

**BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON DC 20268-0001**

REGULATIONS ESTABLISHING SYSTEM )  
OF RATEMAKING )

Docket No. RM2007-1

**COMMENTS OF  
NATIONAL POSTAL POLICY COUNCIL  
ON ORDER NO. 26**

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**BEFORE THE  
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**REPLY COMMENTS OF  
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ON ORDER NO. 26**

The National Postal Policy Council (“NPPC”) respectfully submits these comments in response to Order No. 26, “Order Proposing Regulations To Establish A System Of Ratemaking,” issued by the Commission on August 15, 2007, and published in the Federal Register at 72 Fed. Reg. 50744 (September 4, 2007).

The regulations proposed by the Commission in general strike a reasonable balance between the statutory goals of greater pricing flexibility and the need for residual safeguards to protect the users of market dominant products. NPPC also applauds the Commission’s efforts to issue final rules in advance of the 18-month statutory deadline for doing so. In a few areas, however, the proposed rules warrant clarification or modification. We discuss each area in turn.

**I. PROCEDURES FOR RATE ADJUSTMENTS OF GENERAL APPLICABILITY  
(RULES 3010.10 THROUGH 3010.14)**

The proposed rules for filing and review of index-based (“Type I-A”) rate adjustments are generally consistent with the language and underlying purposes of the

Postal Accountability and Enhancement Act (“PAEA”). In particular, the following aspects of the Commission’s proposals advance important goals of PAEA:

- (1) While interested parties may file comments on proposed rate changes within 20 days after the Postal Service files notice of the changes, the “proposed scope of public comment is no longer open-ended,” and the Commission “does not invite, and will not entertain, public comment during the 45-day review period on matters such as costing methods.” Order No. 26 ¶¶ 2023 and 2029; Proposed Rule 3010.13(a) and (b).
- (2) “In keeping with the new statutory emphasis on simpler proceedings, the Commission” properly “does not propose formal discovery, Notices of Inquiry, Presiding Officer’s Information Requests, testimony, [or] hearings.” Order No. 26 ¶ 2026; Proposed Rules 3010.13 and 3010.14.
- (3) The Commission, while declining to impose absolute requirement that rate relationships must satisfy the Efficient Component Pricing Rule (“ECPR”), properly proposes to give heavy weight to this criterion. Order No. 26 ¶¶ 2037-2043; see ANM-NAPM-NPPC Comments (April 6, 2007) at 16-26.

The Commission should clarify or correct these proposed rules in four respects, however. *First*, the Commission should make clear that the term “workshare discounts” covers only a subset of the potential competitive alternatives to services provided by the

Postal Service. The PAEA defines “workshare discounts” as rate discounts for “presorting, prebarcoding, handling, or transportation of mail, as further defined by the . . . Commission” in its rules. 39 U.S.C. § 3622(e)(1). By negative implication, other activities by mailers or third-party vendors that substitute for services offered by the Postal Service do not constitute “worksharing” within the meaning of Section 3622(e)(1).

These include:

- More efficient methods of purchasing and applying postage and evidencing of postage.
- More efficient methods of mail acceptance.
- Use of more efficient mailpiece shapes (e.g., letters vs. flats).

The proper pricing of these and similar activities should be governed by the judgment of the Postal Service and the Commission under ECPR principles, rather than the Section 3622(e)(2) statutory cap.

*Second*, the Commission should clarify that the cap on worksharing discounts established by 39 U.S.C. § 3622(e)(2) has five exceptions, not just the four listed in Order No. 26 ¶ 2037 n. 10. The fifth exception, set forth at 39 U.S.C. § 3622(e)(3), provides as follows:

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.

The Commission's omission of any reference to 39 U.S.C. § 3622(e)(3) in Paragraph 2037 appears to have been an oversight; the statutory provision is expressly referenced in proposed rule 3010.14(b)(6).

