropriate approach for ensuring compliance with the attributable cost rule appears to be similar to that just discussed for the statutory price cap. At the outset, the Commission must require the Postal Service to maintain product-level cost and revenue accounts developed according to a methodology approved by the Commission. The Commission must also define the applicable time period for application of the attributable cost rule. Since costs and volumes vary over time, it is possible that the revenue earned by a product may cover attributable costs one month and not the next. Under pre-PAEA procedures, the Commission set rates to cover attributable costs during a “test year” knowing that, in some cases, rates after the test year could fail to cover costs due to cost increases. Use of a future test period, however, necessarily involves projection of costs and revenues, a procedure about which reasonable persons can and do disagree. Resolving such factual disputes before rates are put into effect is one method of ensuring that the rate for each product covers attributable costs, but it is a cumbersome and costly method.

As suggested by the discussion of the statutory price cap, a simpler and more flexible approach to implementing the attributable cost rule would seem to be to make use of prior year data and end-of-year adjustments. A Commission regulation could require that each market dominant product rate must be high enough so that the revenue generated in the next calendar year exceeds the product of (i) the unit attributable cost of such product during the previous fiscal year *times* (ii) the volume of such product during the previous fiscal year adjusted by Postal Service’s estimate of any volume change for the next calendar year. For example, the rate for a market dominant product in calendar 2009 would have to be high enough to cover the unit attributable costs of such product in fiscal 2008 *times* the volume of such product in 2008 *times* any volume change for calendar 2009

⁸⁰39 CFR § 3001.54 (2006).

⁸¹See also discussion of the calculation of the statutory price cap rule (section 5.4.2), the workshare discount rule (section 5.7.1(c)), and the collective contribution rule (section 6.3.3).

foreseen by the Postal Service.⁸² Rate changes after January 1, 2009, would be tested by reference to the volume conveyed after the corresponding date in fiscal 2008.

As in the statutory price cap calculations, to create an incentive for the Postal Service to estimate volume changes correctly and eliminate the need for detailed ex ante review, the Commission can provide for end-of-year adjustments. Thus, if revenues from a market dominant product cover only 98 percent of attributable costs in fiscal year 2008, then rate for calendar 2009 would have to cover a minimum of 102 percent of attributable cost.

Such a calculation for the attributable cost rule differs from the calculation of the statutory price cap in two respects. First, there is no banking. The fact that a rate exceeded attributable costs in one year does not mean it can fall below attributable costs in a later year. Second, the attributable cost rule must be met each year regardless of whether the Postal Service changes rates. The statutory price cap rule can be ignored if there is no change in rates.

5.6 Regulation of rate relationships - objectives

Five objectives of the nine objectives in § 3622(b) appear to address the regulation of *relationships* between the rates of individual market dominant products:

- (1) To maximize incentives to reduce costs and increase efficiency.
- (3) To maintain high quality service standards established under section 3691.
- (4) To allow the Postal Service pricing flexibility.
- (7) To enhance mail security and deter terrorism.
- (8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.

In addition, the relationship between rates, whether intra-product or inter-product, which are related to one another as “workshare discounts” is constrained by statutory requirements relating to the pricing of workshare products.

5.6.1 Just and reasonable schedule

Of these five objectives, the one that addresses most directly the relationships between rates is plainly objective (8), the requirement of a “just and reasonable

⁸²Volumes and rates would have to be averaged from billing determinant data.

schedule for rates and classifications.”⁸³ As noted above, there appears to be no legislative history that illuminates this objective beyond its plain meaning.⁸⁴

Also as noted above,⁸⁵ former § 3623 was interpreted by the Commission to require the regulation of relationships between rates by the use of “subclasses,” a regulatory concept that did not appear in the statute. In essence, the Commission accepted that broad “classes” of postal products (to use the new terminology) could be defined by content and treated differently for rate purposes. Within the classes, the Commission ruled that the Postal Service could develop different rates for different products (or sets of products) only if the products (or sets of products) qualified as different “subclasses,” i.e., were distinguished by differences in both cost and demand characteristics. Within a subclass, the Postal Service was required to charge the same base rate with variations accordingly by rules defined by the Commission, primarily the rule of “efficient component pricing.”

In the revised statute, there is no separate provision for the regulation of mail classification, no equivalent to former § 3623. The basic standard is the “just and reasonable” standard. How does the pre-PAEA subclass methodology compare with the new objective of fostering a “just and reasonable schedule for rates and classifications”? It seems clear that the subclass methodology constrains relationships between product prices more than would be permitted by the “just and reasonable” standard. Under the subclass methodology, the Postal Service could develop different prices for different products *only if* the products could qualify for different subclasses. Under the “just and reasonable” standard, the Postal Service may develop different prices for different products *unless* the fact of different treatment or the amount of the rate difference is unjust or

⁸³The proviso to objective (8) is exceedingly unclear: “. . . however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.” Presumably, the proviso refers to changes in rates since rates are an obvious element with “magnitude” in ‘a just and reasonable schedule for rates and classifications.’ On the other hand, other elements of ‘a just and reasonable schedule for rates and classifications’ could be said to have magnitude as well, such as the number of items included in a class, the level of cost coverage for products, the number of sequential activities required, etc. Moreover, there is no obvious reason why “a just and reasonable schedule for rates and classifications” would be construed to prohibit changes of unequal magnitude. Inequality is not the same as injustice or unreasonableness. As written, it seems that this opaque clause should be interpreted as emphasizing that a “just and reasonable schedule for rates and classifications” is to read with great latitude.

⁸⁴See section 5.2.2(a), above.

⁸⁵See section 4.1, above.

unreasonable (with certain qualifications discussed below).⁸⁶

To illustrate the fundamental change that PAEA has introduced into the regulation of individual product rates, consider a passage from the Commission's opinion in R2006-1. In referring to inter-BMC parcel post rates, the Commission declared rate differences that are not based on the principle of efficient component pricing may still be considered just and reasonable,

Institutional costs are distributed to each rate cell in proportion to the attributable costs associated with that rate cell. Thus, *rate differences do not equal cost differences*. Because costs for each rate cell are increased by a percentage coverage factor rather than an equal per-unit amount, the difference between rates in each rate cell will exceed the corresponding cost difference. *Although this approach does not equate rate differences with cost differences, it does produce rates that are non-discriminatory.*⁸⁷

The Commission continues, "*No price discrimination exists when the ratio of price to marginal cost is the same for two products.*"⁸⁸ In short, relationships between the different rates are not "discriminatory"—which seems equivalent to not "unjust or unreasonable"—even though they violate the Commission's principle that rates within a subclass should be the same except for demonstrable cost differences. Under the "just and reasonable" standard, it appears that the Postal Service may charge two products so as to achieve the same percentage cost coverage. Indeed, under the "just and reasonable" standard, the Postal Service can go further; it may apply different percentage cost coverages to different products unless differences in the resulting rates are unjust or unreasonable.

At least two qualifications need to be noted in respect to foregoing discussion of the "just and reasonable" standard. First, § 3622(b) declares that the each objective "shall be applied in conjunction with the others." Hence, the just and reasonable standard of objective may be to some degree qualified by the fact that it must be applied in conjunction with other objectives. Second, § 3622(e) applies a different standard to relationships between the rate differences which are "workshare discounts."

⁸⁶Whether the pre-PAEA classification scheme is in all respects "just and reasonable" is an open question to which there is no obvious answer.

⁸⁷PRC Op. R2006-1 (2007) ¶ 4019.

⁸⁸PRC Op. R2006-1 ¶ 4020.

5.6.2 Other objectives

The other four objectives identified above as potentially bearing on the regulation of rate relationships do not appear incompatible with a just and reasonable schedule for rates and classifications, but they might be interpreted as an indication of factors which, in the view of Congress, are significant in assessing justness and reasonableness.

The implication of objective (4) (§ 3622(b)(4)), pricing flexibility, for regulation of rate relationships seems self-evident. Rate regulation should allow the Postal Service discretion to develop and adjust rate relationships as it attempts to carry out its statutory mission. Hence, the “just and reasonable” standard, should be applied elastically rather than rigidly.

Objective (3), high quality service standards, and objective (7), mail security, seem to imply that the relationships between rates might be adjusted, consistent with justness and reasonableness, to foster attainment of these objectives. For example, it would seem compatible with these objectives, and consistent with justness and reasonable, to establish rate differentials that favor mail that is prepared and coded in a manner that promises to improve service quality and mail security over time even if the rate differentials are not cost-justified immediately. Another possibility implied by the objective of high quality service standards could be rebates to large mailers who demonstrate that actual service fell below published standards.⁸⁹

Objective (1), § 3622(b)(1), declares that the modern system of regulation is to “maximize incentives to reduce costs and increase efficiency.” It is not evident, however, whose “costs” and whose “efficiency” are referred to. In setting workshare discounts under pre-PAEA law, the Commission has employed efficient component pricing to reduce the total cost borne by *mailers* for the end-to-end conveyance of mail.⁹⁰ Such discounts result in the Postal Service earning the same institutional contribution on mail entered downstream as on mail entered at the point of origin. Hence, such rates give the Postal Service *no* incentive to reduce the costs or improve the efficiency of upstream operations. If objective (1)

⁸⁹Although the Commission cannot require the Postal Service to reimburse postage under § 3681, there seems to be no bar to the Postal Service offering a tariff that provides for a reimbursement.

⁹⁰See, e.g., PRC Op. R2006-1 ¶ 4023 (“Mailers can act to minimize end-to-end costs only if the difference in rates for mail with differing characteristics reflects differences in the costs incurred by the Postal Service.” [quoting John Panzar with approval]).

refers to the costs and efficiency of the Postal Service, as seems likely,⁹¹ then a different approach to rates may be implied. For example, a just and reasonable rate schedule implemented in conjunction with objective (1) might include rate differentials designed to encourage mailer behavior that will ultimately reduce the costs and improve the efficiency of the Postal Service even though they may raise the cost of mailers for an interim period.

