

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268

ADMINISTRATIVE PRACTICE AND PROCEDURE,
POSTAL SERVICE

DOCKET NO. RM2007-1

REPLY COMMENTS OF TIME WARNER INC.
IN RESPONSE TO INITIAL COMMENTS ON
COMMISSION ORDER NO. 26
(October 9, 2007)

Time Warner Inc. ("Time Warner") hereby submits comments in reply to the initial comments on Commission Order No. 26 that were filed on September 24, 2007. These Reply Comments address four topics:

- (1) proposed rule 3010.61(7), concerning the requirements for exigent rate increases, which is addressed in the initial comments of various parties;
- (2) proposed rule 3010.14(b)(4), concerning failure of a market-dominant class of mail to recover its attributable costs, which is addressed in the initial comments of the Office of the Consumer Advocate (OCA) and Valpak;
- (3) Order No. 26, ¶¶ 3023 and 3079, stating the Commission's intention to treat negotiated service agreements (NSAs) within both the competitive and market-dominant categories as separate products, which are addressed in the initial comments of the Postal Service, Advo, Inc. (Advo), DFS Services LLC, and Parcel Shipper Association (PSA); and
- (4) the arguments of the Office of the Consumer Advocate concerning procedures for implementation of NSAs and requests by the Postal Service to update the mail classification schedule.

I. THE COMMISSION SHOULD (1) CLARIFY ITS DISCUSSION OF PROPOSED REGULATIONS REGARDING EXIGENT RATE INCREASES, AND (2) DELETE FROM ITS PROPOSED REGULATIONS SPECIFIC REQUIREMENTS FOR EXIGENT RATE INCREASES ADDITIONAL TO THOSE STATED IN THE ACT

At the outset of its discussion of "Rules for Rate Increases in Exigent Circumstances," Order No. 26 notes that "Pitney Bowes and Time Warner share the Postal Service's view that the Commission should not attempt to define qualifying circumstances at this time." ¶ 2097. The Commission observes that "[t]he Postal Service describes the PAEA's exigency clause as a safety valve for those "extraordinary or exceptional situations in which the [price] cap cannot be met even through honest, efficient, and economical management"--a description that appears carefully to track the language of § 3622(d)(1)(E)--and it states that the Postal Service "asserts, with respect to defining exigent circumstances, that it is not necessary or prudent for the Commission to attempt to specify in this rulemaking the situations that might be covered in advance of an actual need to do so." ¶ 2096 (citing Postal Service Reply Comments, May 7, 2007, at 15). It also quotes the following recommendation by Time Warner:

. . . the Commission need not and should not attempt to determine a substantive standard for granting Postal Service requests under the exigent circumstances provision (other than the standard set out in § 3622(d)(1)(E) itself) until presented with the concrete circumstances attending an actual Postal Service request under that provision; the kind of judgment that the Commission is called on to make in deciding whether to grant such a request cannot be exercised well in the abstract or upon hypotheticals; moreover, to the extent that such a standard might err of the side of leniency, it would undermine the discipline that the price caps are intended to instill, and to the extent that it might err on the side of stringency, it could create perverse incentives to find alternative ways of circumventing the caps.

¶ 2097.

The Commission's subsequent discussion, however, does not state whether the Commission agrees with these views or regards its proposed regulations as consistent with them. Nor does it make clear that the Commission has correctly understood the comments of the Postal Service, Time Warner, and Pitney Bowes.

Perplexingly, having quoted the Postal Service's description of the exigency clause, which faithfully tracks the language of § 3622(d)(1)(E), and having taken note of the Postal Service's admonition against "defining exigent circumstances . . . in advance of an actual need to do so" [¶ 2096], the Commission states:

At this point, it should be assumed that the Postal Service's intent is to honor the clear import of the PAEA's overarching ratesetting philosophy that exigent requests are meant to be a safety net for dealing with unforeseeable emergencies.

[¶ 2105.]

