

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

REGULATIONS ESTABLISHING SYSTEM)
OF RATEMAKING)

Docket No. RM2007-1

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
COMMENTS ON REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING
IN RESPONSE TO COMMISSION ORDER NO. 26
(September 24, 2007)**

INTRODUCTION

On August 15, 2007, the Commission issued Order No. 26, its "Order Proposing Regulations to Establish a System of Ratemaking." In addition to proposing an initial set of regulations for review, the Commission set out 46 pages describing the proposed rate setting process for market dominant products. These proposed regulations and the accompanying explanation are the product of the Commission's interpretation of the Postal Accountability and Enhancement Act ("PAEA") (Pub. L. 109-435, 120 Stat. 3198) as informed by four prior rounds of comments on rate setting, and three field hearings. (Since no advance rulemaking on classification issues was conducted by the Commission, only four sets of unsolicited comments on mail classification issues were filed.¹) Commission Order No. 30 set September 24, 2007

¹ Supplemental Comments of the United States Postal Service on the Classification Process (June 19, 2007); Office of the Consumer Advocate Comments in Response to Supplemental Comments of the United States Postal Service on the Classification Process (July 3, 2007); Reply Comments of The McGraw-Hill Companies, Inc. in Response to Supplemental Comments of the United States Postal Service on the Classification Process (July 6, 2007); and Reply Comments of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. in Response to Supplemental Comments of the United States Postal Service on the Classification Process (August 14, 2007).

as the deadline for comments on the proposed regulations. Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association (hereafter "Valpak") submit these joint comments in response to this request for comments on the proposed regulations.

**I. COMMISSION-PROPOSED REGULATIONS PROPERLY REJECTED
EXTREME CALLS TO EXCLUDE MAILERS FROM THE RATE SETTING
PROCESS.**

Valpak appreciates that the Commission resolved two hotly-contested issues by rejecting extreme positions which Valpak believes were completely inconsistent with the language of the statute.

First, the Postal Service urged its interpretation that the "not later than 45 days before the implementation" language of 39 U.S.C. section 3622(d)(1)(c) as providing for a maximum number of days for both review by the Commission and notice to mailers (*see, e.g.*, Initial Comments of the United States Postal Service (April 6, 2007), p. 14; Reply Comments of the United States Postal Service (May 7, 2007), p. 5). Valpak and other parties interpreted this language to provide for a minimum review period, *i.e.*, notice could be not less than 45 days before implementation. The Commission agreed that PAEA intended the 45-day period to be a minimum period and that "the Commission may require a longer period in certain circumstances." *See* Order No. 26, pp. 14-15, ¶¶ 2019-2020. (This issue is addressed further in section III.A, *infra*.)

Second, several parties interpreted the pre-implementation rate change review period of section 3622 to virtually preclude public input from mailers. (*See* Order No. 26, pp. 15-16, ¶ 2022.) The Commission properly reads PAEA as anticipating and allowing mailer input during the pre-implementation review process. *See id.*, ¶¶ 2022-2023. Accordingly, proposed

rule 3001.13(a) provides for a 20-day public comment period. Valpak is grateful that the Commission rejected efforts to close mailers out of the ratemaking process. (This issue is addressed further in section III.C, *infra*.)

II. THE COMMISSION'S PROPOSED REGULATIONS COULD ADDRESS MORE FULLY HOW DUE PROCESS WILL BE ASSURED.

A. The Rate Adjustment Review Process.

Near the beginning of its analysis, the Commission asserts that its “proposed regulations are intended to fill in many of the details of ... **due process**.” (Order No. 26, p. 9, ¶ 2009.) Valpak agrees that the due process rights afforded to mailers should be detailed in the procedures established by these regulations.

Valpak believes that due process for mailers, at minimum, includes a meaningful opportunity for interested mailers to review compliance of a rate adjustment (usually, an upwards adjustment) and mail classification changes (*see also* Section IV, *infra*) with PAEA and the opportunity to provide input to the Commission on any violations of PAEA identified prior to implementation of the adjustment.

Rate setting and classification changes are government actions of great concern to the mailing public. The Postal Service is “an independent establishment of the executive branch of the Government of the United States” (39 U.S.C. § 201) with a statutory monopoly over certain products and services by virtue of the Private Express Statutes (18 U.S.C. §§ 1693-1699 and 39 U.S.C. §§ 601-606) and the mailbox restriction (18 U.S.C. § 1725). Particularly now that Postal Service managers have a financial incentive to generate net revenue, it must be asked if it is wise for a government monopoly to be left completely free to (i) set rates subject

to only a cap at the class level and (ii) make sweeping changes in classifications that undergird the rate structure without giving mailers any opportunity to comment? Does a unilateral “hands off” approach constitute a “modern system for setting rates” (and classification changes) by a monopoly?