5.7 Regulation of rate relationships - workshare discount rule

The most important deviation from the flexibility of the “just and reasonable schedule for rates and classifications” is the exception for workshare discounts set out in subsection 3622(e). According to this subsection, when one product is a “workshare discount” to a second product, then the difference between rates for the two products may not, with some exceptions, “exceed the cost that the Postal Service avoids as a result of workshare activity.” This subsection provides as follows:

(e) Workshare Discounts.—

(1) Definition.—In this subsection, the term “workshare discount” refers to *rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a).*

(2) Scope.—The Postal Regulatory Commission shall ensure that *such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity, unless—*

(A) the discount is—

(i) associated with a new postal service, a change to an existing postal service, or with a new work share initiative related to an existing postal service; and

(ii) necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time;

(B) the amount of the discount above costs avoided—

(i) is necessary to mitigate rate shock; and

(ii) will be phased out over time;

(C) the discount is provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or

⁹¹The Senate committee reports implies that objective (1) refers to the costs and efficiency of the Postal Service: “The long term financial viability of the Postal Service is addressed by requiring that the Postal Regulatory Commission maximize incentives for the Postal Service to reduce costs and increase efficiency (Objective 3) thus maintaining affordable and cost-effective postal services.” S. Rept. No. 108-318 (2004) at 8.

(D) reduction or elimination of the discount would impede the efficient operation of the Postal Service.

(3) Limitation.—Nothing in this subsection shall require that a work share discount be reduced or eliminated if the reduction or elimination of the discount would—

(A) lead to a loss of volume in the affected category or subclass of mail and reduce the aggregate contribution to the institutional costs of the Postal Service from the category or subclass subject to the discount below what it otherwise would have been if the discount had not been reduced or eliminated; or

(B) result in a further increase in the rates paid by mailers not able to take advantage of the discount.

(a) Definition of “workshare discount”

The most important issue about workshare discounts appears to be the definition of the term “workshare discount.” Under the PAEA, the Commission is required to develop a specific definition as part of the regulations defining the modern system of regulation. § 3622(e)(1) (reference to “section (a)”).

As described above,⁹² the concept of a “workshare discount” was developed by the Commission in pre-PAEA rate regulation. The term “workshare discount” did not appear in the law prior to the PAEA. In its first extended discussion of the concept of a workshare discount in R77-1, the Commission explained “the purpose of the presort discount was to provide to the mailer who presorts *equitable compensation for the costs avoided by the Service*, to encourage such worksharing, and, as a consequence, improve service.”⁹³ The idea expressed here is not technical or obscure. The mailer incurs a cost in doing preparatory work that the Postal Service is otherwise prepared to spend money doing. The Commission considered that a discount was in order as a matter of “*equitable compensation.*”

Again as described above, in later years, the Commission’s concept of a “workshare discount” evolved into a more technical and less obvious meaning. The Commission today uses the term “workshare discount” as a way to describing rate differentials which are not based on activities that the mailer has undertaken at its expense thereby saving the Postal Service expenses that it was prepared to incur. Today, almost all Standard Mail is “workshared” even though the Postal Service could not possibly perform the “workshared work” and in many cases the mailer does not do the “workshared work” (except in the sense of programming computers to produce the mail in the correct order or location). This has nothing to do with “*equitable compensation.*”

⁹²See section 4.2, above.

⁹³PRC Op. R77-1 (1978) at 247.

The legal question that the Commission must address in specifying a definition of “workshare discount” for purposes of § 3622(e)(1), is this: Should the term be defined in the more obvious, non-technical sense in which it was first introduced or should it be defined in the less obvious, more technical sense into which it has evolved? Which is most consistent with the PAEA?

Reading the amended postal law as a whole and the legislative history supports the conclusion that the earlier, non-technical concept was intended. In § 3622(e), the general rule for workshare discounts is expressed as follow: “such discounts do not exceed *the cost that the Postal Service avoids as a result of workshare activity.*” Other than § 3622(e), the only provision in the postal law using the term “workshare discount” is § 3652(b) which requires the Postal Service to provide an annual report to the Postal Service on workshare discount and, in particular, the “*per-item cost avoided by the Postal Service by virtue of such discount.*” These passages imply that the Postal Service must avoid some cost that it was otherwise ready to incur. In the sparse legislative history of the PAEA, the fullest discussion of workshare discounts occurs in a Senate report on a predecessor of the final bill. The report explains:

The Committee has heard testimony from many parties describing the benefits of the Postal Service’s worksharing program. This program was developed by the Postal Service and the Postal Rate Commission to enable customers to pay lower rates *when they perform mail preparation or transportation activities such as presorting, prebarcoding, and certain other mail handling activities that would otherwise be performed by the Postal Service.* This worksharing program has *induced mailers to invest in equipment and processes* that facilitate the Postal Service’s automation program, has reduced mailing costs, and has otherwise made mail a more economically attractive medium.⁹⁴

These indications, too, imply that “workshare discount” was understood to refer to a discount in the earlier, non-technical sense of an activity that the Postal Service was prepared to do but was saved from doing by the mailer’s undertaking of costs that save the Postal Service money.

(b) Reconciliation with other objectives

The workshare discount rule is generally inconsistent with the broader objectives of the modern system of regulation. The rule obviously reduces the pricing flexibility of the Postal Service which objective (4) of § 3622(b) seeks to

⁹⁴S. Rept. No. 108-318 (Aug. 25, 2004) at 12. See also *id.* at 43 (“These are activities that would ordinarily be performed by the Postal Service.”).

promote. Since the workshare discount rule requires the Postal Service to price the workshared activity at or below attributable cost, it gives the Postal Service no incentive to improve the efficiency of the workshared activity. Not only does the Postal Service earn no institutional contribution from the workshared activity, but it is forced to pass on 100 percent of any reduction in costs to the mailer in the form of lower rates (i.e., smaller discounts).⁹⁵ This is hardly the result embraced in objective (1) (“maximize incentives to reduce costs and increase efficiency”).⁹⁶ Moreover, if, as is normally the case, the “workshared” activity is offered in competition with private companies, then the Postal Service is *required* by the workshare discount rule to provide what is, in essence, a competitive product which bears *no* share of the institutional costs of the Postal Service, contrary to the spirit, at least, of objective (9) (“allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products”).

As discussed above,⁹⁷ under the new definition of “product,” it seems possible for the Postal Service to establish separate upstream and downstream products. If the Postal Service were to do so, and it is not market dominant in the upstream market, then the upstream product would be a competitive product. Under the pricing principles of § 3633(a), the pricing rule applicable to competitive products, the Postal Service would be required to set a rate for this upstream product that covers the attributable cost of providing this service and makes at least some contribution to institutional costs. At the same time, if the rate of the upstream product were regarded as a “workshare discount,” a quite different pricing rule would have to apply: the Postal Service would be prohibited from charging a rate that exceeds the attributable cost (i.e., the avoided cost) of the upstream service.

These observations suggest a possible reconciliation between the concept of the workshare discount and the more general pricing principles of the new law: *the workshare discount rule should be inapplicable to upstream services provided under conditions where the Postal Service is not market dominant.* Indeed, such a conclusion could also be inferred from the discussion of the definition of workshare discount in the previous section. If the Postal Service faces substantial competition in an upstream market, then it may be questioned whether the upstream services provided by the market are in fact services that “would

⁹⁵For example, if the Postal Service were able to reduce upstream cost per piece from 5 cents to 4 cents, it would be required to reduce the discount from ‘no more than 5 cents’ to ‘no more than 4 cents.’ The Postal Service is barred from converting the cost reduction into a higher profit on upstream services.

⁹⁶See the discussion of objective (1) in section 5.6.2, above.

⁹⁷See section 3.2.3(c), above.

otherwise be performed by the Postal Service” (to quote the Senate report) since, as practical matter, the Postal Service is probably unequipped to handle the entirety of the activity. This principle of limiting the workshare discount rule to market dominant activities should apply regardless of whether or not the Postal Service defines the upstream activity to be a separate product since the Postal Service’s discretion to define products should not be available to defeat basic pricing principles of the act.

(c) Calculation of the workshare discount

The workshare discount rule is one of the four statutory rate rules that the Commission must implement by regulation.⁹⁸ A simple yet flexible approach for implementing the first rate rule, the statutory price cap, was discussed above.⁹⁹ The basic idea was (i) to adopt guidelines based on data from the previous fiscal year and (ii) to adjust the guidelines for the subsequent year to account for any shortfall or overshoot. The same general strategy seems feasible in the case of workshare discounts; however, weighting by prior year volumes is unnecessary because a workshare discount involves only a single product pair of products.

Under such an approach, a workshare discount proposed for year 2 would be considered lawful if it does not “exceed the cost that the Postal Service avoids as a result of workshare activity” according to the data available for fiscal year 1. If, at the end of fiscal year 2, it appears that the workshare discount did in fact exceed the limit implied by the prior year data, then the difference would be added to the limit for year 3. For example, suppose the cost data from fiscal year 1 showed that a particular workshare activity saved the Postal Service \$ 0.10 in fiscal year 1. Then, in the following calendar year, year 2, the Postal Service could introduce a workshare discount of up to \$ 0.10. Suppose at the end of fiscal year 2, it appears that the actual cost avoided by the Postal Service was only \$ 0.09. Then, in calendar year 3, the Postal Service could introduce a workshare discount of up to \$ 0.08, i.e. the cost avoided (\$0.09) less an overshoot amount of \$0.01. If the actual cost avoided in fiscal year 2 was \$ 0.11, then there would be no adjustment for calendar year 3 since the statutory workshare discount rule allows the Postal Service to charge less than the cost avoided.¹⁰⁰

⁹⁸See also discussion of the calculation of the statutory price cap rule (section 5.4.2), the attributable cost rule for market dominant products (section 5.5) and competitive products (section 6.3.2), and the collective contribution rule (section 6.3.3).

⁹⁹See section 5.4.2, above.

¹⁰⁰If the Commission established a regulatory rule requiring the Postal Service to charge 100 percent of costs avoided, then end-of-year adjustment could increase as well as decrease the workshare discount in calendar year 3.

