

Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Regulations Establishing System
of Ratemaking

)
)

Docket No.RM2007-1

OFFICE OF THE CONSUMER ADVOCATE COMMENTS
IN RESPONSE TO ORDER NO. 26 PROPOSING REGULATIONS
TO ESTABLISH A SYSTEM OF RATEMAKING

Respectfully submitted,

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September 24, 2007

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INTRODUCTION

The Office of the Consumer Advocate (“OCA”) hereby responds to the Commission’s Order No. 26 proposing regulations to establish a system of ratemaking pursuant to the provisions of the Postal Accountability and Enforcement Act (“PAEA”).¹ The Commission’s rules will govern the implementation of the legislative intent to streamline and regularize the process of rate adjustments and to maintain rate increases that are no greater than the rate of inflation.

OCA’s comments are offered in the interest of easing the transition to the new rules and improving transparency surrounding the regulation of the Postal Service under the PAEA. Suggestions are also offered to ensure the new processes will be implemented smoothly and that procedures are clearly established. In this regard, OCA identifies areas which may benefit by clarification or modification of the rules. The comments also request that the Commission discuss its expectations and views

¹ “Order Proposing Regulations to Establish a System of Ratemaking,” Order No. 26, August 15, 2007.

regarding the interpretation of certain proposed rules. Their purpose is to avoid potential misunderstandings, controversies and even litigation concerning the application of the rules.

The following matters are discussed below:

1. Need to provide for additional information in notices of agreement supporting negotiated service agreements.
2. Whether and when Commission information requests to the Postal Service, and the responses to those requests, will be made public and whether they will become part of the record in Commission proceedings.
3. Procedures, if any, for participants to obtain information from the Postal Service in order to comment on rate adjustments, and whether that information should be made available to other interested participants and the public.
4. Provisions for participation by an officer of the Commission in public Commission proceedings.
5. Product list description revisions
6. Application of the §3622(c)(2) requirement that market-dominant rates must recover attributable costs.
7. If the Postal Service files an omnibus rate case prior to December 20, 2007, does the Commission contemplate the new rules would permit the Postal Service to obtain a PAEA rate adjustment pursuant to a Type 1, Type 2, or Type 3 filing prior to the conclusion of the rate case?
8. Clarification or correction of various proposed rules that either do not fully implement the Commission's intent as discussed in Order No. 26 or do not track the language of the PAEA.

DISCUSSION

1. Proposed rules containing filing requirements for negotiated service agreements should incorporate aspects of the Commission's "suggested framework" to permit determinations required by the statute.

Subpart D addresses rate adjustments for Negotiated Service Agreements (NSAs) in four proposed rules. Proposed rule 3010.40, "Negotiated service agreements," expresses the Commission's objective to allow implementation of negotiated serviced agreements that satisfy the statutory requirements of §3622(c)(10)(A) and (B) of the PAEA. The statutory requirements establish two tests. In this regard, negotiated service agreements must:

- (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.

Proposed rule 3010.40 incorporates these statutory tests.

The remaining three proposed rules introduce filing requirements to permit the Commission to determine whether the statutory tests have been met. Proposed rule 3010.41, "Procedures," requires the Postal Service to provide notice to the general public, and provide a "notice of agreement" to the Commission, concerning Type 2 rate adjustments for market dominant products subject of an NSA not later than 45 days prior to the intended implementation date. Proposed rules 3010.42, "Contents of notice of agreement in support of a negotiated service agreement," and 3010.43, "Data collection plan," specify the information to be included with each notice of agreement,

and the information to be collected by the Postal Service under a data collection plan after implementation of an NSA.

However, the proposed filing requirements for NSAs do not take account of the new statutory standards required for approval. Under the former Postal Reorganization Act, the Commission established “reasonable likelihood” of a net increase in contribution as the standard for approving NSAs.² Consistent with the PAEA, the Commission proposes “must improve the net finances of the Postal Service” as the standard for approving NSAs.³ This is a significantly more stringent standard. Yet, the filing requirements proposed are essentially the same as those developed pursuant to the PRA.

Given that NSAs now “*must . . . [i]mprove the net financial position of the Postal Service,*”⁴ the OCA suggests incorporating into the new rules aspects of the “Suggested Framework” from Docket No. MC2004-3.⁵ OCA believes aspects of the Suggested Framework, if incorporated into the proposed rules, would increase Commission and public confidence that implementation of future NSAs will improve the net financial position, i.e., increase overall contribution, of the Postal Service. To satisfy the new statutory standard, i.e., determine whether there is increased contribution above what would be realized absent an NSA, the Commission must find that “additional mail

² PRC Op. MC2004-3, “Bank One Opinion and Further Recommended Decision” (herein “Bank One Further Recommended Decision”), para. 5010.

³ Docket No. RM2007-1, Order No. 26, “Order Proposing Regulations to Establish a System of Ratemaking,” (herein “Order No. 26”), at 38.

⁴ *Id.* at 115, proposed § 3010.40(a) (emphasis added).

