

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

**Regulations Establishing System
of Ratemaking**

Docket No. RM2007-1

**COMMENTS OF PITNEY BOWES INC. IN RESPONSE TO ORDER
PROPOSING REGULATIONS TO ESTABLISH A SYSTEM OF RATEMAKING**

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I. INTRODUCTION

Pursuant to PRC Order No. 26 (August 15, 2007), the Order Proposing Regulations to Establish a System of Ratemaking (Order), Pitney Bowes Inc. (Pitney Bowes) hereby submits these comments on the proposed rules.

As an initial matter, Pitney Bowes commends the Postal Regulatory Commission (Commission) for moving so far, so fast. The Commission's acceleration of the schedule for implementing the new ratemaking system benefits all stakeholders in the mailing community and will allow the Postal Service to transition effectively to the modern ratemaking system.

Many of these comments are in the nature of an endorsement. The Commission's proposed rules successfully capture the letter and intent of the Postal Accountability and Enhancement Act (PAEA).¹ The proposed rules appropriately balance the often competing statutory objectives of pricing flexibility, predictability, and stability. The proposed rules also establish an important and continuing active role for the Commission in administering the modern ratemaking system.

The Commission understandably did not endeavor to address every issue that might arise under the PAEA. It could not, and should not, have done so in the time it allowed itself. Nevertheless, Pitney Bowes appreciates the Commission's effort to fashion clear, advance guidance as to the functional framework of the new ratemaking system. Clear, advance guidance will promote stability, economy of resources, and future investment in the mailstream.

¹ See Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006).

II. RULES APPLICABLE TO MARKET DOMINANT PRODUCTS

A. Comments on Subpart B – Rules for Rate Adjustments of General Applicability (Type 1 Rate Adjustments)

1. To Satisfy Important Policy Objectives of the PAEA, the Commission’s Rules Should Further Encourage Cost-Reflective Rates as a Means to Promote Efficiency and Protect Competitive Access.

The Commission correctly recognizes “that efficient component pricing should be used as a guiding principle in establishing and maintaining workshare discounts.” Order at 23. The first stated objective of the modern system of rate regulation under the PAEA is “to maximize incentives to reduce costs and increase efficiency.” 39 U.S.C.

§3622(b)(1). This paramount statutory objective should serve as the touchstone for the Commission’s proposed rules. No other objective better serves to promote and sustain a vibrant, growing mailing industry, enhance the value of the mailstream, and ensure universal, affordable mail service. To achieve this objective, the Commission’s rules should require, to the maximum extent practicable, cost-reflective pricing through the application and extension of the principles underlying efficient component pricing (ECP).

Below we discuss how the proposed rules may be revised to better ensure ECP is observed as a “guiding principle” and comment on concerns expressed by others.

a. The Proposed Workshare Rules Should Be Amended to Promote Efficiency and Minimize Uncertainty.

Proposed rule 3100.14(b) should be amended as follows:

(6) Separate justification for all proposed workshare discounts that exceed avoided costs. Each such justification shall reference applicable reasons identified in 39 U.S.C. 3622(e)(2) or (3). The Postal Service shall also identify and explain discounts that are set ~~substantially~~ below avoided costs and explain any relationship between discounts that are above and those that are below avoided costs.

This change would improve the proposed rule in several respects. First, the amended rule would better reflect the Commission’s general adoption of ECP as a “guiding principle” for establishing and maintaining workshare discounts. Second, it would better serve important policy objectives of the PAEA, promoting productive efficiency of the postal sector by increasing the likelihood that workshare discounts pass through 100 percent of the avoided costs.

Revising this rule also serves a practical purpose. Because the qualifying adjective, “substantially,” is not a defined term in the proposed regulations and is inherently subjective, the proposed amendment would help avoid uncertainty and litigation regarding what constitutes a “substantial” deviation from avoided costs. The Commission could articulate a specified range or particular number (e.g., 85 percent), but there is no principled reason to deviate from 100 percent pass through. Deviations should be the exception, not the rule.

Finally, the revised rule would not prejudice any party, including the Postal Service. It would not preclude the Postal Service from proposing rates that vary from ECP if that is consistent with the objectives and factors of the PAEA. It simply requires that if the Postal Service departs from cost-reflective pricing it must explain why it has done so.

b. Efficient Component Pricing and Cost-Reflective Rates Should be Applied to Non-Workshare Related Cost Differences.