As with the other rate rules, implementation is greatly simplified by relying up prior year data. Nonetheless, over time, the effect of this procedure is to "ensure" (§ 3622(e)(1)) that workshare discount will be no greater than costs avoided. What happens if the Postal Service introduces a new type of workshare discount for which there is no prior year data? So long as the discount is not prima facie unreasonable, it can probably be allowed to become effective without review because the catchup adjustment at the end of the year will substantially penalize the Postal Service for underestimating the costs avoided. Alternatively, the Commission can require more detailed data in support of a new type of workshare discount.

Unfortunately, this simple procedure will not suffice for the workshare discounts that, according to proponents, fall within one of the several exceptions to the general rule. For such workshare discounts, reference to established prior year cost data will be insufficient. It will be necessary to prove that the discount is "necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time" or that "reduction or elimination of the discount would impede the efficient operation of the Postal Service." For exceptional workshare discounts, it may be necessary for the Commission to establish special rules, after notice and hearing, for the calculation of the lawful limits to the discount. If possible, the Commission should develop rules that permit annual adjustments in workshare discounts without re-litigation each year.

5.8 Diminished role of "subclass" and "class"

As described above, the modern system of regulation appears to be directed to "products" provided within the framework of a "just and reasonable schedule for rates and classifications." The traditional regulatory concept of a "subclass" was grounded in the Commission's interpretation of former § 3623. The "subclass" concept provided a regulatory device for constraining relationships between the rates of products within a grouping defined by both cost and demand characteristics.

The revised statute has no equivalent to former § 3623 and hence no role for the traditional concept of a "subclass." In general, so long as all products bear a just and reasonable relationship to one another, this seems to satisfy the basic objective to the modern system of regulation. Put another way, statutory standards for rates appear to apply to each market dominant product individually or to a defined set of market dominant product collectively (e.g., as the statutory price cap). Each product is, in effect, its own subclass.

The only exception to this scheme is a set of intra-product or inter-product rates which have a workshare discount relationship with one another. For reasons discussed above, the workshare discount rule seems to be an exception to the just and reasonable model and hence a rule that should be interpreted narrowly.

Indeed, the concept of a "class" of products likewise seems to have less significance under the new statute. Even under the pre-PAEA, the concept of "class" was never especially significant. The only truly new class, Express Mail, could have been regarded as a subclass of First Class Mail without doing violence to the regulatory framework. Even so, under the revised statute, there seems to be no statutory obstacle to the Postal Service rearranging products into different categories that may be more convenient for marketing purposes. The concept of "class" is not statutorily significant for ratemaking purposes.

The end point of such "classlessness" is an approach similar to the product categorization long followed in international mail. For international mail, the Postal Service groups and regroup products to reflect the needs of mailers. The justness and reasonableness of the rates of different international mail products does not depend on the groupings, but on the product rates themselves, both absolutely and relatively. Indeed, the Domestic Mail Manual follows a somewhat similar approach for domestic mail, grouping all retail products into one group and treating separately discount letters, discount flats, and discount parcels. Under the modern system of regulation, why should the Postal Service not be free to reorganize its "classes" in this manner?

5.9 Regulation of rates – procedures

5.9.1 Procedural objectives

Several of the objectives for the modern system of regulation have procedural implications:

- (2) To create predictability and stability in rates.
- (4) To allow the Postal Service pricing flexibility.
- (6) To reduce the administrative burden and increase the transparency of the ratemaking process.

These objectives call for a well-conceived and flexible set of rules rather than a regulatory approach that is primarily dependent on litigation. Neither ex ante litigation of all rate changes (the pre-PAEA procedure) nor case-by-case litigation of the lawfulness of rates (under the complaint procedure of § 3662) would meet these objectives as a general matter. The Commission should aim for regulations which define the outer boundaries of lawful behavior and allow the Postal Service to act with appropriate commercial freedom within those norms.

5.9.2 Requirement for at least 45 days notice to mailers

The procedures which must be followed in changing rates for market dominant products are also constrained by statutory requirements. Paragraph § 3622(d)(1)(C) declares,

(d) Requirements.—

(1) In general.—The system for regulating rates and classes for market-dominant products shall—

....

(C) not later than 45 days before the implementation of any adjustment in rates under this section, including adjustments made under subsection (c)(10)—

(i) require the Postal Service to provide public notice of the adjustment;

(ii) provide an opportunity for review by the Postal Regulatory Commission;

(iii) provide for the Postal Regulatory Commission to notify the Postal Service of any noncompliance of the adjustment with the limitation under subparagraph (A); and

(iv) require the Postal Service to respond to the notice provided under clause (iii) and describe the actions to be taken to comply with the limitation under subparagraph (A);

This provision requires the Commission and the Postal Service to complete four tasks “not later than 45 days before the implementation of any adjustment in rates.” The four tasks are: (i) “notice of adjustment” by the Postal Service; (ii) an “opportunity for review” by the Commission; (iii) a notice by the Commission to the Postal Service of any “noncompliance of the adjustment with the limitation under subparagraph (A)”; and (iv) response by the Postal Service of actions to comply. The conjunction “and” at the end of item (iii) makes clear that all four tasks are to be completed “not later than 45 days before the implementation of any adjustment in rates under this section.” In short, the statute requires that mailers must be given *at least* 45 days notice of the final version of new rates before adjusting rates of market dominant products.

Because of widespread misunderstanding, it is worth emphasizing what this provision does *not* require. It does not require the Commission to do anything more than check for “noncompliance of the adjustment with the limitation under subparagraph (A),” i.e., the statutory price cap. This provision does not require the Postal Service to submit cost data. This provision does not require a minimum or maximum time period to accomplish these four activities. These four tasks could plausibly be discharged in two weeks. This provision does not bar the Commission from requiring or the Postal Service giving more than 45 days notice to mailers; it only says that, as a minimum requirement, the modern system of

regulation must give mailers notice of the final rates “not later than 45 days before the implementation.”

One source of confusion about this provision is a 2004 Senate committee report on a predecessor of the final bill. It describes a different procedure for reviewing rate adjustments, as follows:

To provide for adequate review of any proposed changes in market-dominant product price, a 45-day prior review period is established. This period begins with the Postal Service's public notice of a price adjustment affecting a market-dominant product or products and will provide the Postal Regulatory Commission an opportunity to review the adjustment. If the Postal Regulatory Commission finds that the price adjustment is not in compliance with the established statutory and regulatory requirements, it must notify the Postal Service within the 45-day notice period. In response to this notice, the Postal Service shall describe the actions to be taken to ensure that the rate change is in compliance with the statutory and regulatory requirements. While the Postal Service is expected to respond adequately to any Postal Regulatory Commission determination of noncompliance prior to the scheduled rate implementation, the burden is on the Postal Regulatory Commission to provide adequate notice of noncompliance permitting a Postal Service response prior to the expiration of the 45-day period. If either intentionally or inadvertently, the Postal Regulatory Commission does not notify the Postal Service of any noncompliance, the Committee believes that there would be no impediments to the Postal Service implementing the rate adjustment as noticed at the end of the 45-day period. The Committee clearly recognizes that the 45-day review period is short and has determined that a short review period is consistent with the goals of increasing Postal Service pricing flexibility. To facilitate review of rate adjustments, the Committee presumes that extremely clear and well-defined standards will be established by regulation allowing the Postal Service and the Postal Regulatory Commission to make a rapid determination of whether a rate adjustment meets the applicable criteria. The review period is not intended to be used to evaluate the regulatory structure; if a full review of the regulatory structure is deemed to be necessary, the Committee expects that, during the period of any review of the regulatory structure, the Postal Service will be permitted to adjust rates under the regulatory requirements in effect as of the date of public notice of the adjustment. Therefore, any changes in the regulatory structure will be applicable only to rate adjustments noticed by the Postal Service

after the date the new regulations are established.¹⁰¹

The committee report thus describes a “45-day prior review period” that “begins with the Postal Service’s public notice of a price adjustment.” If the Commission finds the proposed rate adjustment does not comply with statutory criteria, “it must notify the Postal Service within the 45-day notice period.” If the Commission does not notify the Postal Service of non-compliance, “there would be no impediments to the Postal Service implementing the rate adjustment as noticed at the end of the 45- day period.” The committee report is silent on the crucial issue, the procedure following a Commission notice of non-compliance. Nor does the committee report indicate a minimum period of advance notice to mailers of the finally approved rate changes. The procedure described in the committee report is incomplete and inconsistent with the statutory text. Even though the bill text that it purports to describe was ultimately included in the final bill, the report language cannot be used to impeach the plain meaning of a statute which is sensible on its face.

5.9.3 Application to baseline NSAs

It should be noted that the review procedure and notice to mailers required by § 3622(d)(1)(C) applies to “any adjustment in rates under this section, including adjustments made under subsection (c)(10).” The reference to § 3622(c)(10) refers to Negotiated Service Agreements as follows:

(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including *agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—*

(A) either—

(i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or

(ii) enhance the performance of mail preparation, processing, transportation, or other functions; and

(B) do not cause unreasonable harm to the marketplace.

Although completely clear, this provision appears to refer to NSAs as templates—i.e., “agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers”—rather than as particular contracts. It thus seems plausible to interpret the reference to (c)(10) as requiring a notice to mailers of 45 days or more for new *baseline* NSAs but not for new *functionally equivalent* NSAs.

¹⁰¹S. Rept. No. 108-318 (2004) at 11.

5.9.4 Reports on adjustments in workshare discounts

In the case of a rate adjustment involving workshare discounts, there is an additional statutory requirement, specified in § 3622(e)(4) as follows:

(4) Report.—Whenever the Postal Service *establishes* a workshare discount rate, the Postal Service shall, at the time it publishes the workshare discount rate, submit to the Postal Regulatory Commission a detailed report that—

- (A) explains the Postal Service's reasons for establishing the rate;
- (B) sets forth the data, economic analyses, and other information relied on by the Postal Service to justify the rate; and
- (C) certifies 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.