⁵ “Bank One Further Recommended Decision,” paras. 5010-5038.

volume is caused by the incentive to mail additional volume (because of the mailer's demand characteristics), and not because of exogenous factors."⁶

In its original form, the Suggested Framework was intended for use with NSAs consisting of discounted rates in exchange for additional volumes, in order to prevent a mailer from earning discounts on volume increases caused by non-price exogenous factors (*i.e.*, a shift in a mailer's demand curve). The Postal Service and its NSA partner were to agree on a range of volume that would be caused by the discounts alone.⁷ Uncertainty or disagreement as to the size of the volume range and its starting point (threshold) was to be resolved during negotiations by adjusting discounts and volume tiers.

The beauty of the Suggested Framework is that it causes the NSA partner to focus on *all* the factors that could affect its mail volume and to filter out factors that would generate extra volume absent discounts. As designed, the Suggested Framework introduces significant incentives for the NSA partner to identify a discount-induced volume range, bounded by the discount threshold and estimated after-rates volume. Such bounds serve as "triggers" for the incentives. One trigger, the discount threshold, would result in discounts being earned by the mailer. The other trigger, the estimated after-rates volume, would be a cap which, if breached, would preclude payment of any discounts (*i.e.*, void the agreement). Such an outcome, resulting from

⁶ *Id.*, para. 3006.

⁷ The process of agreeing to this increment involved (1) the mailer's forecasting its annual volume after discounts were implemented, (2) the parties' agreeing to a demand elasticity that held all factors except discounts constant, and (3) determining the mailer's annual volume without discounts implied by the "after-discount" volume and the price elasticity. The increment of volume referred to in the text is the difference between the "after-discounts" volume and the "without-discounts" volume. The "without-discounts" volume would be the threshold beyond which the mailer would earn discounts on the increment, and the "after-discounts" volume would be the cap beyond which the mailer would forfeit all discounts. *Id.*, para. 5017.

the mailer's actual volumes exceeding the estimated after-rates volume, would "represent an unexpected major shift in the mailer's demand due to changes in non-price factors."⁸

Characterizing the Suggested Framework in this fashion allows it to be generalized and applied to any type of incentive contract—volume, cost-saving, performance-based, etc. In its generalized form, reasonable bounds would be established on mailer response so as to achieve the basic aim of the framework—to reduce significantly the probability that discounts are awarded for mailer behavior that would have occurred anyhow in the absence of discounts. This is accomplished with the two triggers—one that represents what a mailer can reasonably be expected to do in the absence of incentives and one that represents the largest plausible response to incentives, exogenous factors held constant. Denying all discounts if a mailer exceeds the second trigger encourages mailers to distinguish shifts in demand curves from responses to incentives when proposing triggers. A mailer would prefer a low threshold and a high cap (or, even better, no cap), but proposing a large difference between triggers risks straining credibility.

The filing requirements of proposed rules 3010.42 and 3010.43 are designed "to enable the Commission and interested parties to evaluate whether each negotiated service agreement has met, and is likely to meet in the future, the expectations that caused the Postal Service to enter the agreement."⁹ However, as a Postal Service witness recently testified, "It is likely that the Postal Service will not be able to

⁸ *Id.*, para. 5018.

⁹ Order No. 26, at 40.

distinguish volume changes caused by . . . other factors from those generated in response to the discounts.”¹⁰

The Commission faces a similar difficulty after the implementation of NSAs in making its Annual Compliance Report, unless it incorporates into the proposed rules the “triggers” of the Suggested Framework as a requirement for filing. Doing so, OCA believes, is essential to assist the Commission in determining whether NSAs satisfy the statutory requirements.

OCA offers modifications to proposed rules 3010.42 and 3010.43. Proposed rule 3010.42(b)(1) is modified to require that all agreements that offer discounts or other rewards to a mailer include a list of changes in mailer behavior to be rewarded, and that a unit measure of cost, volume, or other be estimated for each change in mailer behavior. The modifications also require a minimum (maximum) and maximum (minimum) value of the unit of measure at which rewards commence and are forfeited. Proposed rule 3010.42 is further modified in subsection (d) to require clear and convincing evidence of expected improvements in the net financial position or operations of the Postal Service.

Proposed rule 3010.43 is entitled “Data reporting,” and specifies the annualized information to be provided by the Postal Service within 60 days of each anniversary of the implementation of an agreement. Most importantly, proposed rule 3010.43 (b), as modified, requires the actual value of each unit of measure required under § 3010.42(b)(1)(ii) of the proposed rules.

¹⁰ Docket No. MC2007-4, Postal Service Response to Interrogatory OCA/USPS-T1-7(a), September 7, 2007.

While OCA's modifications to the proposed rules do not remove all uncertainty as to whether volumes or operational improvements are discount-induced or caused by exogenous factors, the triggers and accompanying incentives incorporated herein improve the likelihood that future NSAs will increase overall contribution to the Postal Service as required by the statute.

The specific changes proposed are set forth immediately below. For convenience, Appendix A reproduces the entire Subpart D of Part 3010, Rules for Rate Adjustments for Negotiated Service Agreements (Type 2 Rate Adjustments) with the proposed changes inserted and the deletions bracketed.