The Commission correctly recognizes ECP as a “guiding principle” in establishing and maintaining workshare discounts. Order 26 at 23. The Commission, however, should clarify that ECP is a “guiding principle” not just with respect to

workshare discounts, but also to ensure cost differences are reflected in rates. As the Commission noted in its most recent Opinion and Recommended Decision:

The basic economic argument in support of cost-based rate differentials is the same as that for avoided cost worksharing discounts. 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.

PRC Op. R2006-1, ¶ 4023 (citing and quoting the Testimony of Pitney Bowes witness John C. Panzer, PB-T-1 at 45-46).

The Commission concluded that witness Panzar's argument was persuasive and that,

[t]he virtue of ECP or an ECP approach beyond worksharing is that it continues to promote productive efficiency. Just as ECP should produce the least cost mail by incentivizing a mailer or third party to workshare if it can perform mail processing or transportation more cheaply than the Postal Service, so too it should provide appropriate incentives to minimize costs in the case of shape and other mail characteristics.

PRC Op. R2006-1, ¶ 4024.

The arguments in favor of extending ECP and cost-reflective pricing to non-workshare related cost differences apply with even greater force under the modern ratemaking system. The principles underlying ECP can and should be extended by the Commission regulations to apply to all cost-causative characteristics of mail including shape, weight, distance, payment evidencing, address hygiene and others. As with workshare discounts, if the Postal Service departs from cost-reflective pricing it should be required to explain why it has done so.

c. Concerns about ECP Are Misplaced.

In the explanatory discussion accompanying the proposed rules, the Commission cited “reasons [posited by others] that ECPR should not be followed in setting rates under the PAEA.” Order at 22 (citing and quoting Advo Reply Comments, May 7, 2007, at 6). As perhaps the foremost proponent of ECP as the guiding principle under the PAEA, we believe this discussion deserves brief comment.

The first reason cited is that “the statute does not permit consideration of factors other than compliance with price caps in the review process.” *Id.* But this statement confuses the scope of the Commission’s review under section 3622(d)(1)(C), the 45-day “quick look” review, with the Commission’s review in connection with the annual determination of compliance under section 3653. By its terms, the Commission’s annual determination of compliance under section 3553(b)(1) is substantially broader than its 45-day review of the price cap. The statute requires the Commission to make a written determination as to “whether any rates or fees in effect during the year . . . were not in compliance with *applicable provisions* of this chapter[.]” 39 U.S.C. § 3653(b)(1) (emphasis added). The fact that “quick look” compliance review is limited to price cap compliance issues, as Pitney Bowes has consistently maintained that it is, has no bearing on the Commission’s authority (or statutory obligation) in the context of the annual determination of compliance under section 3653 to require the Postal Service to justify rate differences that fail to reflect cost differences.

The second reason cited for not following ECP is that “although useful in theory as a pricing tool, [it] is not the only appropriate consideration.” Order at 23 (citations omitted). We agree, but that is no reason to exclude ECP as a relevant consideration.

None of the parties advocating in favor of ECP are suggesting that the Commission apply ECP mechanically, nor has the Commission ever done so. Rather, the Commission is urged to develop rules that require a presumption in favor of ECP-compliant or cost-reflective rates. To the extent the Postal Service must deviate from that presumptive starting point, it should identify and explain its reasons, as suggested above.

The third reason cited is that “the adoption of ECP . . . will inevitably and unnecessarily impinge on the Postal Service’s pricing flexibility[.]” *Id.* Although it overstates the case, this concern does raise the important question of the interplay among independent, and often competing, statutory objectives. One of the central features of the PAEA is the expanded pricing flexibility afforded to the Postal Service. This expanded pricing flexibility is critically important to the Postal Service and should inure to the benefit of all stakeholders in the mailing community. Nevertheless, this new authority is not absolute and must be viewed in the context of the PAEA. The PAEA’s promotion of expanded procedural flexibility should not be read to relieve the Postal Service from complying with other statutory objectives and factors. In fact, in several important respects the PAEA directly limits the pricing flexibility of the Postal Service. For example, section 3622(e) imposes limitations on workshare discounts and section 3622(c)(2) imposes a “requirement” that each class of mail or type of mail service cover its attributable costs. *See* 39 U.S.C. §§ 3622(e), 3622(c)(2).