Although the Commission is required expressly to review a proposed rate increase for compliance with the rate cap (39 U.S.C. § 3622(d)), PAEA also anticipates that the “modern system” created by these regulations will ensure that rates and classifications conform to **all** objectives, factors, and requirements of 39 U.S.C. section 3622 as well as all other relevant sections of PAEA.² The requirement in 39 U.S.C. section 3622(d)(1)(c) to review does not exempt any issues from Commission consideration. Indeed, to do so would be to ignore entirely the Objectives and Factors set forth in 39 U.S.C. section 3622(b) and (c) immediately prior as well as the various other statutory limitations in ratesetting. If the only review of rate submissions/requests by the Commission were to consist solely of verifying compliance with the rate cap, Valpak believes such a narrow review would fail to ensure that the objectives, factors, and other limitations of PAEA that Congress expressly made part of a modern system for regulating rates would be met. Curiously, the Commission’s proposed regulations require Postal Service discussion of objectives and factors (§ 3100.14(b)(7)) but bar mailers from reacting to the Postal Service required filing. Indeed, such a curtailed review procedure would

² Some of the other statutes of Title 39 that bear on the rate setting of market dominant products are: 101(a), (d), and (e); 403; 404(b)-(c); 407(a) and (b)(1); 3626; 3627; 3629; 3661(a); 3682; 3683; and 3685.

take one of the elements of PAEA, “pricing flexibility” (Objective 4 and Factor 7), and elevate it over all others, to the virtual exclusion of all other elements in the new regulatory system.

Under the Commission’s proposed rules, in typical rate adjustment proceedings (*e.g.*, Type 1-A and Type 1-B) under the proposed regulations, public comment, *i.e.*, input from mailers, would be limited to two issues:

- (1) Whether the planned rate adjustments measured using the formula established in rule 3100.21(b) are at or below the annual limitation established in rule 3100.11; and
- (2) Whether the planned rate adjustments are consistent with the policies of 39 U.S.C. § 3622 and any subsequent amendments thereto. [Proposed rule 3100.13(b), p. 106.]

The Commission explains:

The proposed scope of public comment is no longer open-ended. **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, p. 18, ¶ 2029 (emphasis added).]

By this language, the Commission would appear effectively to preclude public comment to a government agency on an unspecified range of topics, including relevant topics, in a way that is highly unusual. Although it could be permissible for the Commission to have different types of proceedings addressing different topics, in this case, the Commission does not say when, if ever, such comments would be entertained and/or addressed. Comments pertinent to a rate change need to be made and considered when the rate change is noticed.

For example, if the requirement in section 3622(c)(2) that each class of mail bear its direct and indirect attributable costs is being violated, a mailer might desire to provide comments to the Commission on a particular planned rate adjustment with respect to policies of

section 3622(c)(2), but such comments presumably would be ignored and even struck by the Commission as “public comment ... on matter such as costing methods.”

B. Annual Review

The absence of due process protection in the rate setting process is not balanced by providing mailers extensive rights to be involved during the annual review. Indeed, the annual review process required by 39 U.S.C. section 3652 has not been addressed yet by the Commission in proposed regulations. The Commission has stated only that it is developing rules for the annual reports required by the Postal Service that “will include data on service achievement.” Order No. 26, p. 33, ¶ 2067. While Valpak assumes that this is not an exhaustive list of what the Commission will require in Postal Service annual reports, in Order No. 26, the Commission otherwise did not provide any information on how these annual reports and their review process will make up for any due process shortfall in the rate change review procedure for market dominant products.

Valpak expects that the annual report review process will provide some meaningful consideration of the information required by section 3652. However, it is likely that this procedure will suffer from the inherent defects similar to those in the complaint process of section 3662 (see below). Thus, Valpak believes that the annual review process is not an adequate replacement for pre-implementation comment and review.

C. The Complaint Process

Apparently, the cornerstone by which mailers are permitted to challenge the legality of rates and classification changes will be the complaint process. However, here again the

proposed regulations and comments thereto say nothing about the complaint process with respect to the regulation of rates of market dominant products.

Unfortunately, any remedy resulting from a complaint is likely to be **too late**; irreparable harm already may have occurred. The Commission’s power to fine the Postal Service is problematic, primarily penalizing mailers. Lastly, mailers might not have (or be able to obtain) sufficient **evidence** to prosecute a complaint, particularly given their lack of ability to participate in any review of rate adjustments proposed by the Postal Service.