Replace § 3010.42(b)(1) with:

(1) A copy of the negotiated service agreement. All agreements that reward mailers (either with money or in kind) shall contain the following terms:

- (i) A list of changes in mailer behavior to be rewarded;
- (ii) For each change in mailer behavior, a unit of measure (volume, unit cost, etc.);
- (iii) For each change in mailer behavior,

(A) a minimum (maximum) value of the unit of measure at which rewards commence, and

(B) a maximum (minimum) value of the unit of measure at which all rewards are forfeited;

(iv) For each change in mailer behavior that is rewarded in kind, liquidated damages to be paid in the event rewards are forfeited under § 3010.42(b)(1)(iii)(B).

Replace § 3010.42(d) with

(d) Clear and convincing evidence of the expected improvements in the net financial position or operations of the Postal Service for each year of the agreement.

Replace § 3010.43 with:

§ 3010.43 Data reporting

The Postal Service shall provide the following annualized information within 60 days of each anniversary of implementation of an agreement:

(a) An estimate of the change in net financial position as a result of the agreement.

(b) The actual value of each unit of measure required under § 3010.42(b)(1)(ii).

(c) A discussion of the changes in operations of the Postal Service that have resulted from the agreement. This shall include, for each year of the agreement, identification of each component of the agreement known to enhance the performance of mail preparation, processing, transportation, or other functions in each year of the agreement.

(d) An analysis of the impact of the negotiated service agreement on the marketplace, including a discussion of any and all actions taken to protect the marketplace from unreasonable harm.

2. Public availability of Commission requests for information and the responses to those requests

The proposed rules contemplate that the Commission may obtain additional information from the Postal Service about a rate adjustment filing by requiring the Postal Service to provide the name of a Postal Service official who will be available to respond

to Commission requests for clarification. See §3014.14(4).¹¹ The rules do not indicate the Commission's intentions about making public either its requests for information or the clarifications received from the Postal Service. Further, if clarifications and other data will be made public, will they be available in a timely manner for participants to factor them into their comments? It would benefit all participants and avoid a potentially needless waste of resources by those commenting on erroneous documents if this information is available to the public, particularly information that clarifies (or corrects) errors in data or calculations. Also, if the need for substantive information arises, the availability of that information to all commenters would ease the burdens on commenters and assist the Commission by ensuring more meaningful comments.

3. Procedures for participants to obtain information from the Postal Service and its public availability

In several instances, the proposed rules require the Postal Service to provide the name of an official to be responsive to requests for information from the Commission. For example, see §3010.14(a)(4).¹² The proposed rules do not refer to potential requests by persons other than the Commission for either additional information, or clarification, from the Postal Service that may be needed by interested persons to comment fully on a Postal Service rate adjustment. The omission of procedures for obtaining information by other parties suggests the Commission does not contemplate that participants may wish to request, even in an informal way without the restrictions of

¹¹ Section 3010.14(4) provides, "The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission."

¹² Section 3010.14(a)(4) provides, "The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission." See also, §3010.42(b)(4) (NSA filings) and §3010.61(b) (exigent circumstances).

formal interrogatories, information from the designated Postal Service official. Some discussion by the Commission of its views regarding participants obtaining information from the Postal Service would clarify the procedures that may be available to participants. Discussion may avoid unnecessary motions practice prior to the date for participants' comments,¹³ complaints, or even potential litigation over claimed rights or needs for additional information and the possible lack of transparency.

If there are requests for information from participants, and if information is obtained from the Postal Service by participants, the further question arises as to whether that information should be made available to the Commission and/or the public in a timely manner. Information obtained by a participant concerning an area the Commission has not explored may be as useful to the Commission in reaching its determinations. The Commission has often benefited from data that participants have gathered from the Postal Service. Also, in such cases it would be important for the Commission to have available all of the information provided to participants in order to insure that comments appropriately and properly represent the data provided by the Postal Service.

¹³ The Commission's rules regarding the filing of motions are not altered by these proposed rules. The rules of practice of the Commission "are applicable to proceedings" before the Commission (§3001.3) and, during proceedings, motions are the vehicle to apply for a Commission ruling "not otherwise specifically provided for in this Part [3001]." (§3001.21(a).) Unless the rate adjustment matters are not deemed proceedings, requests for Commission rulings regarding procedural issues, during rate adjustment filings, may be submitted by motion.

4. Officer of the Commission

Some discussion by the Commission may be useful regarding the rules providing for the designation of an officer of the Commission in appropriate proceedings. The PAEA provides, “The Postal Regulatory Commission shall designate an officer of the Postal Regulatory Commission in all public proceedings (such as developing rules, regulations, and procedures) who shall represent the interests of the general public.” (§505.)¹⁴ Three of the proposed Commission rules in Part 3020 provide for the designation of an “officer of the Commission to represent the interests of the general public”:

1. Requests initiated by the Postal Service to modify the product lists (Subpart B, §3020.33(d));
2. Requests initiated by users of the mail to modify the product lists (Subpart C, §3020.53(d)); and
3. Proposals initiated by the Commission to modify the product lists (Subpart D, §3020.73(d)).

However, there is no provision for designation of an officer of the Commission within the following proposed rules even though the rules relate to proceedings that, while streamlined, nevertheless, will be public proceedings.