Because the PAEA requires, subject to certain enumerated exceptions, that worksharing discounts cannot exceed the avoided costs of the Postal Service, to the extent that the Postal Service exercises its pricing flexibility to depart from full recognition of cost differences in rate differences, it will most likely depart in the

direction of passing through less than the full measure of the avoided costs. As a practical matter, such departures will impair the productive efficiency of the postal sector and will exclude more efficient providers of upstream postal services. Accordingly, if the Postal Service departs from cost-reflective pricing it should be required to explain why it has done so.

2. The Proposed Rules Regarding the Notice of Rate Adjustment Appropriately Balance the Statutory Objectives of Reduced Administrative Burden and Enhanced Transparency.

Section 3622(b)(6) provides that the Commission shall design a modern ratemaking system for market dominant products to “reduce the administrative burden and increase the transparency of the ratemaking process.” 39 U.S.C. § 3622(b)(6). The proposed rules addressing the schedule and procedures for proposed rate adjustments facilitate these potentially competing objectives by promoting increased procedural pricing flexibility while at the same time ensuring that interested parties are afforded a meaningful opportunity to review the proposed rates. *See* proposed 39 C.F.R. § 3100.13. These rules require the Postal Service to provide sufficient contemporaneous data and information to allow interested parties to assess the underlying cost basis for and relationships among rates. The rules require the Postal Service to discuss how its proposed rates will help achieve the PAEA’s objectives and take into account its factors. *See* proposed 39 C.F.R. § 3100.14(b)(7). This will help determine compliance with the policies of the PAEA.

The proposed rules afford interested parties the opportunity to file comments on cap compliance issues and issues of general compliance with the policies of the PAEA but limit the Commission’s review upon the notice of rate adjustment to price cap

compliance issues. Thus, it appears the Commission does not intend to allow this process to develop into a “mini” rate case. It should not. With the exception of *new* statutorily-defined workshare discounts, workshare discounts and other compliance determinations should be reserved for the annual determination of compliance under section 3653, not the “quick look” process contemplated under section 3622(d).

The proposed rules also simplify, to the extent possible, determinations as to compliance with the PAEA’s workshare discount limitations under section 3622(e) by providing that these will be based on historical avoided cost information as developed in the Commission’s most recent Annual Compliance Report. This approach is consistent with the use of historical data for purposes of determining the annual limitation under section 3622(d)(1)(A), and should minimize the administrative burden on the Postal Service. Because the underlying cost relationships will change over time, the Postal Service and interested parties should be afforded the opportunity to review the underlying methodologies and the cost models during the annual compliance process. This issue should be addressed in the regulations on reporting requirements necessary to implement section 3652.

Similarly the proposed rules minimize the administrative burden on the Postal Service in connection with the workshare reporting requirements under section 3622(e)(4). *See* 39 U.S.C. § 3622(e)(4). The proposed rules appropriately distinguish between newly “establish[ed]” workshare discounts and existing discounts for purposes of both the nature of the information and data required and when that data and information must be provided.

With respect to the timing of the notice of rate adjustment, section 3622(d)(1)(C) provides that “not later than 45 days before implementation of any adjustment” the Postal Service must provide public notice of the proposed rate adjustment. 39 U.S.C. § 3622(d)(1)(C). Proposed rule 3100.10 appropriately emphasizes that forty-five days is the minimum notice period, not a maximum. *See* proposed 39 C.F.R. § 3100.10. Rule 3100.10(b) also correctly encourages the Postal Service to provide as much advance notice as possible to ensure a successful implementation of its rate changes, particularly when additional time will be needed for the development of software and systems necessary to implement more complex rate changes that involve classification or operations changes likely to have material impact on mailers. *See* proposed 39 C.F.R. § 3100.10(b). Ample advance notice is critical to smooth implementation of rate changes.

B. Comments on Subpart C – Rules for Applying the Price Cap

The proposed rules for applying the price cap are well developed and will provide enhanced rate predictability and stability. The Commission appropriately adopted the 12-month moving average method for purposes of calculating changes in the Consumer Price Index (CPI). As explained in the previous comments of Pitney Bowes and other parties, this methodology exhibits greater fidelity to the language of section 3622(d) and furthers the statutory objective that the new rate system “create predictability and stability in rates,” 39 U.S.C. § 3622(b)(2), by smoothing out variations in the monthly percentage changes in the CPI.