This formulation is quite different from the Postal Service's description of the exigency clause quoted by the Commission, and it appears to add to the definition of "exigent circumstances" elements not found in the statutory text. Subsection (7) of proposed rule 3010.61, which sets out the requirements for requests for exigent circumstance rate increases, incorporates this characterization of "the clear import of the PAEA's overarching ratesetting philosophy." Among the things the Postal Service would be required to provide is:

(7) A justification for exigent treatment which analyzes why the circumstance giving rise to the request was neither foreseeable nor avoidable by reasonable prior action. . . .

The Comments of the National Postal Mail Handlers Union (NPMHU) argue that the Commission's characterization of "the PAEA's overarching ratesetting

philosophy" and its proposed subsection (7) go well beyond the requirements for an exigent circumstances increase stated in the Act and are, in fact, "contrary to the PAEA's language and legislative history." NPMHU Comments at 5. According to NPMHU, the requirements that exigent circumstances amount to an "emergency," that they not have been "foreseeable," and that they not have been "avoidable by reasonable prior action" are all unsupported by and inconsistent with the language of the exigent circumstances provision.

With respect to whether exigent circumstances must have been "unforeseeable," NPMHU points out that the final bill's replacement of "the Senate's conjunctive requirement that circumstances be both 'unexpected *and* extraordinary' (emphasis added) . . . with explicitly disjunctive language, under which an above-CPI adjustment could be justified by circumstances that are '*either* extraordinary *or* exceptional' (emphasis added)" indicates that "Congress flatly rejected the notion that the availability of above-CPI rate adjustments was limited to circumstances that were 'unforeseeable' or 'unexpected.'" This argument appears well-nigh unanswerable. In any event, as far as Time Warner is aware, it has never been answered.

With respect to whether the circumstances must constitute "an emergency," NPMHU states:

While it may be expected that most, if not all, requests for rate adjustments under § 3622(d)(1)(E) will be "exigent" in the sense of "urgent" (and therefore will be "expedited," as § 3622(d)(1)(E) requires), that term by no means defines the circumstances under which an above-CPI rate adjustment may be made. The test for whether such an adjustment request should be approved under § 3622(d)(1)(E) is not whether it is "exigent," but rather whether there exist "either extraordinary or exceptional circumstances," such

that the adjustment is “necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” 39 U.S.C. § 3622(d)(1)(E).

NPMHU's formulation of "[t]he test for whether such an adjustment request should be approved" is virtually identical to that of the Postal Service quoted by the Commission. Moreover, it is difficult to argue with the proposition that the terms "extraordinary or exceptional" and "necessary," while they may connote circumstances that are quite unusual and entail some degree of urgency, cannot, without exceeding their definitional breaking point, be made synonymous with "unforeseen emergency."¹

NPMHU doesn't quite manage to state why the proposed requirement that the circumstances not have been "avoidable by reasonable prior action" is equally objectionable as going beyond the terms of the statutory language. But it is not difficult to fill in the steps here. The exigent circumstances provision states that the requested rate increase must be “necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” That language is virtually identical to language in § 3621 of the PRA, which the Postal Rate Commission sought to rely on as authority for withholding requested revenues from the Postal Service when the Commission

¹ NPMHU also points out that "[t]he terms 'exigent' and 'exigency' appear nowhere in the statute" and that the frequent repetition of these terms "as a substitute for the above-CPI rate adjustments available under § 3622(d)(1)(E) . . . readily leads the reader to assume . . . that this is the relevant statutory term and the basis for determining whether rates can be adjusted under § 3622(d)(1)(E)." NPMHU Comments at 8-9. For want of an equally convenient shorthand reference, Time Warner uses those terms herein, but we grant that NPMHU makes a fair point.

concluded that the underlying costs had not been "prudently incurred" (i.e., had not been incurred through "honest, efficient, and economical management"). The courts rejected the Commission's assertion of such authority, holding that the division of powers created by the PRA vested the Governors with final authority on policy judgments about the Postal Service's revenue requirement.²