1. Section 3010.13(a) provides, “The Commission will establish a docket for each rate adjustment filing, promptly publish notice of the filing in the Federal Register,

¹⁴ The PAEA also specifies an officer of the Commission shall have opportunity to comment on, or participate in, Postal Service compliance reports (§3653), significant changes in service nationwide (§3661), and accounting rules recommendations of the Secretary of Treasury (§2011(h)(2)(A)). In other cases, an officer of the Commission may initiate complaints: rate and service complaints (§3662) and complaints regarding Postal Service rules regarding competition, disclosure of certain information or use of certain specific information (§404a). These comments do not rely upon those sections of the PAEA.

post the filing on its website, and allow 20 days from the date of the filing for public comment.” (Part 3010-Rules of Practice and Procedure, Subpart B-Rules for Rate Adjustment for Rates of General Applicability (Type 1 Rate Adjustments) §3010.13 Proceedings for Type 1-A and Type 1-B rate adjustment filings.)¹⁵

2. Section 3010.60, *et seq.* does not provide for designation of an officer of the Commission even though the special procedures applicable to exigent requests states that after notice in the *Federal Register*, “The Commission will hold a public hearing on the Postal Service request.” (Part 3010, Subpart E-Rules for Rate Adjustments in Exigent Circumstances (Type 3 Rate Adjustments) §3010.65(b).)

3. Section 3020.11 provides that upon the filing of the initial mail classification schedule the Commission will notice the filing in the *Federal Register* and provide opportunity for public comment. (Part 3020-Product Lists §3020.11.)¹⁶

4. Amendments to the mail classification schedule will also be noticed in the *Federal Register* and may result in comments from the public if invited by the Commission. (§3020.12(c)(2).)

The proposed rules indicate the above four proceedings will be public proceedings. If so, §505 of the PAEA will be applicable and requires designation of an officer of the Commission in those proceedings. Indeed, upon a request for rate change

¹⁵ The rules pertaining to notices by the Postal Service for Type 2 rate adjustments to change rates pursuant to negotiated service agreements do not provide for either PRC docketing of the Postal Service filing, nor do they provide for any public proceedings such as notice and comments to the Commission. In these instances, the requirements of §505 of the PAEA would not appear to be applicable. However, the NSA rules contemplate requests by the Commission for clarification from the Postal Service. If further proceedings of a public nature are instituted, the applicability of §505 of the PAEA would then need to be considered by the Commission.

¹⁶ If the initial mail classification schedule is designated as a filing within the current docket, RM2007-1, then the question as to designation of an officer of the Commission would be moot inasmuch as an officer of the Commission has been designated in this docket.

due to exigent circumstances, the proposed rules provide that a public hearing will be held. Except for the hearings provided for with respect to exigent circumstances, the other three types of proceedings appear to provide for less complex Commission procedures and for more limited public participation than in the procedures contemplated in rules where an officer of the Commission is specifically designated. Yet, all of the proceedings would be, or in the case of amendments to the mail classification schedule may be, public in nature. As noted above, §505 of the PAEA requires that an officer of the Commission “shall” be designated “in all public proceedings.”

In order to avoid potential issues in future cases as to whether or not an officer of the Commission should have been appointed in a proceeding to protect the interests of the general public, discussion of the Commission’s basis for providing for the designation of an officer of the Commission in some public proceedings, but not others, may be helpful. It may also be useful to indicate whether the Commission anticipates that it may designate an officer of the Commission to represent the interests of the general public in future proceedings where designation of an officer of the Commission is not specified in the proposed rules.

In the event the Commission determines it is appropriate to modify the proposed rules to include the designation of an officer of the Commission, the following amendments are proposed:

At the end of §§3010.13(a) and 3010.65(a), add the words “and designate an officer of the Commission to represent the interests of the general public.”

In §3020.11, after the sentence, “The notice shall provide the opportunity for public comment.” add the phrase “and designate an officer of the Commission to represent the interests of the general public.”

In §3020.12(c)(2), amend the section to read, “When the Postal Regulatory Commission invites comments from the public and designates an officer of the Commission to represent the interests of the general public...”

5. Product list description alterations

The Commission rules, as proposed, may contain a gap that will enable the Postal Service to change substantively its market-dominant and competitive product descriptions with a shortened notice period of 15 days and without provision for public comment.

The new Mail Classification Schedule for market-dominant products will contain a “list of market dominant products” and includes their descriptions as specified in §3020.13(a) and §3020.13(a)(2). The rules contemplate two types of changes to the product list of market-dominant products. One is a modification of the product list, defined as “adding a product to a list, removing a product from a list, or moving a product from one list to the other list.” (§3020.30 (Postal Service modifications)).¹⁷ A second type of change to the product list is an alternative to a modification of the list. This rule is styled as “Requests by the Postal Service to Update the Mail Classification

¹⁷ The definition is repeated in other sections of the proposed rules, §3020.50 (Users requests) and §3020.70 (Commission proposal).

Schedule” and provides for “corrections” to product descriptions “that do not constitute a proposal to modify the market dominant product list.” (§3020.90.)