The proposed rules also appropriately require the use of historical data to measure volume and revenue for purposes of determining compliance with the annual limitation. This use of historical volume weighted averages is consistent with the PAEA and has

several advantages. First, the use of historical volume weights provides a simple and verifiable means of determining whether proposed rate changes comply with the annual limitation. Second, as the Commission correctly observes, “any attempt to develop a forecast of billing determinants would likely be controversial and complex, and a worthwhile analysis and resolution cannot realistically be achieved in the context of the pre-implementation [45-day “quick look”] review under section 3622(d)(1)(C).” Order at 35.

The proposed rules do not address the question of how best to calculate the annual change in rates in the case of a substantially altered rate design. The Commission thus reserves for case-by-case determination what additional data or information will be required in such a case.

The Commission’s proposed rules applying the price cap properly encourage the Postal Service to pursue the pricing flexibility and product innovation contemplated by the PAEA. Under proposed rule 3100.24, mail volumes sent at non-tariff rates under negotiated service agreements (NSAs) will be either included in the calculation of percentage change as though they paid the appropriate rate of general applicability or excluded where this is impractical. *See* proposed 39 C.F.R. § 3100.24. This rule should encourage the Postal Service to pursue new product or pricing innovations, including expanded negotiated service agreements and dynamic pricing via seasonal or temporary rates, both of which are expressly accommodated in the proposed rules.

The proposed rules must be clarified, however, to make clear that the Commission will assess compliance with the annual limitation on the basis of the average revenue per piece within a particular class, and not on the basis of the actual “current rate.” The

proposed regulations may be read to require an assessment on the basis of average revenue per piece derived from historical billing determinants information. This is an appropriate approach and one that will provide mailers with the assurance inherent in the PAEA that from year to year postage rates within a given class of mail, on average, will not increase at a rate greater than inflation. Nevertheless, the proposed rules could be clearer and the explanatory narrative and the proposed rules should be further clarified to make this point explicit.

The Commission's proposed rules appropriately address how the amount of "unused rate adjustment authority" is determined and how it may be used. Rules 3100.25-28 address the use of unused rate authority under section 3622(d)(1)(C). *See* proposed 39 C.F.R. §§ 3100.25-28(7); 39 U.S.C. § 3622(d)(1)(C). The proposed rules provide that unused rate authority adjustments may be used to *supplement* or augment CPI-based adjustments, but may not be used *in lieu of* a CPI-based rate adjustment. *See* proposed 39 C.F.R. § 3100.25. The proposed rules also clarify that any "unused rate adjustment authority" may only be applied to the class from which it originated. *See* proposed 39 C.F.R. § 3100.26(b). The proposed rules thus preclude the Postal Service from circumventing the statutory price cap by transferring unused rate authority among the classes which are separately subject to the cap.

The proposed rules applying the price cap fail to address the possibility that the Postal Service may evade the strictures of the cap by reducing costs through service degradation that adversely affects mailers or by reducing its costs by imposing additional preparation or operational requirements on mailers. They also fail to address the possibility that the Postal Service could unfairly charge mailers for technological or other

innovative enhancements to mail that increase its value, but impose no costs on the Postal Service. Charging for “value added” by mailers is equivalent to a tax on innovation and should be discouraged. Either path, if taken by the Postal Service, would frustrate the purpose of the annual limitation and undercut the discipline on operational efficiency that the price cap is intended to provide.

C. Comments on Subpart D – Rules for Rate Adjustments for Negotiated Service Agreements (Type 2 Rate Adjustments)

The PAEA provides a statutory foundation for negotiated service agreements, eliminates the need for advance, on-the-record hearings and review, and significantly expands the bases for such agreements. *See* 39 U.S.C. § 3622(c)(10). Rule 3100.41 provides streamlined procedures that should appropriately facilitate the expedited implementation of NSAs under the new ratemaking system. *See* proposed 39 C.F.R. § 3100.41. Rules 3100.42-43 set forth the requirements of the notice accompanying a Type 2 rate adjustment and the data collection plan to accompany the agreement. *See* proposed 39 C.F.R. §§ 3100.42-43. We understand the Commission’s obligation to ensure that NSAs do not inadvertently have adverse effects on the mailing community as a whole and its need for information to protect against this possibility. We are concerned, however, that the procedural and data production and collection requirements imposed by the proposed rules may put NSAs beyond the reach of all but those few with very large mail volumes and substantial resources. The Commission should consider fashioning exceptions to its data production and collection requirements for small-volume mailers.