This provision requires the Postal Service to supply an economic justification and assurance whenever it “establishes” a workshare discount. It seems plausible that the Postal Service “establishes” a new discount whenever it “adjusts” the rates of products.¹⁰² Hence, whenever the Postal Service provide a “notice of adjustment” for rates of a subclass containing workshare discount products, it must also file the required data and assurances. On the other hand, this provision, unlike § 3622(d)(1)(C), does not mandate “an opportunity for review by the Postal Regulatory Commission.” Therefore, this provision does not, standing alone, require an investigation into the economic justification for workshare discounts before implementing an increase in rates for market dominant products generally or even an increase in rates for workshare products.

Nonetheless, as discussed above,¹⁰³ it seems possible to interpret the requirements of § 3622(e)(2) so that the annual report on workshare discounts need not be much more elaborate than the submission accompanying a general notice of adjustment in rates. For ordinary workshare discounts, i.e., those that “do not exceed the cost that the Postal Service avoids as a result of workshare activity,” it seems possible to use prior year data to simplify implementation of the workshare discount rule in much the same way prior year data can be used to simplify implementation of other statutory rate rules. The report, and the Commission review, should not be any more difficult or elaborate than for increases in non-workshare rates.

¹⁰²In order for the Commission to “ensure that such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity,” § 3622(e)(2), it would seem necessary for the Commission to examine specific rates and discounts.

¹⁰³See the discussion in section 5.7.1(c), above.

6 Regulation of Rates for Competitive Products

6.1 New relationship between Governors and Commission

As noted above in discussing market dominant products,¹⁰⁴ the Governors are authorized to establish rates and classifications for all postal products, including competitive products, by § 404(b), which provides:

(b) Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rate of postage and fees for postal services in accordance with the provisions of chapter 36. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

In addition, the Governors are authorized to establish rates and classifications for competitive products by § 3632(a), which provides:

(a) Authority To Establish Rates and Classes.—The Governors, with the concurrence of a majority of all of the Governors then holding office, shall establish rates and classes for products in the competitive category of mail in accordance with the requirements of this subchapter and regulations promulgated under section 3633.

As discussed in the context of market dominant products, the PAEA has fundamentally changed the ratemaking relationship between the Postal Service and the Commission. Before the PAEA, for domestic competitive products, “ratemaking . . . authority [was] vested primarily in [the] Postal Rate Commission.” After the PAEA, the authority to establish rates and classes for products in the competitive category of mail is vested primarily in the Postal Service. The role of the Commission has shifted from ratemaker to regulator.

However, the dual authority of the Governors in respect to establishing rates for competitive products is curious. In § 404(b), the Governors are authorized to establish “reasonable and equitable” rates and classifications. In § 3623(a), the Governors are authorized to establish any rates and classifications for competitive products consistent with the statute. Apparently, in the case of competitive products rates, the Governors should proceed under the more specific, and less constrained authority of § 3623(a).

¹⁰⁴See section 5.1, above.

6.2 Objectives of regulation

The statute does not provide explicit objectives for the regulation of competitive products as it does for the regulation of market dominant products. In committee reports, the general aim of Congress was expressed as follows. The 2005 House committee report, the most recent, declared,

H.R. 22 would direct the PRC to prohibit subsidizing competitive products by market dominant products, ensure that each competitive product covers its attributable costs, and ensure that all competitive products collectively make a reasonable contribution to the institutional costs of the Postal Service. *After these requirements have been implemented, the USPS could change rates for competitive products without consulting the PRC, as long as the cost coverage requirements are met.* The Postal Service, however, would have to provide public notice and justification of changes in rates.¹⁰⁵

The Senate committee report, in 2004, described the intended regulation of rates of competitive products as follows:

This bill establishes a flexible system of pricing the Postal Service's competitive products which reduces regulatory burdens and *permits more customer- and market-responsive pricing.* It does this while establishing appropriate safeguards to ensure that a level playing field is maintained and that the Postal Service does not unfairly compete. . . .

To protect both customers and competitors of the Postal Service, this legislation establishes a prior review process to ensure that the Postal Service is not pricing competitive products inappropriately and to ensure that the Postal Regulatory Commission and all interested parties have the opportunity to review the proposed competitive products prices and to determine that the requirements of this act are met. The public notice and concurrent Postal Regulatory Commission review period for competitive product price change is limited to thirty days. As compared to current statute, which allows the Postal Rate Commission up to ten months to review all Postal Service price requests, the limited thirty day review period should substantially increase the ability of the Postal Service to adjust its competitive pricing and products to react to market changes and customer needs. If the Postal Regulatory Commission finds that any proposed competitive product price change does not meet the requirements of the regulatory structure, it is required to notify the Governors of the noncompliance and the

¹⁰⁵H.R. Rept. No. 109-66 (2005) at 86 .

Governors are required to respond to this notice by describing the actions to be taken to comply.

The Postal Regulatory Commission is required, within 180 days of enactment, to promulgate regulations that prohibit the cross-subsidization of competitive products by market-dominant products, ensure that each competitive product covers its attributable costs, and that all competitive products collectively cover their share of the Postal Service's institutional costs. *These regulations are intended to ensure that the Postal Service competes fairly in the provision of competitive products. However, the Committee feels that the regulation of competitive products should be constructed to result in the minimum possible regulatory burden and to facilitate a short and limited review of proposed competitive product price changes. As a result, established regulations are expected to be clear and easily interpreted to facilitate the short prior review process established by this legislation.* The Governors, in turn, are expected to provide a clear and concise explanation of how and why the proposed rate changes meet the established requirements to facilitate Postal Regulatory Commission review. *The review process is intended to ensure that the Governors' proposed competitive price adjustments meet the established requirements, not to serve as an evaluation of the merits of each proposed rate as compared to any other alternative rates.*¹⁰⁶

Thus, the House committee report envisions a very limited review procedure under which the Postal Service could "change rates for competitive products without consulting the PRC, as long as the cost coverage requirements are met." The Senate report seems to agree by referring to a procedure that is only detailed enough "to ensure that the Governors' proposed competitive price adjustments meet the established requirements, not to serve as an evaluation of the merits." At the same time, and some somewhat inconsistently, other portions of the Senate report seems to suggest a more extensive ex ante review ("a prior review process . . . to ensure that the Postal Regulatory Commission and all interested parties have the opportunity to review").

It should be noted, however, that in each case, the committee bills explicitly provided that the Commission should review competitive product rates prior to effectiveness, whereas the final statute does not. Hence, if anything, the committee reports understate the degree of commercial freedom which Congress intended to grant the Postal Service in respect to the pricing of competitive products.

¹⁰⁶ S. Rept. No. 108-318 (2004) at 14-16.

Overall, the objectives of rate regulation of competitive products seem to be give the Postal Service maximum price flexibility consistent with the prevention of the unfair competition that would result from charging less than attributable costs or shifting an inappropriate level of overhead costs to market dominant products.

6.3 Rate regulation

Section § 3633(a) requires the Commission to adopt regulations that provide for regulation of competitive product rates as follows:

(a) In General.—The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, promulgate (and may from time to time thereafter revise) regulations to—

(1) prohibit the subsidization of competitive products by market-dominant products;

(2) ensure that each competitive product covers its costs attributable; and

(3) ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.

Although statute provides that the Postal Service must give advance notice of changes in competitive product rates, it does not explicitly authorize the Commission to review rates for competitive products prior to effectiveness. However, under § 3662, any person may file a complaint against a competitive product rate as soon as it is announced. Hence, to avoid regulation by litigation, it will be necessary for the Commission to announce standards of lawfulness even if they are not applied by the Commission by prior review.

6.3.1 Prevention of cross-subsidy

Although each of the requirements in § 3633(a) is aimed at the same target, prevention of unfair competition, the role of paragraph § 3633(a)(1) is very unclear. Paragraph § 3633(a)(2) appears to require that the revenue derived from each competitive product exceeds its attributable costs.¹⁰⁷ Leaving aside minor differences between attributable costs and incremental costs, this condition is sufficient to prevent what most economists would call “cross-subsidy.” In competition among private companies, paragraph § 3633(a)(2) would in most cases be considered an adequate safeguard against anticompetitive behavior. Paragraph § 3633(a)(3) requires the Postal Service to take an additional step by

¹⁰⁷While the statutory text is not as clear as it might be, this appears to be the meaning of a product “covering” its costs.

increasing the prices of competitive products collectively to cover “appropriate share of institutional costs.” Such a safeguard has been considered appropriate in other regulatory frameworks involving a public utility that benefits from legal privileges (such as the European Postal Directive). In addition, the Postal Service is required to keep the costs and revenues, as well as the assets and liabilities, associated with competitive products in a separate account, the Competitive Product Fund. § 2011. Revenues earned from market dominant products may not be used for any of the purposes, functions, or powers for which the Competitive Products Fund may be used. § 2003(a).

What more does paragraph § 3633(a)(1) require in order to “prohibit the subsidization of competitive products by market-dominant products”? The term “subsidization” is undefined and used only one other time in the revised postal law.¹⁰⁸ The answer seems to be that the only function of paragraph § 3633(a)(1) is to emphasize the importance of implementing the full range of measures aimed at preventing cross-subsidization of competitive products using revenues earned from market dominant products. Note that this, too, appears to be the only plausible interpretation of objective (9) of the modern system of regulation for market dominant products, § 3622(b)(9). That is, this objective appears to have no substantive legal effect; it only emphasizes the need “to allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products,” a need that is wholly accomplished by § 3633(a)(3).¹⁰⁹

6.3.2 Minimum rates - calculation of attributable cost rule

Under paragraph § 3633(a)(2), the Commission must “ensure” that “each competitive product covers its costs attributable.” The simplest and most flexible method for implementing this rule would seem to be the same as discussed in the context of the application of the attributable cost rule to market dominant products.¹¹⁰

6.3.3 Cost coverage - collective contribution rule

Under § 3633(a)(3), the Commission must also “ensure that all competitive products collectively cover what the Commission determines to be an *appropriate share* of the institutional costs of the Postal Service.” This collective contribution

¹⁰⁸§ 2011(h)(1)(A)(i)(II) requires the Secretary of the Treasury to develop recommendations with respect to accounting practices and principles that should be followed by the Postal Service with the objective of “preventing the subsidization of [competitive products] by market-dominant products.”