It would be beneficial if the Commission elaborated on the meaning of the term “correction.” A correction may simply be a change in a numbering scheme to accommodate the insertion of additional information or a spelling correction. However, the term “correction” might be interpreted more broadly as allowing the Postal Service to change a product description in a way that has substantive impact under the guise of a correction. For example, assume that postal operations change such that Standard Mail carrier route pieces could be processed more efficiently if the minimums were changed from the existing volume of 200 pieces per mailing to 225 pieces per mailing. The change, which might be claimed a “correction” because it does not change the product list, may have a significant impact on mailers entering Standard Mail carrier route mail. Even more onerous, suppose that the Postal Service chose to modify or eliminate price categories or entry levels in a particular product description. Separate price categories or entry levels are not separate products. (OCA argued in the initial comments that they should be separate products.) These updates of far-reaching substantive consequences might be labeled as mere “corrections” under the proposed rules and could be changed on 15 days notice without opportunity for comment.

There is no specific provision for the Postal Service to make changes to the list of product descriptions that have substantial substantive impact.¹⁸ What may appear as a seemingly small insignificant change may have major impacts on mailers and their

¹⁸ Similarly, while the rules provide for proposed changes to the product lists by users or the Commission (§§3020.50 and 3020.70), they do not appear to provide for proposed substantive changes to product descriptions.

mailing behavior. If the Commission does not specifically address this type of change in a product's description, a substantive change with only 15 days notice to mailers might be made. It could be contended that a substantive change in the description of the product amounts to removing the existing product from the list and adding a new product to the list pursuant to §3020.30 and, therefore, that this action gives rise to a change in the product list requiring Commission docketing and notice pursuant to §3020.33. Alternatively, it may be argued that any change to the description of a product, or a portion of a product on the list, that does not include a proposal to modify the product list, is deemed a "correction." Unless more specific guidance is provided by the Commission, the Postal Service may be able to make substantive changes to price categories or entry levels of products simply by changing product descriptions in ways that are neither corrections nor additions or subtractions of products from the product list.

Section 3020.1 (Applicability) states, "Once established, the Mail Classification Schedule may be modified subject to the procedures specified in this part." However, the above-mentioned types of modifications are not provided for in this part. The Commission should, therefore, for clarification, make provision in the rules for those types of changes to the product descriptions that are neither changes in products nor corrections to the lists, but are somewhere in between; those that may effectuate substantive changes in terms of service or availability of the products offered by the Postal Service.

6. Application of §3622(c)(2) requirement

Section 3622(c)(2) of the PAEA retains a fundamental principle of traditional Postal Service rate regulation established by the Postal Reorganization Act by providing for a system of regulation requiring postal rates to recover attributable costs. Under the PAEA, when establishing a system of regulation, the Commission must factor in the requirement that rates for a class or type of mail service cover attributable costs. See §3622(c)(2). The PAEA continues to emphasize the importance of costs in establishing rates. Emphasis on rates that will recover attributable costs does not hinder the Postal Service; it merely requires that the relevant costs be known and that decisions be based on transparent information. More detailed guidance from the Commission would facilitate an understanding about the Commission's views regarding the interplay of §3622(c)(2) and the other sections of the PAEA.

Clearly, there is a link between the financial well-being of the Postal Service and rate increases limited to a rate cap. The Postal Service may find ways to improve its productivity and efficiency, cover its attributable costs for each a particular class or type of mail service, and still maintain rates under the CPI cap. If the Postal Service is unable to balance the capped rate increases with increased costs, then tension will exist between the rate cap limitation and the need to assure adequate revenues, particularly the need to assure that attributable costs are being covered.¹⁹ For example, under the PAEA, tension arises between: 1) the requirement that the "system for regulating rates

¹⁹ See Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc., "Comments On Regulations Establishing A System Of Ratemaking in Response to Commission Order No. 2," Docket No. RM2007-1, April 6, 2007, at 10-11.

and classes for market-dominant products shall” include an annual limitation based on the CPI adjustment, (§3622(d)(1)(A)), and 2) the requirement establishing or revising a modern system for regulating rates and classes for market-dominant products such 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....” (§3622(c)(2).) The consensus of commenters is that the annual CPI limitation trumps all other provisions except perhaps the exigent circumstances provisions even if the attributable costs are not being met.

The Commission’s Order 26 touches upon the reverse situation, where the rate adjustment for a class is not as high as the annual CPI limitation allowable (new unused rate authority), but where the rates proposed do not cover attributable costs. Order No. 26 recognizes the possibility where a proposed rate adjustment may not generate enough revenue to cover attributable costs. The Order states:

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 at 19.)

This notion is essentially restated in the proposed rules:

§(3010.14(b) The notice of rate adjustment shall be accompanied by:

* * * * *

(4) The amount of new unused rate authority, if any, that will be generated by the rate adjustment calculated as required by rule 3100.26 [3010.26]. All calculations are to be shown with citation to the original sources. If new unused rate authority will be generated for a class of mail that is not expected to cover its attributable costs, the Postal Service should explain the rationale underlying this rate adjustment.