D. Benefits of Mailer Input to the Commission

The process that the Commission has utilized in the instant docket demonstrates the value of seeking and considering mailer input. Wisely, the Commission sought both initial and reply comments on two advance rulemakings, conducted three public hearings as well as initial and reply comments on these proposed regulations. The Commission has commented on its belief that these comments have been valuable to the Commission (*e.g.*, Order No. 26, ¶¶ 2012 (p. 11), 2019 (p. 14), 2022 (p. 15), and 2032-2036 (pp. 19-21)). Mailer input would provide the same benefits to the Commission with respect to rate and classification changes.

III. THE COMMISSION’S PROPOSED REGULATIONS ABOUT POSTAL SERVICE RATE INFORMATION SHOULD BE MODIFIED TO PROVIDE THE INCREASED TRANSPARENCY REQUIRED BY PAEA.

One of PAEA’s central objectives was promotion of “transparency” in ratemaking. Indeed, transparency is expressly mandated by one of the statutory ratemaking objectives.

“(b) OBJECTIVES.—Such system shall be designed...:
“(6) To ... **increase the transparency of the ratemaking process.** [39 U.S.C. § 3622(b)(6) (emphasis added).]

It is interesting that Congress not only has mandated **transparency**, but also has mandated that the level of transparency which existed under the Postal Reorganization Act of 1970 (“PRA”) actually be **increased**. Achieving this objective requires the Commission to examine the level of transparency provided by the ratemaking process under PAEA, and to design a system which **increases** that level of transparency over that previously provided under the PRA.

The Commission correctly describes the tension between “transparency,” on the one hand, and pricing flexibility (39 U.S.C. section 3622(b)(4) and (c)(7)), on the other. On three occasions in its commentary in Order No. 26, the Commission expressly discusses how best to “**increase**” **transparency** of the ratemaking process with respect to non-exigent rate increases. It is suggested that each of these three policy statements about increasing transparency could be constructively implemented by three modifications to the Commission’s proposed regulations.

A. The Postal Service Stated Intent to File 90 Days in Advance Should Be Required.

The Commission stated its rationale for viewing the “at least 45 days” notice requirement of Postal Service notice as being a **minimum**, not a maximum period, rejecting the position of the Postal Service, as follows:

The Commission concludes that as a matter of statutory interpretation, the Postal Service’s position reads the qualifier “at least” completely out of the statute. The conclusion more consistent with **the statute’s overall theme of transparency** is that 45 days is the minimum period required by the statute, and the Commission may require a **longer period** in certain circumstances.... [Order No. 26, pp. 14-15, ¶ 2020 (emphasis added).]

However, it is not clear that transparency could be achieved under the Commission-proposed regulations which would allow only 45 days for both Commission review and public notice.

Under this 45-day period, either Commission review will be unduly abbreviated, or public notice will be too short to meet mailers' needs. Mailers need 45 days from receiving final notice of the amount of the rate increases to the date those increases are implemented. This is not provided by the Commission's proposed regulations.

Although the Postal Service took a different reading of the statute, from certain of the Postal Service's comments it appears that, as a practical matter, it does not believe it would be hampered by a 90-day requirement. Indeed, the Commission's footnote to the policy statement quoted above notes that the Postal Service has publicly stated its intention to file "90 days in advance of implementation with the first 45 days constituting the statutory period for Commission review and the second half for implementation." Order No. 26, p. 15, n.9 (paraphrasing the Postal Service's comments).

Valpak proposes that the Commission increase transparency by responding to what is already the stated intention of the Postal Service by requiring that the Postal Service's filing be made at least 90 days in advance of the implementation date desired for rate changes. This would require minor changes in 3100.10(a)(1), (a)(2), and (b), and 3100.14(a)(3) of the Commission's proposed regulations.

B. Requirements for the Postal Service Rate Filing Should Be Strengthened.

The Commission summarized the burden of proof imposed on the Postal Service to demonstrate how its rates comply with the objectives and factors of the PAEA as follows:

Nonetheless, the Commission recognizes that other factors must also be considered, and that the PAEA grants the Postal Service substantial **flexibility** in setting rates. However, in the interest of **transparency** and accountability, **the Postal Service has a burden to explain how its rates**, including workshare discounts,

meet the objectives and factors of the PAEA. [Order No. 26, p. 23, ¶ 2043 (emphasis added).]

This policy is currently to be implemented by a PRC-proposed rule which states that the Postal Service rate increase documents “shall be accompanied by”:

(7) A **discussion** of how the proposed rates will help achieve the **objectives** listed in 39 U.S.C. § 3622(b) and properly take into account the **factors** listed in § 3622(c). [Proposed rule 3100.14(b)(7), proposed regulations (emphasis added).]

