

Commission has developed a coherent, practical set of implementing regulations that is faithful both to the text and the fundamental purposes of the PAEA.

Illustrative of the high quality of the Commission's work are its treatment of the overarching issue of the "hierarchy" of policy values implicit in the structure of the PAEA and its resolution of the textual conundrum created by the Act's definition of the term "product."

In response to voluminous, often challenging commentary addressing the "hierarchy" of policy objectives embodied in the PAEA, the Commission has declined to prejudge the merits of differing interpretations of specific statutory "Objectives" and "Factors" but has embraced a sound general principle on which nearly all commenters are in agreement:

These comprehensive provisions unequivocally establish subsection 3622(d) as the administrative cornerstone of the new rate setting system for market dominant products. Collectively, streamlined advance review procedures, the price cap mechanism, the banking exception, and the exigency clause are designed to foster pricing flexibility, reduce burden, and facilitate quick implementation of rate changes.

72 FED. REG. 50745 [¶ 2009].

In keeping with this principle, the Commission has rejected suggestions that the scope of issues considered in pre-implementation review of market-dominant rates essentially replicate the scope of issues in a traditional omnibus rate case. It has instead accepted the view that "we have to keep proceedings simple and rules of practice simple to avoid a system that only postal attorneys and economists can use."²

² 72 FED. REG. 50746 [¶ 2012] (quoting Testimony of William S. Berkley, President and CEO, Tension

In coming to grips with one of the Act's more daunting textual challenges-- making sense of the statutory definition of the term "product" (39 U.S.C. § 102(6))-- the Commission has provided a careful, closely reasoned analysis that keeps the overall statutory scheme firmly in view and avoids doing violence to the literal terms of the definition:

Suggestions that the term "product" be applied in a blanket fashion are neither practical nor justified. . . . Plainly, product cannot reasonably be read as equivalent to subclass since product is defined as having either "a distinct cost or market characteristic"⁶⁹ whereas, under the Commission's long-established practice, subclass requires both cost *and* demand differences. . . .

Rate cells generally reflect cost differences, but that is not the same as having separate distinct cost characteristics. There are myriad cost driving factors, *e.g.*, degree of preparation, density, weight, shape, distance, and type of delivery, that may be characterized as cost characteristics. Rate cells identify variations within characteristics such as zoned rates, or levels of presortation. . . . [T]he existence of a separate rate, implying a cost difference, does not require that the particular postal service, *e.g.*, rate cell, be deemed a product. A rule of reason must be applied. . . .

Transparency cannot be achieved if the term "product" is applied too broadly, *e.g.*, solely at the subclass level. Aggregating postal services into only a few products, a result urged by several parties, forfeits transparency and serves no legitimate business or regulatory need. . . . By the same token, pricing flexibility is illusory if the term "product" is applied too narrowly, *e.g.*, at the rate cell level. Disaggregating postal services into too many products would impose unwarranted administrative burdens on the Postal Service, thwart pricing flexibility, and serve no legitimate business or regulatory need.

72 FED. REG. 50765-66 [¶¶ 3063-64, 3066-69].

Time Warner therefore believes that the proposed rule deserves high commendation. There are, however, three issues respecting which, revisions to the proposed rule are desirable. One of these involves the elimination of a potential ambiguity respecting the scope of pre-implementation review of adjustments to market-dominant rates. Another involves the reservation of judgment by the Commission on the question of whether after-the-fact review of compliance with the annual limitation of § 3622(d) is either desirable or permissible. And the third involves the uncharacteristic importation into the PAEA of a standard for negotiated service agreements that was applied under the Postal Reorganization Act (PRA) but that appears to be inconsistent with the text and spirit of the PAEA.