The rule’s provision for an explanation from the Postal Service of the reason for the inadequate rate adjustment, rather than an outright prohibition of such shortfall in rates, appears to negate long-standing Commission practice. That practice has been

based on interpretation of the same statutory language just re-enacted in the PAEA to ensure that the rates for each class or type of mail recover its direct and indirect attributable costs. The proposed rule diminishes the “requirement” by assuming the Postal Service’s failure to propose rates to meet the requirement may be explained away, thus essentially weakening the requirement that has been the bedrock of Commission ratemaking. For example, in Docket No. R2006-1, this Commission stated:

Recommended rates are developed in a two-step process. First, recommended rates for each class or type of mail *must* be adequate to recover “the direct and indirect postal costs attributable to that class or type [of mail].” (Emphasis supplied.)²⁰

Given the apparent dichotomy between the proposed rule §3010.14(b)(4) and the long standing practice of requiring rates to cover attributable costs, the Commission should explain its interpretation of the §3622(c)(2) requirement. If attributable costs are not covered by a particular class or type of mail service, the rates could be unjust. The Greeting Card Association comments in this docket clearly articulate this concern:

An individual rate may ultimately be labeled “unjust” seemingly without reference to other portions of the rate schedule; but it may in fact warrant that label just because of the flawed relationship with other rates. One clear case would be rates that fail to recover the attributable costs of the subclass concerned. ... [T]he injustice lies in the fact that (rates for) other mail must cross-subsidize the subclass enjoying non-compensatory rates.²¹

The restatement in the PAEA of the former provision in the Postal Reorganization Act, §3622(b)(3), supports continued emphasis on rates that cover attributable costs.

²⁰ PRC Op. R2006-1, paras. 4042-43.

²¹ Comments Of The Greeting Card Association In Response To Advance Notice Of Proposed Rulemaking, Docket No. RM2007-1, April 6, 2007, page 6, note 8.

Comments in this docket filed by the Association of Priority Mail Users, Inc. (APMU) illustrate the problem.

The draft Cost and Revenue Analysis ("CRA) [sic] for FY 2006 shows that one market-dominant product, Periodicals, lost the Postal Service \$355.1 million in FY 2006 – certainly not the first time that Periodicals rates have been set so low that they create a deficit that must be made up by other mailers. Certainly it is vital that steps be taken to ensure that products like Periodicals do not continue to be priced so low that actual revenues and costs demonstrate a loss, causing a hemorrhage in Postal Service revenues which would need to be made up by remaining products, including competitive products.²²

In view of the Commission's proposed rules, it would be helpful to the Postal Service and mailers to understand how a situation similar to the one identified above by APMU would be dealt with by the PRC in light of the proposed rule §3010.14(b)(4). For example, would the Commission view the Postal Service's filing under the previously mentioned conditions as a case acceptable for an exigent circumstances rate adjustment? In other words, it is possible that the limitation on the CPI adjustment, and when there is no banked rate authority, may preclude rates from recovering the costs attributable for a given class of mail that has no banked rate authority. Would such a circumstance qualify the Postal Service to file for an additional rate increase under the terms of an exigent case?

Additionally, the mailing community would benefit from the Commission's interpretation of the requirement in §3622(c)(2) for the following scenarios. For example, suppose the Postal Service proposes a rate increase for a given class of mail that would not cover that class's attributable costs. Further, assume that the given class does have banked rate increase authority. Given the requirement in §3622(c)(2), rather

²² Association of Priority Mail Users, Inc. "Comments on Regulations Establishing a System of Ratemaking in Response to Commission Order No. 2," Docket No. RM2007-1, April 6, 2007 at 2.

than merely offering an explanation pursuant to rule §3010.14(b)(4), should not the Postal Service be required to increase immediately that class's rates by using either the unused CPI authority or, if that limit is reached, use its banked rate increase authority, up to a maximum of two percent above the CPI?

7. The impact of an omnibus rate case filed prior to December 20, 2007, upon the operation of the proposed rules.

If the Postal Service files an omnibus rate case prior to December 20, 2007, does the Commission contemplate the new rules would permit the Postal Service to obtain rate adjustments pursuant to a Type 1, Type 2, or Type 3 filing prior to the conclusion of the rate case? The proposed rules do not restrict the Postal Service from also filing for rate adjustments during the pendency of an omnibus rate proceeding. The proposed rules may, however, restrict rate adjustments for 12 months after the date of implementation of omnibus rate proceeding rates as the rules limit rate adjustments in excess of the annual CPI limitation during each 12 month period. (§3010.11(c).)²³

Order No. 26 does not discuss the possibility of the Postal Service filing PAEA type rate adjustments during an omnibus rate case, or the potential impact on a rate adjustment filing, nor do the rules refer to such a possibility. Neither does Order No. 26 consider how such a rate adjustment might interfere with the procedures of a possible omnibus rate case. The Commission may wish to consider this possibility and discuss the matter, or provide in the final rules, whether there may be, or would be, restrictions

²³ However, this is not certain. The proposed rules might be deemed to limit rate increases within a twelve month period only if the increases are pursuant to the new system of regulation. Legacy rate increases resulting from an omnibus rate increase might be construed as not relevant to the new rules and therefore not recognized by the proposed rule as having occurred within the previous twelve month period.

or prohibitions placed upon rate adjustments if filed pursuant to the proposed rules during the pendency of an omnibus rate proceeding.