¹⁰⁹See section 5.3.2, above.

¹¹⁰See section 5.5, above.

rule is one of four statutory rate rules that the Commission must implement.¹¹¹ While the “appropriate share” of institutional costs is an exceedingly vague standard, some general interpretative guidelines seem plausible.

First, the “appropriate share” of institutional costs cannot be derived by reference to practices under former law. Prior to the PAEA, the Commission made no evaluation of the appropriate share of institutional costs borne by competitive products. The Commission allocated institutional costs to domestic competitive products based upon statutory objectives that are substantially different from those in current law. Moreover, the pricing and classification freedom granted the Postal Service under the new law is materially greater than under former law. Then, too, cost coverage for competitive international mail products was determined by the Postal Service without Commission review.

Second, § 3633(b) requires the Commission to conduct a review every five years of the allocation of institutional costs to competitive products, as follows:

(b) Review of Minimum Contribution.—Five years after the date of enactment of this section, and every 5 years thereafter, the Postal Regulatory Commission shall conduct a review to determine whether the institutional costs contribution requirement under subsection (a)(3) should be retained in its current form, modified, or eliminated. In making its determination, the Commission shall consider *all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products.*

While the statute does not explicitly direct the Commission to revise its interpretation of “appropriate share” in light of the “relevant circumstances” named in the subsection, there seems to be no other purpose to this 5-year review. By the same token, if “appropriate share” is to be reinterpreted in this manner every five years, then it appears that the initial interpretation of “appropriate share” should likewise take all “relevant circumstances” into account.

Third, “appropriate share” should be interpreted in light of the basic intent of Congress to establish a level playing field between the Postal Service and private competitors. This general intent is evident from the whole structure of the act as well as the legislative history. To effect a level playing field, the starting point might be a determination as to the overhead costs that a private company would experience under similar circumstances. This determination might be modified to the extent that the costs of the Postal Service’s competitive products are raised or

¹¹¹See also discussion of the calculation of the statutory price cap rule (section 5.4.2), the attributable cost rule for market dominant products (section 5.5) and competitive products (section 6.3.2), and the workshare discount rule (section 5.7.1(c)).

lowered by its status as a government entity. In this respect, the results of the FTC study on equal application of laws would appear of some relevance. PAEA § 703. In any case, the purpose of Commission's setting an "appropriate share" is *not* to maximize the income of the Postal Service (e.g., by applying Ramsey pricing principles) nor to ensure the ability of the Postal Service to provide competitive products. The objective is some semblance of a "level playing field."

Fourth, the "appropriate share" level set by the Commission is a regulatory floor, not a "stretching" standard. It should be set at the minimum level considered which the Commission believes necessary to achieve a reasonably level playing field. At the same time, the level of "appropriate share" should be set at a realistically high level because competitive income earned in excess of the "appropriate share" is (or should be) regarded as profit and subject to the assumed federal income tax of § 3634.

Finally, as with other statutory rate rules, the collective cost coverage test requires consideration of the time period to be used as the base period and the handling of shortfalls and overshoots. In general, it would seem plausible to implement the collective cost rule in the same manner as the other rate rules. That is, develop a simple method for setting approximate guidelines for year 1 using prior year data and, at the end of year 1, adjust the guidelines for year 2 using any discrepancy between the actual results and the guidelines for year 1.

6.3.4 Procedures

Under subsection § 3632(b), the Postal Service must give the public notice 30 days before changes in rates for competitive products that are of "general applicability" (a term to be defined by the Commission). For competitive products that are not of general applicability, the Postal Service must give the Commission, but not the public, 15 days advance notice. In neither case does the statute explicitly provide for an automatic review of competitive rate changes by the Commission.

Based upon the foregoing analysis, it does not seem that the Commission needs to provide for an automatic review process to accomplish its statutory tasks.¹¹² An annual adjustment for shortfalls will create a strong disincentive for the Postal Service to set rates for individual competitive products below attributable costs and rates for competitive products collectively below the "appropriate share" standard. In order to justify an adjustment in competitive rates, it seems sufficient for the Governors to affirm that they are satisfied that the

¹¹²In addition, advance notice allows an opponent of a change in a competitive rate to file a complaint under § 3662 before the rate goes into effect.

rates for individual products at least cover attributable costs. Where there is reasonable cause for doubt, the complaint process is available to provide review prior to the annual compliance report.

7 Regulation of Service

7.1 Service standard regulations for market dominant products

The general statutory requirements listed in section 2, above, include several references to the scope and quality of services to be provided by the Postal Service. The statutory declaration postal policy in § 101 states that the Postal Service should provide “prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities.” § 101(a). While this injunction might be considered qualified by the simultaneous need to meet other policy objectives, subsection § 403(a) is not so qualified. It says that the Postal Service shall “plan, develop, promote, and provide adequate and efficient postal services” and shall “serve as nearly as practicable the entire population of the United States.” In a similarly unqualified manner, § 3661(a) repeats that the Postal Service shall “develop and promote adequate and efficient postal services.”

Section § 3691, added by the PAEA, requires the Postal Service to adopt service standards that define service standards for *market dominant* products (not competitive products).

(a) Authority Generally.—Not later than 12 months after the date of enactment of this section, the Postal Service shall, in consultation with the Postal Regulatory Commission, by regulation establish (and may from time to time thereafter by regulation revise) a set of service standards for market-dominant products.

(b) Objectives.—

(1) In general.—Such standards shall be designed to achieve the following objectives:

(A) To enhance the value of postal services to both senders and recipients.

(B) To preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining.

(C) To reasonably assure Postal Service customers delivery reliability, speed and frequency consistent with reasonable rates and best business practices.

(D) To provide a system of objective external performance measurements for each market-dominant product as a basis for measurement of Postal Service performance.

(2) Implementation of performance measurements.—With respect to

paragraph (1)(D), with the approval of the Postal Regulatory Commission an internal measurement system may be implemented instead of an external measurement system.

(c) Factors.—In establishing or revising such standards, the Postal Service shall take into account—

- (1) the actual level of service that Postal Service customers receive under any service guidelines previously established by the Postal Service or service standards established under this section;
- (2) the degree of customer satisfaction with Postal Service performance in the acceptance, processing and delivery of mail;
- (3) the needs of Postal Service customers, including those with physical impairments;
- (4) mail volume and revenues projected for future years;
- (5) the projected growth in the number of addresses the Postal Service will be required to serve in future years;
- (6) the current and projected future cost of serving Postal Service customers;
- (7) the effect of changes in technology, demographics, and population distribution on the efficient and reliable operation of the postal delivery system; and
- (8) the policies of this title and such other factors as the Postal Service determines appropriate.

(d) Review.—The regulations promulgated pursuant to this section (and any revisions thereto), and any violations thereof, shall be subject to review upon complaint under sections 3662 and 3663.

The objectives of the service standards are stated explicitly in § 3691(b). These objectives are somewhat different from the general statutory requirements relating to the scope and quality of postal services found in § 101(a), § 403(a), and § 3661(a). In particular, the twice-repeated statutory requirement to supply "adequate and efficient" postal services seems to be less prescriptive and more market-oriented than the approach embraced in the objectives of § 3691(b). Nonetheless, the objectives and general requirements appear to be statutory commands of equal weight. Perhaps Congress intended that § 3691 service standards should attain the general statutory requirements as well as the specific objectives, although the correct interpretation is unclear. Section § 3691 also repeats the division of statutory desiderata into objectives and factors found in § 3622. While the purpose of this organization in § 3622 was apparently to give continuing but lesser weight to the ratemaking goals of the prior statute, the reason for this division in § 3691 is less evident since the prior statute did not provide for regulation of service quality. In any case, as in the interpretation of § 3622, it seems clear that the "factors" must be given substantially less than the objectives.

Once service standard regulations are adopted by the Postal Service, the Commission can require the Postal Service to comply with the regulations by

means of remedies associated with the annual determination of noncompliance (§ 3653) and the complaint procedure (§ 3662). If the Postal Service fails to provide the level of service required by its service standard regulations, the Commission can “order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance.” § 3662(c).

The Postal Service has broad discretion over the content of the service standard regulations. Nonetheless, the Postal Service’s discretion is limited to some extent by the objectives listed in § 3691(b) and, to a lesser degree, by the factors listed in § 3691(c). Under the complaint procedure of § 3662, an affected party may ask the Commission for a remedial order to the Postal Service if the Postal Service’s regulations do not correctly implement the objectives and factors of § 3691.¹¹³ However, in reviewing the service regulations of the Postal Service, the Commission would presumably adopt the same high level of deference which a court is required to adopt in reviewing regulations of an independent agency. Hence, the Commission’s control over service standard regulations appears to be highly attenuated. On the other hand, the Commission may criticize the Postal Service’s service standards more directly in a report issued under using § 3661 (see next section).

Division of regulatory responsibility for services and rates between the Postal Service and Commission has logical consequences. Since the Postal Service has more control over service standard regulations than rate regulations, the statute implies—indeed, effectively directs—that the Postal Service should adjust the service standard regulations to fit the financial constraints imposed by rate regulations, rather than the other way around.

7.2 Adequate and efficient postal services

Sections § 3661(b) and § 3661(c) provide a second regulatory mechanism for controlling the quality of postal services. As noted above, § 3661(a) obliges the Postal Service to provide “adequate and efficient” postal services. The remainder of the section then delegates to the Commission authority to the Commission (not the Postal Service) and applies to all postal products (not only market dominant products). Section § 3661 provides as follows:

¹¹³Subsection § 3691(d) also states that Postal Service’s service regulations “shall be subject to review upon complaint under sections 3662 and 3663.” Section § 3663, however, provides only for review of an order or decision by the Commission by the federal court of appeal, not for review of an order or decision of the Postal Service. While the reference to § 3663 may allow for judicial review of service regulations adopted by the Postal Service, this interpretation is uncertain.

(a) The Postal Service shall develop and promote adequate and efficient postal services.