2. The Commission should make clear that pre-implementation review of adjustments to market-dominant rates pursuant to § 3622(d)(1)(D) is confined to the issue of compliance with the annual limitation

A potential ambiguity concerning the scope of pre-implementation review of market-dominant rates pursuant to § 3622(d)(1)(D) is created by two of the proposed regulations: § 3010.13(b)'s provision for public comments addressing, in addition to "[w]hether the planned rate adjustments . . . are at or below the annual limitation," whether they are "consistent with the policies of 39 U.S.C. § 3622" (thus including, *inter alia*, compliance with the "Objectives" and "Factors" sections of the Act); and § 3010.14's requirement that the Postal Service include extensive information regarding workshare discounts in its "notice of rate adjustment." 72 FED. REG. 50778. That the Commission does *not* intend the scope of pre-implementation review to include compliance with "the policies of . . . § 3622" in general, or compliance with the workshare requirements of § 3622(e), seems apparent both

from a careful reading of the explanatory text regarding these provisions and from proposed § 3010.13(c), which provides in relevant part:

(c) Within 14 days of the conclusion of the public comment period the Commission will determine whether the planned rate adjustments are consistent with the test for compliance with the annual limitation and issue a notice and order announcing its findings.

(1) If the planned rate adjustments are in compliance with the annual limitation and, if applicable, with the exception for unused rate adjustment authority, they may take effect; . . .

72 FED. REG. 50778.

To prevent possible misunderstanding, however, the Commission should state unambiguously that pre-implementation review of announced rate adjustments will be limited to the issue of compliance with the annual limitation and that the regulations providing for public comment on compliance with other provisions of § 3622 and for the filing by the Postal Service of information regarding workshare discounts are not intended to provide an additional basis for pre-implementation review. Time Warner assumes that these regulations are intended to insure that the Postal Service is duly mindful of all of the provisions of § 3622 when it prepares rate adjustments, and perhaps to facilitate eventual enforcement of those provisions in annual review or complaint proceedings. If this interpretation of what the Commission intends is correct, we believe that it might help to prevent misunderstanding were the Commission to so state unambiguously.

3. The Commission should reject all suggestions for "after-the-fact" reviews to assess compliance with the cap

An issue of great importance to the successful implementation of price-cap regulation is whether, as a test of compliance, it is appropriate to calculate the percentage increase of a rate proposal using before-rates billing determinants or whether some kind of "after-the-fact review" may be needed. Beginning at the pre-implementation stage, Order No. 26 introduces this issue as follows:

[T]o determine compliance in the context of a pre-implementation compliance review of a notice of rate adjustment, it is necessary to develop rules that provide a means of calculating the aggregate percentage change in rates for each class. To accomplish this, weights (in the form of billing determinants) must be applied to the set of rates that comprise a class.

72 FED. REG. 50754 [¶ 2070].

Then, after reviewing the "near universal support for the Postal Service's proposed approach" of "apply[ing] the most recent available billing determinants to the current rates, then apply[ing] the same billing determinants to the new rates and compar[ing] the resulting revenues," the Commission explains:

The Commission's proposed rules calculate the percentage change in rates using the most recent available billing determinant[s] as weights.

72 FED. REG. 50754 [¶ 2075].

However, having arrived at what we believe should constitute the first and last hurdle of compliance, the Commission proceeds to leave the door open at least a crack to the possibility that compliance cannot really be assured without waiting for after-rates volumes, saying:

Some commenters suggest that the after-the-fact review will be the most effective means of ensuring compliance with the rate cap. . . . The statute requires the Commission to monitor the effectiveness of these rules and consider modifications to improve their effectiveness as events warrant.³

That the Commission stops short of rejecting categorically the need for “after-the-fact” reviews appears based on a concern that its pre-implementation analysis, using before-rates billing determinants and no forecast, “is not a perfect measure of what the actual change in rates will be.” 72 FED. REG. 50754 [¶ 2077]. It is of course true that the “adjustments for classification changes will be imperfect” and that the “billing determinants to be used will likely not correspond to a single set of rates.” *Id.* One could add in addition that there will be a gap between the end of the billing determinant period and the date of implementation of the rate adjustment. But these imperfections are no more than standard fare for estimates, and they do not make after-the-fact review an attractive alternative.

Time Warner understands that there are difficulties associated with the estimation of before-rates billing determinants and that some effort will be required to develop defensible estimates. However, there are also practical difficulties associated with after-the-fact estimates and their use, including, importantly, the fact that there is a powerful theoretical case against the proposition that “after-the-fact review will be the most effective means of ensuring compliance with the rate cap.”

