

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

REGULATIONS ESTABLISHING SYSTEM)
OF RATEMAKING)

Docket No. RM2007-1

**COMMENTS OF
ALLIANCE OF NONPROFIT MAILERS AND
MAGAZINE PUBLISHERS OF AMERICA, INC.
ON ORDER NO. 26**

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**BEFORE THE
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REGULATIONS ESTABLISHING SYSTEM)
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**REPLY COMMENTS OF
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ON ORDER NO. 26**

The Alliance of Nonprofit Mailers (“ANM”) and Magazine Publishers of America, Inc. (“MPA”) respectfully submit these comments in response to Order No. 26, “Order Proposing Regulations To Establish A System Of Ratemaking,” issued by the Commission on August 15, 2007, and published in the Federal Register at 72 Fed. Reg. 50744 (September 4, 2007).

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

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

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

Postal Accountability and Enhancement Act (“PAEA”). In particular, the following aspects of the Commission’s proposals are clearly consistent with the statute:

- (1) While the Commission may require a notice period longer than 45 days under 39 U.S.C. § 3622(d)(1)(C), which requires that the Postal Service provide notice of proposed rate changes “not later than 45 days before the implementation of any adjustment in rates under this section,” a general rule requiring a longer period (e.g., four months) would be inconsistent “with the notion of streamlined review” contemplated by Congress. Order No. 26 ¶ 2020.
- (2) While interested parties may file comments on proposed rate changes within 20 days after the Postal Service files notice of the changes, the “proposed scope of public comment is no longer open-ended,” and the Commission “does not invite, and will not entertain, public comment during the 45-day review period on matters such as costing methods.” Order No. 26 ¶¶ 2023 and 2029; Proposed Rule 3010.13(a) and (b).
- (3) “In keeping with the new statutory emphasis on simpler proceedings, the Commission” properly “does not propose formal discovery, Notices of Inquiry, Presiding Officer’s Information Requests, testimony, [or] hearings.” Order No. 26 ¶ 2026; Proposed Rules 3010.13 and 3010.14.

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

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

- (1) The “moving average” method proposed by the Commission for calculating the CPI-U limitation is reasonable and consistent with the statute. Order No. 26 ¶¶ 2049-2063; Proposed Rules 3010.21 and 3010.22.
- (2) Unused rate authority for a given class of mail may be applied only to the class where the authority originated. Order No. 26 ¶¶ 2064-2065; Proposed Rules 3010.26(b), 3010.27; see *also* ANM-MPA Reply Comments (May 7, 2007) at 3-6.
- (3) The weighting method for calculating the overall rate increase for a class of mail is generally reasonable and consistent with the statute. Order No. 26 ¶¶ 2069-2078.
- (4) The billing determinant adjustment specified in proposed rule 3010.23(d) provides an appropriate method for calculating weighted average revenue for a class in the presence of classification changes. See ANM-MPA Comments (June 18, 2007) at 1-3.

The Commission should clarify or modify two aspects of these rules, however. First, the third sentence of proposed rule 3010.23(b) states that “In the case of seasonal or temporary rates, the most recently applied rate shall be considered the current rate.”

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

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

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

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

is particularly important in rate indexing for regulated industries that are not experiencing rapid productivity gains.³

The Commission, while emphasizing that it is “sympathetic to these concerns,” proposes to defer consideration of a quality adjustment until after the promulgation of rules for the collection of data on service performance. Order No. 26 ¶ 2067. In the interim, the Commission states only that it “expects that the Postal Service will operate within both the letter and the spirit of the PAEA.” *Id.* ¶ 2068.

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

Fleshing out the details of such an adjustment mechanism will become more practical once service standards and performance measurement systems are in place. The issue should be revisited as soon as possible after that occurs, as the Commission appears to contemplate doing. Relying indefinitely on nothing more than a general admonition “that the Postal Service will operate within both the letter and the spirit of the

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

PAEA” would leave a major gap in the regulatory safeguards against abuse of the Postal Service’s residual market power.

III. RATE ADJUSTMENTS IN EXIGENT CIRCUMSTANCES (RULES 3010.60 THROUGH 3010.66)

ANM and MPA also support the Commission’s overall approach to implementing the exception to the index-based cap authorized by 39 U.S.C. § 3622(d)(1)(E) for “extraordinary or exceptional circumstances.” See Order No. 26 ¶¶ 2093-2105. In particular, the Commission has acted properly by declining to “explicitly define ‘exigent circumstances’” and by “explicitly convey[ing] the message that exigent requests are indeed ‘extraordinary or exceptional.’” *Id.* ¶ 2105.⁴

Several aspects of the proposed rules for exigent circumstances, however, warrant clarification. First, proposed rule 3010.61(a)(6) directs the Postal Service, in requesting approval of an exigent rate increase, to explain “when the exigent increase will be rescinded” and if the increase “is intended to be permanent or temporary.”

⁴ For the reasons explained in the April 6 comments filed jointly by ANM and MPA, the language, structure and legislative history of § 3622 do not authorize the Postal Service to raise rates above the levels authorized by § 3622(d) on the theory that the class would otherwise fail to recover its attributable costs. ANM-MPA Comments (April 6, 2007) at 2-9. For similar reasons, the failure of an individual class of mail to cover attributable costs cannot, without more, constitute the “extraordinary” or “exceptional” circumstance required to justify an above-CPI increase for the class under the exigency provision of Section 3622. ANM-MPA Comments (April 6, 2007) at 11-12. The Commission cites, without discussion, the suggestion of another party, Time Warner, that the failure of a single class to recover attributable costs might, in theory, “constitute exigent circumstances justifying above-cap increases” if the revenue shortfall is extreme enough. Order No. 26 ¶ 2102. It is difficult, however, to imagine any circumstance in which a negative cost coverage for an individual class of mail (particularly a relatively low-volume class like Periodical Mail) could have financial consequences so severe as to threaten the continuation of mail service without having the underlying changes in costs, revenue or volume cause significant losses in other mail classes as well.

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

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

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

Third, the Commission should administer the exigency provision in a manner that is consistent with the PAEA’s shift to a rate index-based system for market-dominant products. The proposed rules should specify that the only remedy allowed in an exigent circumstance is an across-the-board increase in the price cap. For example, if a four percent increase is found to be necessary, the allowable rate increase for each market-dominant mail class must be established at four percent. Allowing the Postal Service to

implement non-uniform increases in an exigent circumstance could inappropriately trigger a return to cost-of-service regulation.⁵

CONCLUSION

ANM and MPA respectfully request that the Commission adopt its proposed rules with the changes discussed herein.

Respectfully submitted,

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⁵ For similar reasons, the Postal Service should be required to use all unused rate increase authority in all classes before requesting a rate increase under the exigency provision.