As written, this language does not expressly require the Postal Service to discuss **each** postal product, and does not expressly require the Postal Service to discuss **each** objective and factor.

This language easily could be strengthened, to give more meaningful effect to the Commission’s policy statement above. At a minimum, the regulations could require that the Postal Service provide both representation that its rates comply with PAEA, and “a complete explanation” rather than only “a discussion” of how its rates for “each product” “will help achieve” **each** of “the **objectives** listed in 39 U.S.C. § 3622(b) and properly take into account **each** of the **factors** listed in § 3622(c).” Beyond this change, the Commission needs to determine how reductions in the information previously provided by the Postal Service under PRA comports with the Congressional requirement to increase transparency.

C. The Commission Should Clarify that All Information Exchanges with the Postal Service Will Continue to Be Public.

The Commission explains that it cannot adopt a system based only on “pricing flexibility” alone, but that flexibility must be tempered by other factors, particularly “providing increased transparency:”

The Commission’s goal is to make this new system of rate adjustment advantageous for all stakeholders, enabling the Postal

Service to **price its own products**, ensuring the lawfulness of competitive rates, **providing increased transparency**, and maintaining universal service at affordable rates. Fulfilling these objectives requires that **competing interests be carefully balanced**. [Order No. 26, p. 2, ¶ 1004 (emphasis added).]

The Commission's explanation of its proposed regulations explains how information will be obtained from the Postal Service:

the Commission does not propose formal discovery, Notices of Inquiry, Presiding Officer's Information Requests, testimony, and hearings. It anticipates handling resolution of discrepancies or other matters through direct communication with the Postal Service. [Order No. 26, p. 17, ¶ 2026.]

Although this description of how rate filings will be handled is brief, two conclusions can be drawn from this language. First, mailers will have no right to seek information directly from the Postal Service. Second, the Commission will not employ standard tools used in the past to obtain information from the Postal Service. It is not clear how the Commission will achieve statutorily-mandated "increase" in "transparency" if the Postal Service is not required to respond to mailer requests for information, and if the Commission's PRA-era information-gathering techniques are abandoned.

In explaining its intentions, the Commission states that it will use "direct communications with the Postal Service" to resolve discrepancies or other matters. Order No. 26, ¶ 2026, p. 17. However, it was not expressly stated what form these "direct communications" would take and, of critical importance, it is not stated whether they will be public (as currently). Certainly, PAEA-mandated transparency cannot be achieved by private communications, such as meetings or briefings held behind closed doors. Rather than

achieving PAEA-mandated increased transparency, the result would be much-reduced transparency.

Therefore, it is suggested that the Commission clarify that it intends to conduct “direct communications” on ratesetting and classification changes with the Postal Service in public, and preferably in writing, and that, if briefings or meetings are held, the public would be invited to observe those briefings or meetings. Nothing less would even maintain current levels of transparency, which we feel would then be in clear violation of PAEA’s requirement of “increased” transparency.

IV. CLASSIFICATION CHANGES THAT RESHAPE OR RESTRUCTURE THE FRAMEWORK UNDERLYING RATES THAT MAILERS PAY REQUIRE PRE-RATE-IMPLEMENTATION REVIEW.

The Commission has accepted a Postal Service offer to prepare a draft Mail Classification Schedule (“MCS”). Order No. 26, p. 2, ¶ 1005. That MCS will identify and list the various products offered by the Postal Service, including market dominant and competitive products. Proposed rule 3020.13. Once the MCS is established, the proposed regulations set forth the procedure that will be followed when modifying the product lists described within the MCS by **adding** a product to a list, **removing** a product from a list, or **moving** a product from one list to the other list. Regardless of the party that proposed any change in classification that constitutes such a modification, the Commission proposes to open a formal docket. For **all other classification changes**, the Commission proposes a much shorter review, as discussed below.

Section 3020.13 of the proposed regulations requires that for each market dominant product the MCS include a schedule listing the current rates and fees, and Section 3020.110

requires that the description of each product include applicable size and weight limitations. The Commission also noted a Postal Service statement that it “may be appropriate for the Mail Classification Schedule to be at a similar level of detail as the previous Domestic Mail Classification Schedule (DMCS).” Order No. 26, pp. 86-87, ¶ 4008. Presumably, then, this MCS will describe components of the rate structure for each product, including such detail as the applicable size and weight limits, the minimum number of pieces to qualify for bulk rate categories, the number of presort categories, the basis for any applicable surcharges, the extent to which different rates apply to destination entry or zones, applicable container charges, and other relevant details.