*Third*, the Commission should delete proposed requirement that the Postal Service, when establishing a "new workshare discount rate," certify that "the discount will not adversely affect either the rates or the service levels of users of postal services who do not take advantage of the discount." Proposed rule 3010.14(c)(3); Order No. 26 ¶ 2046. Nothing in existing law, let alone the PAEA, elevates the avoidance of such push-up effects to an absolute value that trumps all other policy considerations in rate design. To the contrary, rate increases for mailers that previously benefited from an internal cross-subsidy within the existing rate structure are a typical, if not inevitable, consequence of movement toward more efficient price signals. Hence, the Commission properly has rejected the notion that the beneficiaries of existing cross-subsidies and rate preferences within rate classes have a permanent entitlement to these benefits. The issue is not *whether* the Postal Service may move toward greater cost recognition through worksharing discounts, but how rapidly. R2005-1 PRC Op. & Rec. Decis. (Nov. 1, 2005) at ii & ¶¶ 5030-5032. As the Commission noted in connection with its decision earlier this year to deepen letter/flat rate differentials for Standard Mail, "It does not seem reasonable for mailers receiving a preference at variance with appropriate principles to say: 'It is unfair to take away the preferential treatment that has been bestowed upon me.'" R2006-1 PRC Second Opinion and Rec. Decis. on Reconsideration (May 25, 2007) ¶ 2035 (quoting Valpak witness Robert Mitchell).

The PAEA is consistent with these principles. A showing that a proposed worksharing discount would not “result in a further increase in the rates paid by mailers not able to take advantage of the discount,” 39 U.S.C. § 3622(e)(3)(B), is merely one of several alternative ways to justify making the discount deeper than cost savings. Requiring that *no* worksharing discount could exceed 100 percent of cost savings unless that test was satisfied—let alone that *no* new worksharing discount could be established unless it caused no increase whatsoever “in the rates paid by mailers not able to take advantage of the discount”—would be flatly at odds with the language and structure of PAEA.

*Fourth*, while NPPC believes that the Commission’s interpretation of the minimum notice period required by 39 U.S.C. § 3622(d)(1)(C) for Commission review of proposed rate changes is a reasonable one, it must be emphasized that the minimum notice period needed for mailers and third-party vendors to *implement* rate changes will often be considerably longer—particularly when classification changes require substantial rewriting of software. We remain encouraged in this regard that the Postal Service, which faces similar operational constraints, has indicated that it will provide mailers, vendors and consumers adequate advance notice for implementation of changes in rates and associated mail preparation requirements.

## **II. COMPUTATION AND APPLICATION OF THE PRICE CAP (RULES 3010.20 THROUGH 3010.28)**

The proposed rules for applying the price cap under 39 U.S.C. § 3622(d) are also generally sound. In particular:

- (1) The “moving average” average method proposed by the Commission for calculating the CPI-U limitation is reasonable and consistent with the statute. Order No. 26 ¶¶ 2049-2063; Proposed Rules 3010.21 and 3010.22.
- (2) Unused rate authority for a given class of mail may be applied only to the class where the authority originated. Order No. 26 ¶¶ 2064-2065; Proposed Rules 3010.26(b), 3010.27; see *also* ANM-MPA Reply Comments (May 7, 2007) at 3-6.
- (3) The weighting method for calculating the overall rate increase for a class of mail is reasonable and consistent with the statute. Order No. 26 ¶¶ 2069-2078.

The Commission should clarify or modify two aspects of these rules, however. First, the third sentence of proposed rule 3010.23(b) states that “In the case of seasonal or temporary rates, the most recently applied rate shall be considered the current rate.” This provision could be read as authorizing the Postal Service to gross up its base rates by implementing “seasonal” or “temporary” rate increases shortly before filing index-based rate increases of general applicability. Proposed rule 3010.23(a), particularly the second sentence of that rule, provides a sufficient and more appropriate standard: “seasonal or temporary rates, for example, shall be identified and treated as rate cells separate and distinct from the corresponding non-seasonal permanent rates.” The Commission should delete the third sentence of proposed rule 3010.23(b) or clarify that the second sentence of proposed rule 3010.23(a) controls.