8. Clarification or correction of various proposed rules that either do not fully implement the Commission's intent as discussed in Order No. 26 or do not track the language of the PAEA

In this section, the OCA identifies issues and concerns about the Commission's proposed rules that warrant clarification. In some cases, specific words are proposed to be added; in others, more extensive changes to the proposed rules are offered. These changes are designed to clarify intent by aligning the wording of the proposed rules with the discussion in Order No. 26 or with the relevant statutory language applicable to such rules, or by modifying the wording to remove ambiguities. In each of the proposed rules reproduced below, specific word additions to the proposed rules are underlined. Each change is followed by a comment. Deleted text is bracketed ([]).

§ 3010.2(b) Upon the establishment of unused rate adjustment authority in any class or service, the Postal Service shall devise and maintain a schedule that tracks the establishment and subsequent use of unused rate adjustment authority by class and service.

To facilitate proper accounting through a Postal Service schedule that tracks the establishment and use of unused rate adjustment authority, the modifications proposed here clarify that unused rate adjustment authority may be established for any class "or service," and that the schedule is to track the establishment and use of unused rate authority "by class and service." This proposed change follows from a plain reading of the authority granted the Postal Service concerning the use of unused rate adjustment authority and the limitations on such use found in section 3622(d)(2)(C)(ii)-(iii). Clause (ii) permits the Postal Service to "use any unused rate adjustment authority for any of

the 5 years following the years such authority occurred,” subject to the limitations in clause (iii). Clause (iii) provides:

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

* * * * *

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

It is clear that the statute contemplates that the Postal Service could use any unused rate adjustment authority for any class or service, as long as that use did not exceed the annual limitation by more than 2 percentage points. It is therefore reasonable for the Commission to require the Postal Service to have a schedule that tracks the establishment and use of unused rate authority by class and service.

In other proposed rules, similar references to “service” have also been omitted. In the interests of completeness, the term “service” should be added to the following rules to make clear that the schedule is applicable not only to any class but to any service for which there is unused rate authority, and that unused rate authority can be used for services as well as mail classes: Rules 3010.3(c); 3010.4(a) and (b); 3010.11(b); 3010.14(b)(4); 3010.26(b); 3010.27; 3010.28; and, 3010.63 (a) and (c).

§ 3010.6(c) A Postal Service request for a Type 3 rate adjustment is subject to notice and opportunity for a public hearing and comment [public participation] and Commission review within 90 days.

The proposed additional text quotes the statutory requirement for public participation at section 3622(d)(1)(E) of the PAEA, and is consistent with proposed rule

3010.65, “Special procedures applicable to exigent requests,” which provide for notice, a public hearing and comment.

§ 3010.11(c) In any 12-month period the inflation-based annual limitation plus [combined with] the allowable recapture of unused rate authority, not exceeding the annual limitation by more than two percent, equals the price cap applicable to each class of mail or service.

Proposed § 3010.11(c) seeks to define the limit of rate increases applicable to market-dominant products in any 12-month period involving the use of unused rate authority. The price cap involving the use of unused rate authority is clearly described in proposed rule 3010.28. The changes OCA proposes here for rule 3010.11(c) seek to conform the defined limitation with the description of the price cap. Thus, the maximum size of unused rate authority that may be used is stated directly as “not exceeding the annual limitation by more than two percent.” In addition, the word “annual” is inserted before “limitation” to clarify that the inflation-based limitation is for an annual period, consistent with the wording of the statute in section 3622(d)(1).

§ 3010.13(b)(1) Whether the planned rate adjustments measured using the formula established in rule 3010.21(b) are at, [or] below, or above the annual limitation established in rule 3010.11; and

The change proposed here includes the term “above” to make explicit that public comments should also bring to the Commission’s attention planned rate adjustments that *exceed* the annual limitation measured using the formula established in rule 3010.21(b).

§ 3010.13(c) Within 14 days of the conclusion of the public comment period the Commission will determine whether the planned rate adjustments are consistent with the test for compliance with the annual limitation and issue a public notice and order notifying the Postal Service and announcing its findings.

Section 3622(d)(1)(C)(iii) of the PAEA directs “the Postal Regulatory Commission to notify the Postal Service of any noncompliance of the adjustment with the limitation under subparagraph (A).” The modification to proposed rule 3010.13(c) serves two purposes. First, it clarifies that the Commission’s notice satisfies the statutory requirement to notify the Postal Service where the Commission finds any noncompliance with respect to the adjustment. Second, the change enhances transparency by making clear that the notice and order and the Commission’s findings will be public.

§ 3200.12(c)(1) Except for final regulations published as provided in paragraph (2) of this section, only notices rather than a complete text of changes made to the Mail Classification Schedule are published in the *Federal Register*. These notices are published in the form of one summary transmittal letter for each issue of the Mail Classification Schedule. A complete issue of the Mail Classification Schedule, including the text of all changes published to date, will be filed with the Director, Office of the Federal Register.

Proposed rule 3200.12(c)(1) is corrected to add two words in the first sentence inadvertently omitted. The word “for” is inserted after “Except” and the word “a” is inserted after “than.”

CONCLUSION

Wherefore, OCA respectfully submits these comments to Order No. 26 and asks that they be considered by the Commission.