Assuming the level of detail just outlined, any change in the way rates for different products are structured would likely require a change in the MCS, which, as indicated in draft section 3020.90 of the Commission’s proposed regulations, must be kept up to date by the Postal Service. The procedure for changes, or “updates,” to size and weight limits for market dominant mail is contained in section 3020.111. Updates for size and weight limits require 45 days notice and provide for public comment. Following are some examples of possible updates to size and weight that could be subject to the 45-day notice and comment rule. Depending on how this is interpreted, a change in size or weight could be limited to changes such as a decision to extend Standard rates to weights above 16 ounces. But it could also extend to:

- 1) A decision to charge First-Class rates that vary by ½-ounce increments, or by 3-ounce increments;

- 2) A decision to eliminate the minimum-per-piece structure in Standard rates and institute a piece-pound structure over the entire weight range; and
- 3) A decision not to allow non-machinable pieces (*e.g.*, parcels) in Standard Mail.

Other updates or modifications to product descriptions in the MCS are covered in Subpart E — Requests Initiated by the Postal Service to Update the Mail Classification Schedule (proposed rules 3020.90-92). If the MCS were updated to accord with updates or modifications falling within this subpart, proposed section 3020.91 would require a minimum of only 15 days notice. During this 15-day period, the Commission would consider editorial and formatting adjustments (proposed rule 3200.92), described by the Commission as “minimal review” (*Id.*, ¶ 4042). Nothing in proposed sections 3020.90-92 would allow for public comment. Following are examples of possible changes in rate structures that do not involve any change in size or weight, yet probably would require changes in the MCS and, presumably, would fall within the scope of Subpart E:

- 1) A decision to zone rates for all First-Class bulk mail;
- 2) A decision to implement destination entry rates for First-Class bulk mail;
- 3) A decision to allow a per-piece editorial discount for In-County Periodicals;
- 4) A decision to subject the weight of editorial content in Regular Periodicals to zoned rates;³

³ The possibility of zoning the weight of the editorial content in Regular Periodicals was discussed by McGraw-Hill in its Reply Comments in Response to Supplemental Comments of the Postal Service on the Classification Process, July 6, 2007.

- 5) A decision to grant a discount for destination-entered Standard Mail that is entered on pallets;
- 6) A decision to impose a surcharge on Standard Mail that is entered in sacks;
- 7) A decision to require that all mail be in envelopes; and
- 8) A decision to expand the definition of materials that, if sent through the mail, **must** be sent First Class.

If a 45-day notice of a rate adjustment were given, consistent with proposed section 3010.1, *et seq.*, and the public were given 20 days to comment, consistent with proposed section 3010.13, proposed section 3020.92 would require notice of any associated classification changes on day 30 of the 45-day review period. Under these conditions, or similar ones, it would seem that notice of the classification change should be required on the same day the notice of rate adjustment is given. Valpak also believes that comments should be allowed to address classification change as well, and that the Commission's review of the classification changes with those comments could be of great benefit, and thus involve more than editing and formatting.

But the situation presents difficulties that go beyond the need to allow a 20-day comment period regarding classification changes associated with rates. Under PAEA, the Postal Service is expected to act more like a business and has a profit incentive to make changes in rates and classifications that it might not have considered before. The result easily could be classification changes of considerable importance to mailers and the nation, such as the eight examples given above. The possibility of such classification changes, could be what the Commission had in mind when it speculated there could be "abuses," the Commission

pointed to the availability of “after-the-fact review[s]” and complaint proceedings. Order No. 26, p. 97, ¶ 4042.

Effects on mailers of major classification changes can be substantial. In fact, some firms and publications could find their very viability threatened by certain changes. After-the-fact annual reviews would not be considered an attractive remedy by mailers so affected (especially any mailer or publication that ceased to exist on account of the change in classification and rates), and retroactive postage adjustments are not permitted. *See* 39 U.S.C. § 3681. Also, it seems entirely possible that it could be difficult to backtrack after such adjustments are implemented.

The prospect of complaint proceedings also holds disadvantages for mailers, as well as, potentially, the Postal Service. In the past, when major classification changes have been proposed by the Postal Service, they have elicited considerable response from mailers, and many of the proposals have been rejected by the Commission. Accordingly, it seems entirely possible that complaints could be filed during the 45-day (or longer) review period for changes in rates. Having this happen might stall the rate process, when the Postal Service needs the revenue.

An alternative way of handling major classification changes should be considered. Sections 3200.90-92 of the proposed regulations suggest that review begin “no later than 15 days prior to the effective date of the proposed change.” It would seem more productive if review of such changes, with public comment, could be completed prior to the time the Postal Service gives notice of an associated rate adjustment.