Second, the Commission should reconsider its proposed decision not to adopt a quality adjustment to the index. Order No. 26 ¶¶ 2066-67. There is a broad consensus among the mailers in this proceeding that such an adjustment is necessary.<sup>1</sup> This consensus is also supported by the scholarly economic literature. “In contrast to cost-of-service regulation, a price-cap regulated firm has an incentive to reduce quality of service in an effort to reduce costs and increase profits.”<sup>2</sup> Attention to quality of service is particularly important in rate indexing for regulated industries that are not experiencing rapid productivity gains.<sup>3</sup>

The Commission, while emphasizing that it is “sympathetic to these concerns,” proposes to defer consideration of a quality adjustment until after the promulgation of rules for the collection of data on service performance. Order No. 26 ¶ 2067. In the

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<sup>1</sup> See, e.g., ANM-NAPM-NPPC Comments (April 6, 2007) at 7-9; DMA Comments (April 6, 2007) at 6; Mulford Associates (April 6, 2007) at 3; NNA Comments (April 6, 2007) at 10-12; OCA Comments (April 6, 2007) at 18-20; Pitney Bowes Comments (April 6, 2007) at 9; McGraw-Hill Reply Comments (July 30, 2007) at 6-7; Transcript of Kansas City field hearing (June 22, 2007) at 40 (Randy Stumbo testimony for Meredith Corporation); Transcript of Los Angeles field hearing (June 28, 2007) at 38 (John Carper testimony for Pepperdine University); Transcript of Wilmington field hearing (July 9, 2007) at 19-20 (testimony of Sr. Georgette Lehmoth for National Catholic Development Conference); *id.* at 30 (testimony of Daniel C. Emens for J.P. Morgan Chase).

<sup>2</sup> Michael A. Crew and Paul R. Kleindorfer, “Pricing, Entry, Service Quality, and Innovation under a Commercialized Postal Service,” in J.G. Sidak, ed., *Governing the Postal Service* 164-165 (1994); *accord*, Jean-Jacques Laffont and Jean Tirole, *A Theory of Incentives in Procurement and Regulation* 212, 233 (1993). This basic problem is the reason why Pentagon contract managers tend to “favor performance over cost. They often feel that fixed-price contracts encourage contractors to make ‘uneconomic’ reliability trade-offs and be reluctant to make design improvements.” *Id.* at 233 n. 13.

<sup>3</sup> Michael A. Crew and Paul R. Kleindorfer, “A Critique of the Theory of Incentive Regulation: Implications for the Design of Performance Based Regulation for Postal Service,” in Crew and Kleindorfer, eds., *Future Directions in Postal Reform* (2001).

interim, the Commission states only that it “expects that the Postal Service will operate within both the letter and the spirit of the PAEA.” *Id.* ¶ 2068.

The Commission is correct that “no commenter has suggested a method for applying such [quality] adjustments” (Order No. 26 ¶ 2067). The general principle, however, is straightforward. The appropriate adjustment is to add to the weighted average change in rates for each class (1) the additional costs imposed by changes in Postal Service mail preparation requirements, and (2) the diminution in economic value caused by changes in the quality of service. The magnitude of the adjustment (if any) should depend on the best evidence of record in the complaint proceeding or annual compliance proceeding in which the issue is raised.

Fleshing out the details of such an adjustment mechanism will become more practical once service standards and performance measurement systems are in place. The issue should be revisited as soon as possible after that occurs, as the Commission appears to contemplate doing. Relying indefinitely on nothing more than a general admonition “that the Postal Service will operate within both the letter and the spirit of the PAEA” would leave a major gap in the regulatory safeguards against abuse of the Postal Service’s residual market power.

### **III. RATE ADJUSTMENTS FOR NEGOTIATED SERVICE AGREEMENTS (RULES 3010.40 THROUGH 3010.43)**

The Commission proposes to require the Postal Service to submit an array of supporting information about proposed Negotiated Service Agreements (“NSAs”). Proposed rules 3010.40-3010.43; Order No. 26 ¶¶ 2083-2092. The breadth and detail of the required information (see proposed rule 3010.42(c)) are far greater than

necessary for the limited pre-effectiveness review that the Commission may lawfully undertake during the short notice and review period authorized by 39 U.S.C. § 3622(d)(1)(C). Experience with existing NSA proposals makes clear that disputed issues of material fact, if any, concerning matters such the “estimated mailer-specific costs, volumes and revenues” of the Postal Service with and without the NSA, and the “currency and reliability” of other cost data used as proxies for mailer specific costs (proposed rule 3010.42(c)(1), (2) and (4)) cannot be litigated within this time schedule. The current Bank of America NSA case, for example, has been pending for almost nine months, even though none of the participants opposing the NSA sought to file responsive testimony of their own.