The Commission has yet to address the rules necessary to protect commercially sensitive information. We stress that these rules are critically necessary to ensure the increased use of NSAs anticipated under the PAEA.

III. REGULATION OF RATES FOR COMPETITIVE PRODUCTS

One defining feature of the PAEA is the division of postal services into two separate products lines: market dominant and competitive. Another is the substantial pricing flexibility afforded to the Postal Service with respect to its competitive product offerings. The authority to establish rates and classes for competitive products is vested solely in the Postal Service Governors, *see* 39 U.S.C. § 3632, subject to the Commission's rules preventing cross subsidy and ensuring that products are categorized correctly as either market dominant or competitive. *See* 39 U.S.C. §§ 3633, 3634, and 3642.

The Commission has fashioned proposed rules that permit and promote the exercise of pricing flexibility for competitive products. The reporting requirements, while safeguarding against cross-subsidization, are appropriately limited. The use of historical cost attribution methods for purposes of calculating compliance with the competitive products cost attribution floor will further minimize the administrative burden on the Postal Service.

The Commission's proposed rules appropriately recognize the market conditions in which the Postal Service will compete on the competitive products side. The initial quantification of the appropriate share of competitive products' contribution to institutional costs is properly established at or below historic levels.

As in the case of NSAs, however, the proposed rules are incomplete insofar as they fail to address the need to protect and minimize the disclosure of commercially sensitive information. Rules promoting pricing flexibility for competitive products will stimulate innovation and investment in the postal sector. In the private sector, against

which the Postal Service must compete, confidentiality of pricing agreements is the rule. Under the new system, required disclosure or even production of commercially sensitive information or burdensome procedural or transactional requirements or conditions will place the Postal Service at a competitive disadvantage in the marketplace and will have a chilling effect on the willingness of mailers to pursue negotiated deals. Accordingly, the Commission must promulgate rules to protect commercially sensitive information shared with the Postal Service.

IV. REGULATIONS REGARDING PRODUCT LISTS

Pitney Bowes reserves comment on the appropriate form and content of the Mail Classification Schedule until the Postal Service submits its draft on September 24, 2007.

The proposed rules regarding requests to modify the product lists within the Mail Classification Schedule should be amended to provide for a limitation of time for the Commission's review of each request and a specified duration of any further proceedings that may be warranted. As currently drafted, there is no prescribed time limit on the Commission's review or on any further proceedings that the Commission determines are necessary. Such an open ended process is inconsistent with the PAEA's direction for pricing and product flexibility and could needlessly frustrate the expanded classification authority it vests in the Postal Service. Accordingly, proposed rule 3200.34 should be amended as follows:

§ 3200.34 Review.

The Commission shall review the request and responsive comments.
Within 45 days after receipt of the request, tThe Commission shall either:

(a) Approve the request to modify the market dominant and competitive product lists;

(b) Institute further proceedings to consider all or part of the request if it finds that there is substantial likelihood that the modification is inconsistent with statutory policies or Commission rules, and explain its reasons for not approving the request to modify the market dominant and competitive product lists;

(c) Provide an opportunity for the Postal Service to modify its request; or

(d) Direct other action as the Commission may consider appropriate.

Similarly, proposed rule 3200.35 should be amended as follows:

§ 3200.35 Further proceedings.

If the Commission determines that further proceedings are necessary, a conference shall be scheduled to consider the concerns expressed by the Commission. Written statements commenting on the Commission's concerns shall be requested, to be filed 7 days prior to the conference. Upon conclusion of the conference, the Commission shall promptly issue a ruling to:

(a) Provide for a period of discovery to obtain further information;

(b) Schedule a hearing on the record for further consideration of the request;

(c) Explain the reasons for not going forward with additional proceedings and approve the request to modify the market dominant and competitive product lists; or

(d) Direct other action as the Commission may consider appropriate.

(e) In no case shall the Commission's consideration of any further proceedings delay a determination on the request more than 90 days after the date of the initial request.

Conforming amendments should also be made to proposed rules 3200.55 and 3200.56 addressing requests initiated by users of the mail to modify the product lists, and to proposed rules 3200.75 and 3200.76 addressing requests initiated by the Commission to modify the product lists.