The meaning of the "under honest, efficient, and economical management" language, long a subject of controversy under the PRA, was, as far as Time Warner is aware, never definitively settled. Moreover, the exigent circumstances provision of the PAEA effects a crucial change from the PRA; for the first time, the Commission is given final authority to judge the reasonableness of the Postal Service's assessment of its revenue needs. Nevertheless, there are reasons for the Commission to be cautious about interpreting this language as authorizing it to deny an exigent circumstances increase on the grounds that the need for the increase could have been avoided by prudent management action. First, the natural reading of the "honest, efficient, and economical management" language is that it is *prospective* in outlook, i.e., that the requested revenues must be necessary in order to *go forward* with management of the Postal Service on an "honest, efficient, and economical" basis. Second, the reasonableness or efficacy of punishing past mismanagement by withholding requested revenues is likely to depend on the circumstances of the specific case. It may be that the burden would fall on innocent ratepayers or on the financial stability of the system. In order to defeat the argument

² See *Newsweek, Inc. v. U.S. Postal Service*, 663 F.2d 1186, 1205 (2d Cir. 1981), *aff'd sub nom. Nat. Ass'n of Greeting Card Pub. v. U.S. Postal Service*, 462 U.S. 810 (1983) ("the PRC's reduction of the contingency provision . . . was an unlawful intrusion into the policy-making domain of the Board").

for a *requirement* that the exigent circumstances not have been "avoidable by reasonable prior action," it is not necessary to show that this will *always* be the case but only that it may *sometimes* be so.

Having fully reviewed the arguments presented to the Commission thus far, we turn to the question that chiefly animates our concern about subsection (7): how will it look to a reviewing court? We approach that question with two basic precepts in mind. First, courts will give considerable deference to the Commission's exercise of judgment about the overall reasonableness of a requested exigent circumstances increase in light of the particular facts and circumstances of the case and of the various factors, objectives, and requirements contained in § 3622 of the PAEA. (It should be remembered that the exigent circumstances provision exempts the requested rates from the applicability of the annual limitation, but not from other statutory provisions.) Second, the courts will give much less deference to Commission interpretations of the statutory text, and (despite ongoing debates about the appropriateness of consulting legislative history) they will give the least deference to Commission interpretations of law where the legislative history appears to provide a clear answer to the question of Congressional intent.

A rule that displaces the statutory standard with a different one, especially one that was expressly considered and rejected by Congress, could place Commission decisions on exigent circumstances requests in substantial, and unnecessary, jeopardy on judicial review. NPMHU's Comments ought to alert the Commission to the danger that subsection (7) could be seen as such a rule.

Consider a hypothetical case in which the Postal Service requests an exigent circumstances increase on the basis of an arbitrator's decision that increases compensation levels by significantly more than the rate of general inflation. One can imagine a decision rejecting such a request on the grounds that, given the history of labor arbitration awards, the circumstances were not unforeseeable, and that a reasonably prudent Postal Service management ought to have prepared for such an eventuality by devoting more of its previous earnings to debt retirement and less to bonuses. One can also imagine a decision rejecting such a request on the grounds that, given the history of labor arbitration awards, the circumstances were neither exceptional nor extraordinary, and that the goal of maintaining and continuing the development of postal services "under best practices of honest, efficient, and economical management" would better be served by a denial that causes Postal Service management in future to devote more resources to being prepared for such an eventuality than by an approval that encourages Postal Service management to rely on future exigent increases to bail it out in the event of future superinflationary labor awards. And one can also imagine a decision rejecting such a request in which the two rationales described above were both present and in which their roles in determining the outcome were not easily disentangled.

Irrespective of whether the regulations included subsection (7), the first of these three decisions would be subject to reversal on appeal as applying a different standard from that stated in the Act; however, the existence of a subsection (7) might overcome any arguable doubt that the Commission had in fact acted under a misunderstanding of the standard stated in the Act. The second decision would

almost certainly withstand judicial review; however, it bears remarking that, if the regulations included subsection (7), the Commission would have to go out of its way in crafting its decision not to rely on the requirements of that subsection or on the relative adequacy of the Postal Service's arguments that it had met those requirements. The third decision would be vulnerable to a judicial remand for a clarification of the legal bases on which the ultimate outcome reached by the Commission actually relied, and possibly to reversal on the ground that the existence of subsection (7) showed conclusively that the Commission had acted under a misinterpretation of the statutory standard.