(b) When the Postal Service determines that there should be a change in the nature of postal services which will generally affect service on a nationwide or substantially nationwide basis, it shall submit a proposal, within a reasonable time prior to the effective date of such proposal, to the Postal Rate Commission requesting an advisory opinion on the change.

(c) The Commission shall not issue its opinion on any proposal until an opportunity for hearing on the record under sections 556 and 557 of title 5 has been accorded to the Postal Service, users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public. The opinion shall be in writing and shall include a certification by each Commissioner agreeing with the opinion that in his judgment the opinion conforms to the policies established under this title.

Subsection 3661(a) fits uneasily with the statutory revisions effected by the PAEA. As noted above, the "adequate and efficient" service required by § 3661(a) seems to imply a different emphasis than the objectives of § 3691(b). Moreover, § 3661(a), unlike § 3691, applies to competitive and well as market dominant products. Under the complaint procedure of § 3662, an affected party could ask the Commission for a remedial order to the Postal Service if the Postal Service fails to provide "adequate and efficient" service. In evaluating such a complaint, the Commission would not be obliged to give the same level of deference to the Postal Service as would be due in reviewing service standard regulations. Thus, it appears possible, but perhaps unlikely, that the Commission could find that a service standard regulation, although within the authority of the Postal Service to adopt, nonetheless fails to provide "adequate and efficient" postal service. Likewise, it appears possible that the Commission could find that, despite the increased deference to market solutions implied by the PAEA, a competitive product of the Postal Service falls short of "adequate and efficient" service.

The service review procedures of § 3661(b) and § 3661(c) likewise clash with the service standard regulations of § 3691. Apparently, the Postal Service is obliged to seek an opinion of the Commission before changing service standard regulations for market dominant products in a manner that will "affect service on a nationwide or substantially nationwide basis." While the Commission's formal authority to modify or reject § 3691 regulations may be attenuated, the Commission is required to give an opinion in a review under § 3661(b). In addition, under § 3661(b), the Postal Service remains obliged to seek a Commission opinion on changes in national service levels for competitive products as well as market dominant products.

8 Annual Report and Determination of Noncompliance

8.1 Annual report by Postal Service

Within 90 days of the end of the fiscal year, the Postal Service must submit to the Commission an annual report providing cost, revenue, and service quality data. Section § 3652(a) provides as follows:

(a) *Costs, Revenues, Rates, and Service.*—Except as provided in subsection (c), the Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex to the report as the Commission may require under subsection (e))—

(1) which shall analyze *costs, revenues, rates, and quality of service*, using such methodologies as the Commission shall by regulation prescribe, and *in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title*; and

(2) which shall, for each market-dominant product provided in such year, provide—

(A) product information, including mail volumes; and

(B) measures of the quality of service afforded by the Postal Service in connection with such product, including—

(i) the level of service (described in terms of speed of delivery and reliability) provided; and

(ii) the degree of customer satisfaction with the service provided.

The Inspector General shall regularly audit the data collection systems and procedures utilized in collecting information and preparing such report (including any annex thereto and the information required under subsection (b)). The results of any such audit shall be submitted to the Postal Service and the Postal Regulatory Commission.

Subsection § 3652(b) requires cost and revenue data on products which are associated with workshare discounts, as follows:

(b) *Information Relating to Workshare Discounts.*—The Postal Service shall include, in each report under subsection (a), the following information with respect to each market-dominant product for which a workshare discount was in effect during the period covered by such report:

(1) The per-item cost avoided by the Postal Service by virtue of such discount.

(2) The percentage of such per-item cost avoided that the per-item workshare discount represents.

(3) The per-item contribution made to institutional costs.

In addition, subsection § 3652(c) requires data on experimental products to be

included in the annual report.

Data must be prepared according to methodologies approved by the Commission and submitted in a form prescribed by the Commission. Subsection § 3652(e)(1) states,

(1) In general.—The Postal Regulatory Commission shall, by regulation, prescribe the content and form of the public reports (and any nonpublic annex and supporting matter relating to the report) to be provided by the Postal Service under this section. In carrying out this subsection, the Commission shall give due consideration to—

(A) providing the public with timely, adequate information to assess the lawfulness of rates charged;

(B) avoiding unnecessary or unwarranted administrative effort and expense on the part of the Postal Service; and

(C) protecting the confidentiality of commercially sensitive information.

Thus, it is the Commission, not the Postal Service, which determines what level of detail and explanation is “in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title.” § 3652(a)(1).

8.1.1 Cost and revenue data

The annual report will apparently require actual or estimated product-level costs and revenues for all products. For market dominant products, product-level accounts are implied if, as suggested above,¹¹⁴ factor § 3622(c)(2) of the modern system of regulation requires that each “class or type of mail service” bear its attributable cost and the Commission considers each product to be a “type of mail service.” Product-level accounts for market dominant products are also implied by the statutory criteria for workshare discounts. For competitive products, product-level accounts are necessary if the Commission is to ensure that the revenue from each competitive product covers its attributable cost. § 3633(a)(2). Moreover, product-level accounts, or something very similar, will be needed by the Commission in addressing other tasks required by the statute. For example, the Commission must adopt a modern system of regulation that fosters a “just and reasonable schedule for rates and classifications,” § 3622(b)(8), and considerations of justness and reasonableness depend heavily on costs and revenues. In addition, § 3652(e)(2) authorizes the Commission to initiate a proceeding to improve “*attribution of costs or revenues to products.*” PAEA § 702 requires the Commission to report on the “the costs of the Postal Service

¹¹⁴See section 5.2.2(b), above.

attributable to the obligation to provide universal service." PAEA § 708 requires the Commission to estimate "*direct and indirect postal costs attributable to periodicals.*"

8.1.2 Quality of service data

For market dominant products, product-level volume and quality of service data will also be required. Paragraph § 3652(a)(2)(B) requires quality of service data for *each* market dominant product.

8.1.3 Public service data

In addition, subsection § 3651(b) requires the Commission to prepare an annual report for Congress on costs incurred by the Postal Service in providing public services. The concept of "public services" includes universal services that would not otherwise be provided, free or reduced rate services required by statute, and other public services legally required of the Postal Service. The Postal Service is obliged to provide the Commission with information necessary to prepare these reports. Since this information is closely related to the cost and revenue and quality of service data required by § 3652, it seems likely that the Postal Service will be required to address the cost of public services as part of its annual report.

8.1.4 Compliance with other requirements of this title

The statute requires that annual report show that "all products . . . complied with all applicable requirements *of this title.*" The scope of the annual report is thus far broader than necessary for the determination of noncompliance which the Commission must make under § 3653. It is also far broader than the complaint jurisdiction of the Commission under § 3662. The annual report may be intended to serve as a basis for congressional or judicial oversight. As practical matter, however, it will be necessary for Commission to specify with particularity what topics the Postal Service will be required to address in the annual report.

8.2 Relation to financial reports under § 2011(h)

Subsection § 2011(h)(2)(C) authorizes the Commission to require periodic financial reports from the Postal Service. The content of these reports is described in § 2011(h)(2)(B) only as "such information as the Commission may require."

(B)(i) After due consideration of the views and other information received under subparagraph (A), the Commission shall by rule—

(I) provide for the establishment and application of the accounting practices and principles which shall be followed by the Postal Service;

(II) provide for the establishment and application of the substantive and procedural rules described under paragraph (1)(A)(ii); and

(III) provide for the submission by the Postal Service to the Postal Regulatory Commission of annual and other periodic reports setting forth *such information as the Commission may require*.

While it is clear that such information must conform to “accounting practices and principles” and “substantive and procedural rules described under paragraph (1)(A)(ii)” and established by the Commission, this subparagraph does not specify the content of the report. Such information as the Commission may require about what?

Reading § 2011(h) as a whole, it appears that the report in question is to include such information as the Commission, after considering the views of affected parties, may require with respect to topics addressed in a report by the Secretary of the Treasury. This report is described in § 2011(h)(1)(A) as follows:

(h)(1)(A) The Secretary of the Treasury, in consultation with the Postal Service and an independent, certified public accounting firm and other advisors as the Secretary considers appropriate, shall develop recommendations regarding—

(i) the accounting practices and principles that should be followed by the Postal Service with the objectives of—

(I) *identifying and valuing the assets and liabilities of the Postal Service associated with providing competitive products, including the capital and operating costs incurred by the Postal Service in providing such competitive products; and*

(II) *subject to subsection (e)(5), preventing the subsidization of such products by market-dominant products; and*

(ii) *the substantive and procedural rules that should be followed in determining the assumed Federal income tax on competitive products income of the Postal Service for any year (within the meaning of section 3634).*

Paragraph § 2011(h)(1)(A) thus makes clear that the § 2011(h) report is to address three topics. The first topic is accounting for the assets and liabilities associated with competitive products. The third topic is information needed to calculate the assumed Federal income tax on competitive products under § 3634. The second topic is less clearly expressed. Paragraph § 2011(h)(1)(A)(i)(II) says “*subject to subsection (e)(5), prevention of subsidization of such products by market-dominant products.*” The proviso, § 2011(h)(e)(5), relates to the repayment of loans taken out by the Competitive Product Fund with revenues of

competitive products or assets of the Competitive Product Fund. It seems likely, therefore, that the subsidization mentioned in § 2011(h)(1)(A)(i)(II) refers only to the possible misuse of *assets and liabilities* properly associated with market dominant products in such a way as to effectively subsidize competitive product. This is a logical interpretation since there is no need for the § 2011(h) report to address possible use of market dominant *revenues* to subsidize competitive products; this topic is already covered in the § 3652 annual report.¹¹⁵

In brief, then, it appears that the § 2011(h) report should provide an accounting of assets and liabilities and a consolidation of tax-related data. The § 3652 annual report should provide an accounting of costs and revenues and all other information needed to demonstrate that “all products . . . complied with all applicable requirements of this title.” Such an interpretation renders the two reports more or less complementary.