Among the commenters that the Commission cites as favoring this proposition is James I. Campbell Jr., who argues that a revenue cap for the period

³ 72 FED. REG. 50754 [¶ 2077] (*citing* PostCom Comments, June 18, 2007, at 4-6; Transcript of Wilmington Field Hearing, July 9, 2007, at 47 [Emens]; and Campbell, James, *An Analysis of Provisions of the Postal Accountability and Enhancement Act Relating to the Regulation of Postal Rates and Services*, August 3, 2007, at 52-55 [hereinafter “Campbell”]).

during which the new rates are in effect should be calculated by applying the CPI-U cap to the sum-product of the old rates and *the new volumes*. Campbell recommends that if the actual revenue is less than the revenue cap, so calculated after the fact, the difference (expressed in percentage terms) should be *banked* as unused rate authority so that the Postal Service can use it in the future to increase rates even further. Campbell at 54-55.

The alternative positions, calculating the percentage rate change prospectively, based on pre-implementation billing determinants, or calculating it retrospectively, based on billing determinants for the year the rates are actually in effect, boil down, respectively, to a choice between using a Laspeyres index and a Paasche index. Both indexing schemes can be represented by the formula the Commission provides in proposed § 3100.23(c), using, as the Commission does for the *rate* variable, a “c” for current or an “n” for new. Specifically, if the volume variable, *V*, is given the subscript “c”, the formula becomes a Laspeyres index, and if *V* is given the subscript “n”, the formula becomes a Paasche index. The Commission, however, did not put time subscripts on the volume variable.

As a practical matter, taking the Paasche approach presents nothing but difficulties. First, the new billing determinants will either involve a mixture of the old and new rates or their period will not begin until some months after the rates go into effect. Second, mailers adjust to rates over substantial periods, so that it could not be claimed that the new volumes represent mailers' responses to the rate adjustments. Third, another rate increase would be implemented before the retrospective review could be completed. That is, rate-1 is implemented, rate-2 is

implemented, and then the actual volumes for rate-1 become available, but they are not aligned with the rate-1 period and they do not represent full adjustment by mailers.

Fourth, since mailers tend to shift away from mail categories receiving relatively large rate increases, it is the case that a Paasche-calculated increase tends to be lower than a Laspeyres-calculated increase. This means that if a Laspeyres approach is used in the pre-implementation review and compliance is then checked retrospectively with a Paasche index, the result will generally be unused rate authority that can be used down the road by the Postal Service as a basis for further rate increases. These could be called gap rate increases or mid-course corrections; Campbell uses the term “shortfall.” Campbell at 55. There is no evidence in the text of the Act or its legislative history even hinting that such a result was contemplated by the authors of the PAEA.

These reasons alone provide support for using a Laspeyres index.

But the issue has more dimensions than just practicalities. There is a literature on the alternative indexes (Laspeyres and Paasche) that deals not only with the nature of the indexes themselves, but also with their suitability for use in conjunction with price caps.

The use of a Paasche index would undermine the efficiency gains that a price-cap regime is meant to foster. One way to look at this is from the base that mailers are not *required* to make any adjustments at all in their volumes. When they do, therefore, it is to their benefit. That is, the mailer shifts his volume, he gains (or he would not shift), and the revenues and costs of the Postal Service decline. It is

important that if the rates are cost-based, the change in revenue and cost of the Postal Service will be about equal, so that the Postal Service should be relatively indifferent to the change. It is also important that these adjustments by mailers are part of any efficiency improvements brought about by the new rates, designated by Congress to be important, see § 3622(b)(1). Improvements of this kind should not be mitigated by further rate increases. Second, it has been shown in the literature, and is widely accepted, that if a Laspeyres index is used as a pre-implementation guide *and* as a test of compliance, the regulated enterprise will have an incentive to set rates that are economically efficient.⁴

For these reasons, Time Warner believes that the Commission should clarify that a Laspeyres index will be adopted as a test of compliance with the CPI-U cap and that before-rates subscripts (in context, a “c” for current) should be attached to the volume variable (V) in the formula in § 3100.23(c) of the proposed regulations.