V. CLASSES OF MAIL WHERE ATTRIBUTABLE COSTS EXCEED REVENUES.

The PRA contained a **requirement** that revenues from each class of mail must cover attributable costs.⁴ Under the PRA, the Commission consistently interpreted this statutory requirement as applying at the subclass level, and **mandatory**.⁵ Despite the long-standing existence of this statutory, “mandatory” requirement, for the last 10 consecutive years — *i.e.*, **every year** from FY 1997 through FY 2006 — and over the span of four successive omnibus rate cases, revenues from the Periodicals class have been less than their attributable costs.⁶ Moreover, during this 10-year period revenues as a percentage of attributable cost has declined fairly steadily, from a coverage of 96 percent in 1997 to only 85 percent in 2005 and 2006. As a result of this continuing failure of revenues to cover attributable costs, the Periodicals class has received — and other classes of mail have paid — a cumulative **cross-subsidy exceeding \$2.1 billion** at the end of FY 2006.⁷ Clearly, the Commission’s procedures under the PRA

⁴ Former 39 U.S.C. § 3622(b)(3).

⁵ The United States Supreme Court noted this interpretation with approval. National Association of Greeting Card Publishers v. United States Postal Service, 462 U.S. 810, 820 (1983).

⁶ Data are from annual Cost and Revenue Analyses (“CRAs”) at PRC costing. The four rate cases that failed to result in revenues from periodicals covering attributable costs were Docket Nos. R97-1, R2000-1, R2001-1, and R2005-1. The CRA for FY 2007 is not yet available, but since the 18.3 percent rate increase for Periodicals in Docket No. R2006-1 took effect only in the fourth quarter of the fiscal year, it seems likely that the result for FY 2007 will be similar to or worse than the result for FY 2006, *i.e.*, FY 2007 will become the eleventh straight year in which Periodicals revenues failed to cover their attributable costs by a substantial margin, and the cumulative cross-subsidy noted herein will increase yet further.

⁷ Revenues in the Media Mail subclass likewise failed to cover attributable costs for the six-year period 2001-2006.

were not sufficient to ensure that revenues from every subclass of mail would in fact cover its attributable costs, thereby avoiding cross-subsidy between the different classes of mail.⁸

With respect to each class of mail, section 3622(c)(2) of PAEA contains a factor described as a “requirement” similar to the attributable-cost coverage requirement in the PRA.⁹

Section 3622(c)(2) provides:

(c) In establishing or revising such system, the Postal Regulatory Commission shall take into account —

(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; [Emphasis added.]

In addition to the above-cited Factor, section 3622(b) contains the following Objective:

(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.

Failure of any class or subclass of mail to cover its attributable costs necessarily implies that such mail receives a cross-subsidy, which would violate not only the factor in section 3622(c)(2) but also the “just and reasonable” portion of the objective in section 3622(b)(8).

⁸ Under PAEA, the Commission also is charged with ensuring that market dominant products do not cross-subsidize competitive products. In view of the long-running failure to avoid cross-subsidy between classes and subclasses of mail, the Commission may want to strengthen its safeguards in this respect.

⁹ Order No. 2, p. 5 (Jan. 30, 2007).

With respect to classes of mail that fail to cover their attributable costs, the discussion of proposed regulations contains the following statement:

An explanation must be provided if new unused rate authority will be generated for a class of mail that is not expected to cover its attributable costs. [Order No. 26, p. 19, ¶ 2031.]

Curiously, despite the repeated failure of revenues from certain classes and subclasses of mail to cover their attributable costs, this statement in paragraph 2031 appears to be the only place in the proposed regulations that explicitly discusses the requisite Postal Service response in the event that revenues from a class of mail did not cover the attributable costs of that class.

The proposed regulations do not address whether the requirement to cover costs applies at the class or product level. Even if it only applies at the class level, classes of mail are broad groupings that contain a number of postal products, as well as items within each product, which are mailed at a wide variety of rates. It is a truism that if revenues from every product in a class exceed that product's attributable costs, then revenues from the entire class will exceed attributable costs. When revenues from a class of mail fail to cover attributable costs, however, it is likely that within such class of mail the revenues derived from some products or items will exceed their attributable costs, while revenues from other products or items will be less than those products' attributable costs. Under these conditions, it also is a truism that the way to reduce the aggregate deficit of the class is to impose disproportionate rate increases on those loss-making items that fail to cover their attributable costs. The discussion in Order No. 26 explains that:

The Commission does not view capping subclass increases as sanctioned by the PAEA.... It is to be expected that rate adjustments within a class will be both above and below average.