Respectfully submitted,

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APPENDIX: OCA Proposed Modifications to Proposed Subpart D of Part 3010.

**Subpart D—Rules for Rate Adjustments for Negotiated Service Agreements
(Type 2 Rate Adjustments)**

§ 3010.40 Negotiated service agreements.

(a) In administering this subpart, it shall be the objective of the Commission to allow implementation of negotiated service agreements that satisfy the statutory requirements of 39 U.S.C. § 3622(c)(10). Negotiated service agreements must either:

- (1) Improve the net financial position of the Postal Service (§ 3622(c)(10)(A)(i)), or
- (2) Enhance the performance of operational functions (§ 3622(c)(10)(A)(ii)).

(b) Negotiated service agreements may not cause unreasonable harm to the marketplace (§ 3622(c)(10)(B)).

§ 3010.41 Procedures.

The Postal Service, in every instance in which it determines to exercise its statutory authority to make a Type 2 rate adjustment for a market dominant postal product shall provide public notice in a manner reasonably designed to inform the mailing community and the general public that it intends to change rates not later than 45 days prior to the intended implementation date; and transmit a notice of agreement to the Commission no later than 45 days prior to the intended rate implementation date.

§ 3010.42 Contents of notice of agreement in support of a negotiated service agreement.

(a) Whenever the Postal Service proposes to establish or change rates or fees and/or the Mail Classification Schedule based on a negotiated service agreement, the Postal Service shall file with the Commission a notice of agreement. This shall include at a minimum:

- (b) *General.* Each notice of agreement will include:

(1) A copy of the negotiated service agreement[;]. All agreements that reward mailers (either with money or in kind) shall contain the following terms:

(i) A list of changes in mailer behavior to be rewarded;

(ii) For each change in mailer behavior, a unit of measure (volume, unit cost, etc.);

(iii) For each change in mailer behavior,

(A) a minimum (maximum) value of the unit of measure at which rewards commence, and

(B) a maximum (minimum) value of the unit of measure at which all rewards are forfeited;

(iv) For each change in mailer behavior that is rewarded in kind, liquidated damages to be paid in the event rewards are forfeited under § 3010.42(b)(1)(iii)(B).

(2) The planned effective date(s) of the proposed rates;

(3) A representation or evidence that public notice of the planned changes has been issued or will be issued at least 45 days before the effective date(s) for the proposed new rates; and

(4) The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission.

(c) A statement identifying all parties to the agreement and a description clearly explaining the operative components of the agreement.

(d) Clear and convincing evidence of the expected improvements in the net financial position or operations of the Postal Service for each year of the agreement. [Details regarding the expected improvements in the net financial position or operations of the Postal Service. The projection of change in net financial position as a result of the agreement shall include for each year of the agreement:]

[(1) The estimated mailer-specific costs, volumes, and revenues of the Postal Service absent the implementation of the negotiated service agreement;]

[(2) The estimated mailer-specific costs, volumes, and revenues of the Postal Service which result from implementation of the negotiated service agreement; and]

[(3) An analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement.]

[(4) If mailer-specific costs are not available, the source and derivation of the costs that are used shall be provided, together with a discussion of the currency and reliability of those costs and their suitability as a proxy for the mailer-specific costs.]

(e) An identification of each component of the agreement expected to enhance the performance of mail preparation, processing, transportation or other functions in each year of the agreement, and a discussion of the nature and expected impact of each such enhancement.

(f) Details regarding any and all actions (performed or to be performed) to assure that the agreement will not result in unreasonable harm to the marketplace.

(g) Such other information as the Postal Service believes will assist the Commission to issue a timely determination of whether the requested increases are consistent with applicable statutory policies.

§ 3010.43 Data reporting. [Data collection plan.]

The Postal Service shall provide the following annualized information within 60 days of each anniversary of implementation of an agreement: [The Postal Service shall include with any notice of agreement a detailed plan for providing data or information on actual experience under the agreement sufficient to allow evaluation of whether the negotiated service agreement operates in compliance with § 3622(c)(10). This shall include, at a minimum, a plan for providing the following annualized information on a yearly basis within 60 days of the date of implementation of a proposed agreement:]

(a) An estimate of the change in net financial position as a result of the agreement. [The change in net financial position as a result of the agreement. This calculation shall include for each year of the agreement:]

[(1) The actual mailer-specific costs, volumes, and revenues of the Postal Service; and]

[(2) An analysis of the effects of the negotiated service agreement on the net overall contribution to the institutional costs of the Postal Service.]

[(3) If mailer-specific costs are not available, the source and derivation of the costs that are used shall be provided, including a discussion of the currency and reliability of those costs, and their suitability as a proxy for the mailer-specific costs.]

(b) The actual value of each unit of measure required under § 3010.42(b)(1)(ii).

(c) A discussion of the changes in operations of the Postal Service that have resulted from the agreement. This shall include, for each year of the agreement, identification of each component of the agreement known to enhance the performance of mail preparation, processing, transportation, or other functions in each year of the agreement.

(d)[(c)] An analysis of the impact of the negotiated service agreement on the marketplace, including a discussion of any and all actions taken to protect the marketplace from unreasonable harm.