The point of these three hypotheticals is that subsection (7) would, at best, complicate the Commission's task and, most likely, put the Commission's decision at risk on judicial review. If it is the purpose of the Commission to put the Postal Service and other parties on notice that it does not intend to interpret or apply the statutory standard of "extraordinary or exceptional circumstances" in a lax or permissive fashion--to indicate, for instance, that it interprets the exigent circumstances provision as requiring circumstances that are "truly exceptional" rather than exceptional in some trivial sense--then, in Time Warner's view, its purpose is legitimate, laudable, and fully consistent with Congressional intention. Moreover, a statement by the Commission that it would *ordinarily* expect exigent circumstances to involve circumstances that were unforeseeable or, if foreseeable, impossible to prevent or provide for through reasonable prior action, would not entail the dangers of being found to have misinterpreted the statutory standard that would

be entailed in a rule which elevated this general expectation into an inflexible requirement.

Making such an adjustment would not require extensive revision of the Proposed Rule. It could be accomplished by two changes. First, the Commission should clarify that its reference to "the clear import of the PAEA's overarching ratesetting philosophy that exigent requests are meant to be a safety net for dealing with unforeseeable emergencies" is indeed intended as a characterization of the Act's "overarching ratesetting philosophy" and *not* as a restatement of the requirements of § 3622(d)(1)(E). Second, the Commission should revise proposed subsection (7) in order to remove any implication that it describes threshold or definitional requirements for coming within the terms of § 3622(d)(1)(E). Proposed subsection (7) of rule 3010.61 requires the Postal Service to provide:

(7) A justification for exigent treatment which analyzes why the circumstance giving rise to the request was neither foreseeable nor avoidable by reasonable prior action. . . .

An alternative version might require:

(7) An analysis of whether the circumstance giving rise to the request was foreseeable or could have been avoided by reasonable prior action. . . .

Time Warner does not press this matter on the Commission's attention because it is immune to the common aversion of its brethren to the prospect of an exigent circumstances increase. Rather it does so because: (1) it fears that the Commission's proposed regulations may place decisions *rejecting* requests for exigent circumstances increases in danger of reversal on review; and (2) because it does not regard an exigent circumstances increase as *necessarily* the worst

possible outcome in every conceivable set of circumstances that might have been foreseen or averted--for example, in cases where the only alternative to an exigent circumstances increase is (a) severe service degradation, or (b) rate or classification changes within the constraints of the price caps that would have a devastating effect on a substantial portion of the mailstream (see next section), or (c) measures that could undermine the financial stability of the postal system.

II. AT THIS EARLY STAGE OF PAEA IMPLEMENTATION, PROPOSED RULES 3010.14(b)(4) & (7) ADEQUATELY ADDRESS THE ISSUE OF ATTRIBUTABLE-COST RECOVERY BY MARKET-DOMINANT CLASSES

Only one of the proposed regulations specifically addresses the attributable-cost recovery requirement of § 3622(c)(2). Among the requirements for a notice of rate adjustments is proposed rule 3010.14(b)(4), which states in part:

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 initial comments of Valpak Direct Marketing Systems, Inc. and Valpak Dealers Association, Inc. (Valpak) and the Office of the Consumer Advocate (OCA) express dissatisfaction with the Commission's treatment of this issue.

Valpak, stating that it finds it "[c]urious[]" that this "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," recommends that the Commission expand its required explanation:

[U]nder the circumstance where an entire class (or product) of mail has . . . 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 [to] 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.

Valpak Comments at 19, 20.

The more militant OCA would replace "[t]he rule's provision for an explanation from the Postal Service [with] an outright prohibition of such shortfall in rates" and would require the Postal Service "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."

Both of these suggestions prejudge the question of how the failure of a class to recover attributable costs can best be addressed under the PAEA, a question we think better resolved in light of the facts and circumstances of specific cases.