Requiring written justification for individual rates is contrary to the goals of a simple, more flexible, process. [Order No. 26, pp. 20-21, ¶ 2036.]

Notwithstanding the Commission's reluctance to require written justification for individual rates, at least under the circumstance where an entire class (or product) of mail has been the recipient of a cross-subsidy because revenues from that class (or product) failed to cover its attributable costs (either in the last fiscal year or the latest fiscal year for which data are available), it is necessary to enhance transparency and accountability by requiring the Postal Service provide a detailed justification supporting its proposed rates and explaining how far those rates will go towards elimination of the cross-subsidy to effect compliance with section 3622(b)(8) and section 3622(c)(2) of PAEA.

VI. NEGOTIATED SERVICE AGREEMENTS REGARDING MARKET DOMINANT PRODUCTS

The Commission's discussion of Negotiated Service Agreements ("NSAs") with respect to market dominant products (Order No. 26, pp. 38-40) is fairly detailed about the Postal Service's required filing for a proposed NSA. The proposed rules with respect to NSAs, Type 2 Rate Adjustments, are set forth in Subpart D, sections 3100.40-43. However, the proposed regulations do not provide for (1) **public disclosure** of the NSA filing with the Commission; (2) an opportunity for **public input** on the NSA; or (3) any express procedures for **review** by the Commission.

1. Public Disclosure of NSA Filings

The Commission's proposed regulations provide for two notices: one to the public (with no specified contents) and one to the Commission (with specified contents). Both notices

are required to be given at least 45 days prior to the intended implementation date. *See* proposed regulations § 3100.41. The required elements of the notice to be filed with the Commission are set forth in proposed regulation section 3100.42(b).

The proposed regulations do not indicate whether the filing with the Commission will be publically available, nor require that notice, or the terms of the NSA itself, to be publicly available.¹⁰ Valpak submits that the proposed regulations should be amended to specify that NSA filings regarding market dominant products, including the terms of the NSA itself, will be made available to the public.

Although the proposed regulations do not require that the required annual filing be made publicly available, the Commission's discussion states that "the Postal Service is to collect and provide annual data that are intended to enable the Commission and interested persons to evaluate whether each negotiated service agreement has met, or is likely to meet in the future, the expectations...." Order No. 26, p. 40, ¶ 2092. Valpak respectfully submits that "interested persons" should include the mailing public.

2. Public Comment on NSAs

The proposed regulations do not address any due process concerns of other mailers with respect to the NSA review process. A substantial portion of the Commission's proposed regulations has to do with the contents of the NSA filing by the Postal Service. Yet, there is

¹⁰ The Commission indicates that the rates and fees subject to NSAs for competitive products are not required to be disclosed and may be subject to confidentiality requirements. *See* Order No. 26, p. 89, ¶ 4016.

no indication that the Commission will solicit, or even entertain, comments from mailers who are not parties to the NSA.

PAEA requires certain specific standards for NSAs (or what PAEA terms “special classifications ... including agreements between the Postal Service and postal users”).

According to PAEA, NSAs may be permitted if they:

- (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. [39 U.S.C. § 3622(c)(10).]

Valpak reads those (c)(10) requirements as supplementing all of the other factors, objectives, and requirements of section 3622. For example, section 3622(d)(1)(C) requires that rate changes be subject to the at least 45-day notice and review period. That subsection forms the basis for the review of Type 1-A and Type 1-B rate adjustment filings. Moreover, that subsection expressly applies to rate adjustments, “including adjustments made under subsection (c)(10)” — the NSA subsection. However, even if the only standard were (c)(10), public comment would be needed. Valpak believes that the review process of NSAs should generally parallel the review process of “regular” rate changes, with the additional considerations required by subsection (c)(10). Thus, reviews of NSAs should provide for the same opportunity for public comment as other rate changes.

3. Commission Consideration of NSAs

The Commission's proposed regulations require that NSAs meet the specific requirements of subsection (c)(10) only — to the exclusion of all of the other considerations of section 3622. *See* proposed regulations § 3100.40. Valpak believes that the proper reading of section 3622 is that **all of the policies of section 3622** and PAEA (*see* fn.2, *supra*) are applicable to NSAs, including, just as one example, “[t]o maximize incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). An NSA could meet the requirements of subsection (c)(10) but not be consistent with all of the objectives, factors, and requirements of section 3622.

Finally, the proposed regulations do not provide for any Commission decision with respect to an NSA. There are no provisions for a notification back to the Postal Service or an opportunity for the Postal Service to remedy any possible shortcomings in a proposed NSA. Proposed regulation section 3100.13(c) provides for a Commission “**notice and order**” with respect to Type 1-A and Type 1-B rate adjustments. Valpak submits that the regulations should provide for the same procedures the Commission designed with respect to Type 2 rate adjustments.