8.3 Determination of noncompliance

Within 90 days after receiving the Postal Service’s annual report, the Commission is required to make a *determination of noncompliance* if appropriate. Paragraph § 3053(b)(1) provides as follows:

(b) Determination of Compliance or Noncompliance.—Not later than 90 days after receiving the submissions required under section 3652 with respect to a year, the Postal Regulatory Commission shall make a written determination as to—

- (1) whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with applicable provisions of this chapter (or regulations promulgated thereunder); or
- (2) whether any service standards in effect during such year were not met.

If, with respect to a year, no instance of noncompliance is found under this subsection to have occurred in such year, the written determination shall be to that effect.

8.3.1 Nature of the determination

Notwithstanding its heading, this subsection calls only for a *determination of noncompliance*. That is, the Commission is obliged only to find noncompliance; it not obliged to find compliance by the Postal Service. There may be cases in which

¹¹⁵The annual report required by § 3652(a) includes a complete accounting of costs and revenues associated with market dominant and competitive products. Accounts must be sufficient to show that the Postal Service complied with “all applicable requirements of this title,” including the prohibition against the subsidization of competitive products by market dominant products in § 3363(a)(1).

the Commission cannot determine whether the Postal Service has complied with statutory or regulatory standards, for example in cases in which the Commission lacks sufficient data to decide. In such situations, it seems the Commission must withhold a determination of noncompliance.

Although absence of noncompliance does not logically imply compliance, the statute declares that absence of noncompliance shall create a “rebuttable presumption of compliance.” Subsection § 3653(e) provides:

(e) *Rebuttable Presumption.*—A timely written determination described in the last sentence of subsection (b) shall, for purposes of any proceeding under section 3662, create a *rebuttable presumption of compliance* by the Postal Service (with regard to the matters described under paragraphs (1) and (2) of subsection (b)) during the year to which such determination relates.

The precise legal effect of this provision is unclear, for it seems obvious that the starting presumption in any proceeding would be that the Postal Service has complied with applicable law. Creation of an explicit rebuttable presumption does not seem to undercut the fact that § 3053(b)(1) only calls for a determination of noncompliance. The fact that absence of noncompliance does not logically imply compliance should, however, be taken into account by Commission in evaluating the weight of the presumption. The burden of proof needed to overcome the presumption should be set accordingly.

8.3.2 Compliance with norms for rates and fees

The first issue that the Commission must decide in its evaluation of noncompliance is “whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with applicable provisions of this chapter [chapter 36] (or regulations promulgated thereunder).” § 3653(b)(1).

At the outset, it should be noted that, with respect to regulation of rates, the key statutory commands of chapter 36, those in § 3622 and § 3633, are directed to the Commission, not to the lawfulness of rates and fees per nor to the duties of the Postal Service. The Commission is instructed to establish a modern system of regulation to control the rates of market dominant products. And the Commission is directed to establish regulations that ensure that rates of competitive products adhere to statutory standards. These Commission-oriented provisions may be contrasted with the pre-PAEA provisions in § 3626 and § 3629. Section § 3626 says that reduced rates for certain types of mail “shall be established” and “shall be equal to.” Section § 3629 says that the “the Postal Service shall make available” certain rates to State voting registration officials.

The Postal Service cannot logically be found out of compliance with *statutory* commands addressed to the Commission. Noncompliance can be found only if the Postal Service's rates or fees are held to be inconsistent *with Commission regulations*. If a Commission regulation fails to achieve fully its statutory objective, this shortcoming might or might not be grounds for changing the regulation (some degree of imperfection may be inevitable), but it is not grounds for a finding of noncompliance by the Postal Service.

To illustrate this point, consider the statutory price cap. Paragraph § 3622(d)(1)(A) instructs the Commission to include in the modern system of regulation (established by the Commission) an annual limitation (set by the Commission) for the purpose of limiting increases in certain postage rates to the change in the prior year's CPI-U index. As noted above,¹¹⁶ as a practical matter, it is impossible for regulations to ensure that over the course of a forthcoming year the average rate for a class of products does not increase by more than the change in the prior year's CPI-U index. The actual average rate increase will depend upon changes in the volumes of component mail streams and these cannot be known until the end of the year in question. If rates and fees comply with the Commission's regulations during the year in question, then these rates and fees must be found in compliance with the requirements of the act even if the actual average change in a class of postage rates overshoots the change in the CPI-U index. If the regulations are designed correctly, the statutory objective will be met over time, but achievement of the statutory objective is a matter of the design of the regulations not Postal Service compliance.

What is true of regulations relating the statutory price cap is also true of regulations seeking to ensure that workshare discounts and rates of competitive products conform to statutory criteria. The issue of noncompliance comes down to whether rates and fees comply with the modern system of regulation and associated regulations for rates of competitive products. Whether or not the regulations meet all of the statutory criteria set for them is a separate issue.

Even clarified in this manner, the precise meaning of noncompliance is difficult to pin down. Suppose the Commission disagrees with the way the Postal Service has complied with Commission regulations? Consider, for example, a regulation directing the Postal Service to keep accounts so that

The attributable and other costs reasonably assignable [to specific products] shall separately be attributed to mail classes, subclasses, special services, and, to the extent practical, rate categories of mail

¹¹⁶See section 52, above.

service.¹¹⁷

Suppose in its annual report the Postal Service submits accounts that attribute costs to products in one way, but the Commission decides that costs should be attributed in a different way? By its decision the Commission has, in effect, clarified or amended its rules. Prior to such decision, it would seem unreasonable to find the Postal Service out of compliance with the regulation unless the Commission determines that the Postal Service willfully misinterpreted or ignored the regulation. Or suppose that, as a result of a Commission-directed modification in cost allocation methodology, a previously compliant rate falls out of compliance with a regulation requiring product rates to cover attributable costs? Here, too, a finding of noncompliance would obviously be inappropriate.

8.3.3 Compliance with norms for quality of service

The second issue that Commission must decide in its evaluation of compliance is “whether any service standards in effect during such year were not met.” § 3653(b)(2). Although “service standards” is undefined here, the revised statute requires the Postal Service to establish service standards for market dominant products under § 3691. The statute does not explicitly require the Postal Service to establish service standards for competitive products. It appears, therefore, that the quality of service portion of the Commission’s noncompliance evaluation, unlike the rates and fees portion, should address market dominant products only.

As described above,¹¹⁸ § 3691 requires the Postal Service to establish service standards for market dominant products. It seems clear that the Commission cannot find the Postal Service out of compliance with “service standards” unless the services of the Postal Service demonstrably fail to meet the standards set forth in these regulations. Obviously, then, the Postal Service should not adopt service standards that are too rigid. While the service standards themselves are required to meet certain statutory criteria, whether or not they do so would appear to be a separate question, one which may be tested by the complaint procedure of § 3662.

8.3.4 Opportunity for public comment

Under § 3653(a), after the Commission receives the annual report from Postal Service, the Commission must promptly provide “an opportunity for comment . . . by users of the mails, affected parties, and an officer of the

¹¹⁷See 39 CFR § 3001.54(h)(2)(2006). This is the current rule describing data the Postal Service must submit in support of a request for new rates.

¹¹⁸See section 7.1, above.

Commission who shall be required to represent the interests of the general public.” Based upon the preceding analysis, it appears that in general the substance of comments must address the commenter’s reasons for believing that the Postal Service has or has not complied with Commission regulations relating to (i) the rates and fees of all postal products and (ii) the service standards for market dominant products.

Based on the experience of pre-PAEA rate cases, it appears likely that commenters may suggest that the Postal Service has failed to comply with applicable regulations. For example, given the technical nature of cost allocation, it is easy to imagine that a commenter arguing that an econometric model used to allocate costs fails to comply with a Commission regulation requiring a given level of disaggregation or a maximum practicable degree of attribution or a full explanation of methodology. Nor would it be surprising if a commenter disagreed about the treatment of data for which the Postal Service’s claims confidentiality under § 3652(f).

How should the Commission respond to such a comment? To resolve factual disputes in a manner consistent with due process, the Commission must afford adverse parties some type of hearing. Indeed, it is not unlikely that the commenter will need the benefit of discovery to substantiate his case. On the other hand, the statute does not require the Commission to resolve such disputes. The statute merely requires “an opportunity for comment,” i.e. a rulemaking. Indeed, the time limit in the statute makes a full evidentiary hearing a practical impossibility because it requires the Commission to render a determination of noncompliance within 90 days from receipt of the annual report of the Postal Service.

A commenter can, of course, force the Commission to permit or reject an evidentiary hearing by casting his comment in the form of a complaint under § 3662. But a complaint does not suspend the 90-day deadline for rendering a determination of noncompliance.

8.4 Data quality proceeding

Paragraph § 3652(e)(2) authorizes the Commission to initiate a “data quality proceeding” as follows:

(2) Revised requirements.—The Commission may, on its own motion or on request of an interested party, initiate proceedings (to be conducted in accordance with regulations that the Commission shall prescribe) *to improve the quality, accuracy, or completeness of Postal Service data required by the Commission under this subsection* whenever it shall appear that—

(A) the attribution of costs or revenues to products has become significantly inaccurate or can be significantly improved;

- (B) the quality of service data has become significantly inaccurate or can be significantly improved; or
- (C) such revisions are, in the judgment of the Commission, otherwise necessitated by the public interest.

The data quality proceeding is a broader and more flexible regulatory tool than the annual determination of noncompliance. The scope of this review is coterminous with the scope of the Postal Service's annual report under § 3652(a), not the more limited scope of the Commission's determination of noncompliance. The Commission can conduct a "data quality case" by means of an full evidentiary hearing that meets all of the requirements of due process. There is no requirement to undertake such a proceeding annually, nor to address all data quality issues in the same proceeding. Unlike a complaint proceeding devoted to a specific issue, a data quality case will allow the Commission to address all logically interrelated issues at one time.