Moreover, any legitimate purposes of Valpak's proposed expansion of rule 3010.14(b)(4) are already adequately served by rule 3010.14(b)(7), which requires:

[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).

Valpak's and OCA's comments extend beyond their expressions of dissatisfaction with proposed rule 3010.14(b)(4), however. Each gives substantial attention to the subject of the attributable-cost recovery requirement, and each takes the general position that this is a serious matter which the Commission has failed to address seriously. However, both Valpak and OCA completely ignore Time Warner's extensive previous comments covering the same ground. See Reply

Comments of Time Warner Inc. to Initial Comments in Response to Commission Order No. 2 (May 7, 2007), at 23-34.

Time Warner's previous comments addressed in detail "the question of how to enforce § 3622(c)(2)'s attributable-cost recovery requirement" (*id.* at 1). We expressed our full agreement with comments of other parties to the following effect:

(1) § 3622 creates a hierarchy of statutory authority as outlined by the Postal Service, ANM/MPA, and Senators Carper and Collins; (2) that the exigent circumstances and banking provisions of § 3622(d) provide the *exclusive* authority for increasing rates for any market-dominant class in excess of the caps; (3) that the use of the word "requirement" in § 3622(c)(2) does not elevate the failure of a market-dominant class to recover its attributable costs to the status of "exigent circumstances"; and (4) that the proper mechanism for Commission enforcement of compliance with the requirement of 3622(c)(2) is the remedial provisions of § 3662 (which do not include the power to authorize rate increases in excess of the annual limitation), pursuant to proceedings under that section or under § 3653.

Id. at 25-26.

However, we found the comments of other parties to be "less satisfactory . . . in dealing with the significance, if any, of the use of the word 'requirement' in § 3622(c)(2) and with what actions either must or should be taken if a class fails to recover its attributable costs at the maximum rates permitted by the caps." *Id.* at 26. We therefore proceeded to address such questions as the following, which had not been raised in any of the earlier comments:

Granting that failure of a class to recover attributable costs does not, in itself, create a basis for rate increases in excess of the caps, does such a failure *necessarily* constitute "noncompliance" for purposes of applying § 3653 or § 3662?

Granting that failure of a class to recover attributable costs does not, in itself, create a basis for rate increases in excess of the caps, can such a failure (e.g., a chronic or

catastrophic failure to recover attributable costs) ever amount to exigent circumstances?

Id. at 27.

Valpak and the OCA purport to answer those same questions (albeit in some respects elliptically) but are apparently unwilling to come to grips with the more persuasive answers already suggested by Time Warner.

Valpak's Comments provide a stark account of the failure of Periodicals class, by an increasingly large percentage, to recover its attributable costs in any of the past ten years:

The PRA contained a **requirement** that revenues from each class of mail must cover attributable costs. Under the PRA, the Commission consistently interpreted this statutory requirement as applying at the subclass level, and **mandatory**. 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. 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. Clearly, the Commission’s procedures under the PRA 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.

Valpak Comments at 17-18 (footnotes omitted; emphasis in original).

Valpak's plain implication is that under the PRA the Postal Rate Commission persistently failed to carry out its legal obligation to enforce the requirement of § 3622(b)(3).

The course of events that Valpak describes is assuredly both striking and troubling. No participant in Commission proceedings has been more committed than Time Warner to identifying the root causes of these developments--chiefly, excessively high Periodicals class costs, owing in part to flaws in the Postal Service's cost-measurement systems and in part to a Periodicals rate structure that encourages inefficient mailing practices--and to doing everything possible to see that they are eliminated.³ However, in the context of the instant rulemaking, which concerns interpreting the meaning of the PAEA and designing practical and effective steps for carrying out that meaning, Time Warner attributes a different significance to this history than does Valpak. We do not conclude that the Postal Rate Commission persistently failed to carry out its legal obligations under the PRA, but rather that the Postal Rate Commission's understanding of what the attributable-cost recovery requirement of § 3622(b)(3) actually "required" or "mandated" differed from the view espoused by Valpak.