⁴ See Vogelsang, Ingo, “Price Cap Regulation of Telecommunications Services: A Long-Run Approach,” February, 1988, A RAND Note; Bradley, Ian and Price, Catherine, “The Economic Regulation of Private Industries by Price Constraints,” *Journal of Industrial Economics*, XXXVII No. 1 (September 1988), pp. 99-106; and Vogelsang, Ingo, “Incentive Regulation and Competition in Public Utility Markets: A 20-Year Perspective,” *Journal of Regulatory Economics*, 22:1 (2002), pp. 5-27. In the latter article, after discussing the efficiency properties of using a Laspeyres index, Vogelsang notes: “Paasche indices have very undesirable properties and, to my knowledge, are not directly applied anywhere.” p. 12, fn. 14.

4. The proposed rule applies a standard for negotiated service agreements that is consistent with the PRA but not the PAEA

In setting out the requirements for negotiated service agreements, the Commission appears to import into the PAEA a standard that was applied under the PRA, not merely without textual warrant but contrary to the import of the statutory text. Order No. 26 states:

The foundational argument in support of negotiated service agreements is that they can be structured to benefit the participating mailer and the Postal Service, while not harming (and hopefully, benefiting) non-participating mailers.

72 FED. REG. 50755 [¶ 2080].

Consistent with this generalization, the proposed regulation governing "Contents of notice of agreement in support of a negotiated service agreement" requires, among other things, "[a]n analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement." 72 FED. REG. 50780 [§ 3010.42(d)(3)].

A requirement that no other mailer be disadvantaged as a consequence of a negotiated service agreement, whatever its merits under the PRA, finds no support in the text of the PAEA, which instead requires that such agreements "do not cause *unreasonable* harm to *the marketplace*." § 3622(c)(10)(B) (emphasis added).⁵

It is not difficult to fathom the purpose of a requirement that no other mailers be harmed under a regime such as the PRA, in which (1) due to the breakeven

⁵ When the authors of the PAEA intended to establish a rule that no other mailers be harmed, they did so expressly. See § 3622(e)(4)(C), requiring the Postal Service to certify that a discount "will not adversely affect rates or services provided to users of postal services who do not take advantage of the discount rate."

requirement, if the Postal Service incurs losses in providing service to one ratepayer, it must recoup those losses by charging higher rates to other ratepayers, and (2) the Commission effectively sets all rate levels with an eye to the "implicit" cost coverage borne by different types of mail and different mailers. Under the PRA, losses on one product necessitated higher rates for others. Under the PAEA, the replacement of the breakeven requirement by price caps prevents losses on one product from triggering compensating rate increases for other products. Under the PRA, a negotiated service agreement that caused an increase in the institutional cost contribution of non-participating mailers could be seen as altering or circumventing the carefully considered rate relationships recommended by the Commission in an omnibus rate proceeding. But under the PAEA, as the Commission correctly observes, It is "to be expected that rate adjustments within a class will be both above and below average." 72 FED. REG. 50748-49 [¶ 2036]. Consequently, the Commission will no longer be in a position to establish implicit cost coverages within the market-dominant classes. Whenever some rates are increased by a percentage that is less than the annual limitation, others may be increased by a percentage that is greater, and their implicit cost coverages may rise as a consequence.

Under the PAEA, as Order No. 26 observes, "concerning market dominant products, the price cap regulation supersedes attribution." 72 FED. REG. 50766 [¶ 3066]. The proposed requirement that negotiated service agreements not harm any non-participating mailer, making negotiated service agreements the *only* rate adjustments subject to such a rule under the PAEA, would have the perverse effect of making negotiated service agreements an exception to this fundamental shift in

regulatory approach. In this one instance--its conception of negotiated service agreements--the Commission has seemingly failed to fully accommodate the PAEA's "fundamentally different approach to rate regulation for market dominant products." 72 FED. REG. 50748 [¶ 2029]. Time Warner respectfully urges the Commission to reassess its views on this matter.

Conclusion

Time Warner appreciates the full opportunity for commentary and debate on the meaning of the PAEA that the Commission continues to provide and commends the Commission for the commitment to "honor[ing] the spirit and letter of the new law" (72 FED. REG. 50748 [¶ 2029]) that is manifest in its proposed implementing regulations.

Respectfully submitted,

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