In the context of proposed rule 3010.13(b), the Commission has recognized that the short review period authorized by Congress precludes litigation of fact-specific matters such as “costing methods.” Order No. 26 ¶ 2029. The same outcome is required for NSAs. Due process under the Administrative Procedure Act forbids the Commission from adjudicating disputed issues of material fact without adequate opportunity for interested parties to develop an evidentiary record on those issues. See, e.g., *Mail Order Ass’n of America v. USPS*, 2 F.3d 408, 428-430 (D.C. Cir. 1993) (“MOAA”); Order No. 1482 (Nov. 8, 2006).

Moreover, it is difficult to imagine how deferring consideration of these issues to complaint cases (if any) and the Commission’s annual compliance review would jeopardize the interests of mailers not party to the proposed NSA. PAEA has severed the link between the contribution from NSAs and the regulatory ceiling on other postal rates. Regardless of the profitability of any individual NSA, or even all NSAs in the

aggregate, 39 U.S.C. § 3622(d) caps overall increases to the levels justified by the CPI. 39 U.S.C. §§ 3622(d)(2)(A) , 3622(d)(1)(D). BAC Br. 21 (1<sup>st</sup> ¶), 36. Furthermore, proposed rule 3010.24(a) eliminates the possibility that NSA discounts could have a push-up effect on the regulatory ceiling for other rates within the same class by requiring the Postal Service to impute non-discounted rates to the NSA mail volume or, if non-NSA rates do not exist, excluding the volume from the calculation of percentage rate changes. If the Postal Service offers excessive or needless discounts to an NSA partner, the Postal Service alone will bear the financial consequences.

Accordingly, the Commission should clarify that the purpose of proposed rule 3010.42(c) is merely to solicit information for potential use in complaint cases or annual compliance review proceeding, not for use in pre-effectiveness of review of proposed NSAs.

#### **IV. RATE ADJUSTMENTS IN EXIGENT CIRCUMSTANCES (RULES 3010.60 THROUGH 3010.66)**

NPPC also supports the Commission's overall approach to implementing the exception to the index-based cap authorized by 39 U.S.C. § 3622(d)(1)(E) for "extraordinary or exceptional circumstances." See Order No. 26 ¶¶ 2093-2105. In particular, the Commission acted appropriately in declining to "explicitly define 'exigent circumstances'" and in "explicitly convey[ing] the message that exigent requests are indeed 'extraordinary or exceptional.'" *Id.* ¶ 2105.

Two aspects of the proposed rules for exigent circumstances, however, warrant clarification. First, proposed rule 3010.61(a)(6) directs the Postal Service, in requesting approval of an exigent rate increase, to explain "when the exigent increase will be

rescinded” and if the increase “is intended to be permanent or temporary.” Moreover, if the increase is intended to be temporary, “the request should include a discussion of when and under what circumstances the increase would be rescinded, in whole or in part.” The Commission should go further than this, however. The proposed regulations should be modified to require that the exigent increase be rolled back as soon as the cost increases that purportedly justify the rate increases (1) recede or (2) are reflected in the CPI itself.

Precedent from other regulatory regimes supports such a rollback or sunset requirement. See *Railroad Cost Recovery Procedures*, 3 I.C.C.2d 60 (1986), *aff’d*, *Alabama Power Co. v. ICC*, 852 F.2d 1361 (D.C. Cir. 1988) (adopting requirement that, when the railroad cost index declines in a given quarter, rate increases previously established under the index should be rolled back).

Second, the Commission should clarify that cost increases recovered through an exigent increase may not be recovered anew through the CPI index adjustment. Thus, for example, if the Commission finds that exigent circumstances warrant a 10 percent rate increase, and those same circumstances cause an overall increase of five percent in the CPI, the five percent increase should be backed out of the CPI when calculating the next index-based rate adjustment under Section 3622(d).

## CONCLUSION

NPPC respectfully requests that the Commission adopt its proposed rules with the changes discussed herein.

Respectfully submitted,

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