Valpak's discussion reflects a common misunderstanding of the significance of the term "requirement," not only in the PRA (and now the PAEA) but in regulatory statutes in general: namely that what is "required" is some ultimate outcome, whereas in fact all that such laws can and do require is that agencies act in some

³ The state of affairs that Valpak describes was the basis on which Time Warner, in 2004, took the extraordinary step of filing a Complaint requesting a full-scale re-evaluation of the Periodicals rate structures. See Docket No. C2004-1, Complaint of Time Warner Inc. et al. Concerning Periodicals Rates. The Complaint was just one in a series of efforts by Time Warner to bring recognition to the developing problem and see that something was done about it. See, e.g., Docket No. RM92-2, Petition [of Time Warner Inc. et al.] to Initiate a Rulemaking Proceeding to Consider the Costing of Automation-Related Mail Processing Costs (June 26, 1992).

particular way.⁴ The denomination of a thing as a "requirement" in legislation directed to an agency does not normally mean, and does not mean in either the PRA or the PAEA, that the agency must *insure*, or *guarantee*, or *make certain* some ultimate result. It simply means that the thing so denominated is *nondiscretionary* (assuming (1) that the agency has the legal power to carry it out, and (2) that doing so is not incompatible with some other congressional directive that is also denominated as mandatory). (See *National Ass'n. of Home Builders v. Defenders of Wildlife*, 551 U.S. ___ (2007) [slip. op. at 19-21]).

Valpak is therefore strictly *incorrect* when it states: "The PRA contained a **requirement** that revenues from each class of mail must cover attributable costs." It would be more accurate to say: "The PRA contained a requirement that the Commission recommend rates calculated to produce revenues from each class of mail at least equal to that class's attributable costs." This is a requirement which, in Time Warner's view, the Postal Rate Commission consistently carried out in good faith.⁵

⁴ OCA's comments reflect the same mistaken conception of the significance of the term "requirement" (see below). The interpretation of § 3622(b)(3) or the PRA generally rests on a misunderstanding of the import of the Supreme Court's observation in the *NAGCP IV* case that § 3622(b)(3) was the *only* ratemaking factor denominated a "requirement" by the PRA. The meaning of that observation was that the Commission possessed no discretion about whether to recommend rates for each class calculated to recover that class's attributable costs, *not* that the Commission was obliged to arrange some sort of guarantee of the outcome of future events not within its control.

⁵ The reason for the unhappy state of affairs described by Valpak is a prolonged period of inflation in Periodicals class costs in excess of what appeared reasonable or likely to continue into the future. See, e.g.: Docket No. C2004-1, Order No. 1446 (October 21, 2005), at 15: "The inordinately high rate of Periodicals cost increases over a period of years coupled with a perception of declining service has prompted a number of approaches to explaining and attempting to alleviate the problem"; PRC Op. R2000-1 (November 13, 2000), ¶¶ 5577, 5593: "Sharply increasing mail processing costs are a major cause for the Service again proposing above-average rate increases for Periodicals. Therefore, the Commission pressed the Service to assist in identifying definitive reasons for the historical pattern of above-average mail processing cost increases. . . . The only conclusion is not comfortable: there are

Turning from the old law to the new, Valpak argues that, "[w]ith 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," and that under the PAEA "[f]ailure 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)." *Id.* at 18.⁶ Valpak then proceeds to ruminate on a related question: assuming that there is a substantial gap between a

many reasons for believing that costs should have decreased; only a few factors that could be associated with increases; and a persistent net upward trend"; PRC Op. R97-1 (May 11, 1998), ¶ 5812: "Another factor supporting a low cost coverage . . . is the contention that Periodicals costs are too high and have been rising at an excessive and unexplained rate for the last 11 years."

⁶ Though not central to our discussion here, Time Warner does not wish to imply by silence acceptance of the following misconceptions propounded in Valpak's statement.

(1) The PAEA's attributable-cost recovery requirement for the market-dominant category applies to "classes," and there is no evidence that Congress used this term to mean "subclasses" (a category with little continuing significance under the PAEA).