9 Complaint Procedure

9.1 Scope of the complaint jurisdiction

Section 3662 provides that interested persons may file a complaint with the Commission and request an order granting remedial relief in case of alleged violations of certain statutory and regulatory provisions. Subsection 3662(a) describes the complaint jurisdiction of the Commission as follows:

- (a) In General.—Any interested person (including an officer of the Postal Regulatory Commission representing the interests of the general public) who believes the Postal Service is not operating in conformance with the requirements of the provisions of sections 101(d), 401(2), 403(c), 404a, or 601, or this chapter (or regulations promulgated under any of those provisions) may lodge a complaint with the Postal Regulatory Commission in such form and manner as the Commission may prescribe.

The Commission apparently does not have authority to initiate a complaint proceeding on its own. However, since Commission has broad authority to devise regulations to bring about statutory goals with respect to rates and classifications and, under § 503, authority to "promulgate rules and regulations and establish procedures . . . and take any other action they deem necessary and proper to carry out their functions and obligations," it may be possible for the Commission to assume authority to initiate complaints *sua sponte*.

9.1.1 Fairness and non-discrimination: § 101(d), § 403(c)

The complaint jurisdiction allows a party to seek redress from the Commission in case of preferential treatment, where "preference" is defined by two legal standards. The first is the "undue or unreasonable discrimination" standard found in § 403(c), as follows:

(c) In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any *undue or unreasonable discrimination among users* of the mails, nor shall it grant any *undue or unreasonable preferences to any such user*.

Subsection § 403(c) is similar to, but not the same as, the requirement that the modern system of regulation foster a "just and reasonable schedule for rates and classifications." § 3622(b)(8). There is no apparent difference between "just and reasonable," on the one hand, and "not undue or unreasonable," on the other, but perhaps there may be non-apparent differences that will be elicited through experience.¹¹⁹ Nonetheless, the two provisions have quite applications. Subsection § 403(c) applies only to discrimination among "users." In the statute, the term "users" refers to mailers, not to addressees.¹²⁰ In contrast, in the modern system of regulation, "just and reasonable" could be interpreted to refer to discrimination between recipients as well as between mailers.¹²¹ Then, too, § 403(c) applies to competitive products, whereas the modern system of regulation applies only to market dominant products. Furthermore, § 403(c) is directly applicable to the Postal Service. In the modern system of regulation, the "just and reasonable"

¹¹⁹There seems to be no evidence that the term "just and reasonable" in the postal statute is used as a term of art.

¹²⁰See § 101(d) ("to apportion the costs of all postal operations to all *users* of the mail"); § 206(a) ("representatives of major mail *users*" as opposed a representative of the "public at large"); § 3622(c)(3) ("effect of rate increases upon the general public, business mail *users*"); § 3622(e)(4)(C) ("*users* of postal services who do not take advantage of the discount rate"); § 3627 ("revenues received from the *users* of such class"); § 3661(c) ("an opportunity for hearing on the record . . . has been accorded to the Postal Service, *users* of the mail, and an officer of the Commission who shall be required to represent the interests of the general public"). *But cf.* Egger v. United States Postal Service, 436 F. Supp. 138 (W.D. Va. 1977) (court held § 403(c) did not prohibit different levels of delivery to different groups of mail users as long as distinctions are reasonable but did not examine whether addressees were "users").

¹²¹For market dominant products, Objective (8), § 3622(b)(8), which requires a "just and reasonable schedule for rates and classifications," must be "applied in conjunction with" Objective (3), § 3622(b)(3), which requires the modern system of regulation maintain service standards established under § 3691. These service standards, in turn, explicitly address the needs of both "both senders and recipients." § 3691(b)(1)(A). Thus it seems that Objective (8), read in conjunction with Objective (3), may require the modern system of regulation to include recipients as well as senders in its concept of justness and reasonableness.

standard is an objective which must be incorporated into Commission regulations before a party can bring a complaint under § 3662. Thus, enforcement of § 403(c) via the complaint process and the “just and reasonable” standard in the modern system of regulation play different and complementary legal roles.

The other standard for redressing preferential treatment via the complaint procedure is provided by § 101(d), which declares that, “Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a *fair and equitable basis*.” As noted above,¹²² the “fair and equitable” factor was explicitly omitted from the modern system of regulation. How can this omission be reconciled with the fact that the Postal Service is nonetheless required, as matter of general policy, to apportion costs among mailers (§ 101(d) is also limited to “users”) on a “fair and equitable” basis, and mailers are specifically authorized to seek redress from Commission via the complaint procedure? First, it should be noted that “fair and equitable” in § 101(d) it is not an absolute command; it must be read in the context of the other policies. That is, § 101(d) is only an instruction to apportion costs in a “fair and equitable” manner to the extent consistent with the other policies listed in § 101. Secondly, read literally, the statute directs the Commission to design a modern system of regulation that is just and reasonable without the extra scrutiny and adjudication that may be required to protect considerations of fairness and equity lying outside the “just and reasonable” standard. Nonetheless, says the statute, the Postal Service must pay attention to the general policies set out in § 101 and, where a mailer feels that the Postal Service has paid too little attention to the “fair and equitable” aspects of this menu of policies, the mailer may ask the Commission to review and, if necessary, remedy the unfairness. In short, enforcement of the “fair and equitable” standard is set out as an extraordinary remedy, not an element of regulatory design. A fortiori, use of the complaint procedure to impose “fairness and equity” on competitive products should be a still more extraordinary remedy. Since, read literally, the statute appears reasonable and sensible, it should be applied in this manner.

9.1.2 Postal Service rulemaking: § 401(2) and § 404a

Including subsections § 401(2) and § 404a in the complaint jurisdiction gives the Commission authority to quash Postal Service regulations if it concludes that the regulations exceed the authority of the Postal Service. Specifically, § 401(2) authorizes the Postal Service

(2) to adopt, amend, and repeal such rules and regulations, *not inconsistent with this title, as may be necessary in the execution of its*

¹²²See section 5.2.2(a), above.

functions under this title and such other functions as may be assigned to the Postal Service under provisions of law outside of this title

Again, under § 3662(c), if the Commission determines that the Postal Service has acted not “in conformance with” this subsection, it may “take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance.” It appears, then, that the Commission may quash regulations which are not “in conformance with” the authority granted by § 401(2). In the past, adversely affected parties have questioned the Postal Service’s authority to issue certain regulations including, for example, regulations relating to private express laws, international postal treaties, commercial receiving agencies, and cooperative mailing arrangements.

Similarly, § 404a prohibits the Postal Service from adopting certain types of regulations, as follows:

- (a) Except as specifically authorized by law, the Postal Service may not—
 - (1) *establish any rule or regulation (including any standard) the effect of which is to preclude competition or establish the terms of competition* unless the Postal Service demonstrates that the regulation does not create an unfair competitive advantage for itself or any entity funded (in whole or in part) by the Postal Service;
 - (2) compel the disclosure, transfer, or licensing of intellectual property to any third party (such as patents, copyrights, trademarks, trade secrets, and proprietary information); or
 - (3) obtain information from a person that provides (or seeks to provide) any product, and then offer any postal service that uses or is based in whole or in part on such information, without the consent of the person providing that information, unless substantially the same information is obtained (or obtainable) from an independent source or is otherwise obtained (or obtainable).
- (b) *The Postal Regulatory Commission shall prescribe regulations to carry out this section.*

Thus, the Commission may adopt regulations establishing such guidelines and remedies as it deems necessary to implement § 404a.

9.1.3 Postal monopoly exceptions: § 601

A complaint may allege a violation of § 601. This section sets out certain exceptions to the postal monopoly. Private operators may carry letters out of the mails if they conform to § 601. Since § 601 is directed to private companies and not to the Postal Service, how could a complainant claim that “the Postal Service is not operating in conformance with the requirements of” this provision? The

only apparent basis would be efforts by the Postal Service to mislead mailers as to the true scope of § 601 or to search for (under § 603 or § 605) and seize (under § 604) letters lawfully carried by private carriers in conformance of § 601. While such activities by the Postal Service would possibly be appropriate grounds for Commission intervention, they hardly seem likely.

9.1.4 Regulatory framework for rates and services: chapter 36

The final ground for complaint is Postal Service action not in conformance with chapter 36. However, almost all of the norms established under authority of chapter 36 are regulatory norms established by the Commission. Since, under § 503, the Commissioners are separately empowered to “promulgate rules and regulations and establish procedures, . . . and take any other action they deem necessary and proper to carry out their functions and obligations” under chapter 36, it is unclear whether the complaint procedure gives the Commission any additional enforcement authority. Certainly, section § 3662 limit the discretion of the Commission to *withhold* relief upon complaint.

Probably the only material effect of including chapter 36 with the complaint jurisdiction of the Commission is to allow the Commission to enforce certain provisions of chapter 36 which directly address the Postal Service or postal rates. As noted above,¹²³ these include requirements relating to reduced rates for certain types of mail (§ 3626 and § 3629) and a requirement to maintain uniform rates for books and films (§ 3683).

9.2 Remedies – suspension

Subsection § 3622(c) provide for the following remedies in case the Commission finds a complaint justified:

(c) Action Required if Complaint Found To Be Justified.—If the Postal Regulatory Commission finds the complaint to be justified, it shall order that the Postal Service take *such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance* (such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering the Postal Service to discontinue providing loss-making products, or requiring the Postal Service to make up for revenue shortfalls in competitive products).

Subsection § 3622(d) further provides for fines in case of deliberate non-competitive.

¹²³See section 2.4 (reduced rates) and section 2.3 (uniform rates), above.

Under § 3622(c), can the Commission suspend a new rate or classification that a complaint demonstrates to be prima facie contrary to Commission regulations pending a final determination? It is clear that the Commission can order an unlawful rate change or classification canceled. It is also evident that § 3681 prohibits the Commission from ordering the Postal Service to reimburse after charging an unlawful rate.¹²⁴ In view of the Commission's lack of authority to order reimbursement, it does appear beyond the discretion of Commission to assume authority to suspend a new rate or classification where a complaining party makes a strong prima facie case for suspension appears to be the course that can "remedy the effects of any noncompliance."

¹²⁴Section § 3681 provides, "No mailer may be reimbursed for any amount paid under any rate or fee which, after such payment, is determined to have been unlawful after proceedings in accordance with the provisions of sections 3662 through 3664 of this title."