VII. EXIGENT RATE CASES.

In Section II.I (Order No. 26, pp. 41-46, ¶¶ 2093-2106), the Commission discusses rules for rate adjustments in exigent circumstances (Type 3 Rate Adjustments). After considering whether the proposed regulations should attempt to define in advance the circumstances that would warrant the filing of an exigent rate case, in paragraph 2105 the Commission concludes, appropriately, that it is neither necessary nor prudent to do so at this

time, while noting that the proposed regulations require the Postal Service to provide a substantial “focused explanation in support of any exigent request.” It acknowledges that “[t]hese provisions do not explicitly define ‘exigent circumstances,’ and unmistakably convey the message that exigent requests are indeed ‘extraordinary or exceptional.’”

In paragraph 2106, the Commission discusses the procedures it proposes to follow if and when it finds itself in receipt of an exigent request. Insofar as they go, these procedures appear straightforward, reasonable, and in keeping with what many view to be the general spirit of PAEA. But with respect to the day when the Commission is confronted by an exigent request, it also leaves unanswered certain questions that might usefully be addressed at this time, so that mailers would have a better expectation of what they might encounter in the event an exigent rate request were filed.

To elaborate, although the circumstances giving rise to an exigent rate filing are undefined, as stated in section 3100.6(b), “[a]n exigency-based rate adjustment is not subject to the inflation-based limitation or the restrictions on the use of unused rate adjustment authority....” It therefore seems reasonable to presume that any such exigent filing will (1) request rate increases in excess of the rate cap that otherwise would prevail, (2) propose rate increases designed to provide more revenues than could be provided by a rate cap increase, and (3) provide enhanced revenues sufficient to keep the Postal Service operating in a financially solvent condition. *Inter alia*, section 3100.61 requires an exigent filing to include:

- A schedule of the proposed rates;
- Calculations quantifying the increase for each affected product and class; and

- A full discussion of why the requested increases are reasonable and equitable as between types of users of market dominant products.

What seems to be missing are some minimal ground rules as to what mailers might expect to come out of an exigent rate case. For instance:

- In the event of an exigent rate filing, although rate increases will be higher than the inflation-based limitation, will they be subject to a (higher) uniform rate cap applicable to all classes?
 - Alternatively, will the Postal Service be able to impose unequal (higher) rate increases on some classes, particularly any class of mail whose revenues do not cover attributable costs? After all, one obvious source of the financial distress which necessitated the exigent filing would be any class of mail that has failed to cover attributable costs.
 - In the event that revenues from one or more classes of mail or types of mail have failed to cover attributable costs, will the Postal Service's exigent filing be expected to "true-up" rates for those classes so that they will conform with section 3622(b)(8) and section 3622(c)(2) of PAEA?
- If a class of mail has failed to cover its attributable costs and, in consequence thereof, has received a cross-subsidy of, say, \$X million, should any "true-up" or rates be designed not only to cover attributable costs, but also to make a contribution to overhead costs that is at least equal to the \$X million of cross-subsidy received in prior years?

- If not, should all cross-subsidies to any class of mail that fails to cover its attributable costs be construed as one-way gifts? Or, should any class of mail that receives a cross-subsidy by virtue of failure to cover attributable costs somehow be held accountable?
- If disproportionate rate increases among classes are not allowed in an exigent rate case, when and under what circumstances will the Postal Service be permitted (or required) to impose rate increases sufficient to result in each class of mail having revenues that equal or exceed its attributable costs?

On a different matter, proposed section 3100.7, “Schedule of regular rate changes,” is quite explicit about predictability of Type -1A rate changes. With respect to an exigent rate request, however, the proposed regulations appear moot with respect to how any such filing will mesh with the schedule for Type 1-A rate changes.

- In the event the Postal Service files for an exigent rate increase, will such a filing be in lieu of one (or more) of the annual rate increases contemplated under PAEA?
- Or will the Postal Service be permitted to file for annual rate adjustments, subject to the statutory rate cap, with exigent rate filings occurring in between (and in addition to) the annual rate adjustments? That is, in the event an exigent rate request is filed a few months after a Type 1-A rate increase has taken effect, should the exigent filing (and mailers) anticipate another Type 1-A rate increase one year after the preceding Type 1-A increase took effect? Or should the exigent filing be

in lieu of, and presume a one-year hiatus in, the next regularly-scheduled
Type 1-A increase?

Respectfully submitted,

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.