(2) Nowhere does the PAEA imply that the existence of a cross-subsidy necessarily violates the "just and reasonable" requirement. The fact that the PAEA *expressly* creates attributable-cost recovery requirements for certain categories of mail (i.e., market-dominant classes and competitive products) is logically inconsistent with any such inference.

It is true that under the PRA the Commission applied a general (albeit far from binding) presumption against cross-subsidies within classes. However, that policy was grounded in the PRA's "fair and equitable" provision, which has not been carried forward into the PAEA.

The legislative history of the PRA makes clear that the primary purpose of *that Act's* attributable-cost recovery requirement was to prevent inter-class cross-subsidies. That purpose was a fundamental aspect of the regulatory theory on which the Act was based, which included the grouping of products into subclasses with distinct cost and demand characteristics and which required that the total costs of the system be funded through rates.

The purpose of the attributable-cost recovery requirement for market-dominant classes in the PAEA is far less clear. What is clear, however, is: that the requirement is no longer tied to groupings of mail that are defined with respect to a set of relevant common economic characteristics (the concept of "subclasses" is largely abandoned and replaced by "products"); that the requirement is demoted from its place as a central principle of the regulatory scheme (and replaced in that role by the price caps).

class's revenues and its attributable costs, what action must be taken to remedy the situation? Valpak states:

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.

Valpak Comments at 19.⁷

Valpak's logic here is above criticism. It is absolutely true 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." But the approach that Valpak describes suffers from the same deficiency as some other approaches that have been suggested: namely, its totalitarian nature, which subordinates every other possible consideration to a single narrow principle.

For Valpak, the principle is that costs and revenues must be made to

⁷ It is not clear what assumption, if any, Valpak is making about the permissibility of breaching the caps. Nowhere in its discussion does Valpak even refer to the question of whether, and under what circumstances, an exigent rate increase might be a permissible or appropriate way of dealing with an intractable failure by a class to recover its attributable costs even at the maximum rates permitted by the price caps.

converge *immediately, no matter what the practical consequences*.⁸ So, while it is true, for instance, that pricing all products in the Periodicals class at no less than the product's attributable costs would in short order cause revenues for the entire class to exceed costs, it is also true that this result might depend on driving some thousands of magazines out of the mails and out of business. Moreover, other classes might wish to hold off on celebrating the removal of the burden of cross-subsidy that they have been carrying, at least until it is determined how much excess labor capacity the dramatic reduction in Periodicals volumes have created, and where in the system the excess workers have found refuge. Irrespective of such consequences, Valpak implies, the letter of the law must be obeyed.

The OCA's analysis follows essentially the same pattern as Valpak's. The OCA reads the attributable-cost recovery requirement as establishing not merely a *nondiscretionary policy* but a kind of absolute edict similar to a criminal law, and finds the Commission's disinclination to approach the requirement in the same way

⁸ Similarly totalitarian is the approach that would subordinate every other consideration to the principle that rates for the class must not be allowed to exceed the price cap, no matter what the practical consequences. In an earlier round of comments, the National Newspaper Association (NNA), in the course of arguing that failure of a class to recover attributable costs must *never* be a basis for breaching the price caps, stated:

[T]he primacy of the incentive to control costs means that when the attributable cost goal is not met, the Postal Service must return to the expense side of its income statement and address ways to bring the cost into line with the rates it is permitted to charge.

Time Warner replied that this answer "subordinates all other objectives, most importantly quality of service," to the price cap and could mean that a class such as Periodicals might be required to accept devastating reductions in service in order to reduce classwide costs, *even if the consensus of Periodicals mailers, the Postal Service, and the Commission was that rate increases in excess of the caps would be a preferable solution*. See Reply Comments of Time Warner Inc. to Initial Comments in Response to Commission Order No. 2, at 28.

inexplicable. Like Valpak, the OCA regards the Commission's only regulation addressing this issue as woefully inadequate and strongly implies that it amounts to dereliction in the performance of the Commission's legal responsibilities. The OCA states:

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. . . .

.....

[S]uppose 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 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?

OCA Comments at 18-19, 21-22.

Had the OCA considered the points raised in Time Warner's previous comments, it might have avoided some of the fallacies in this analysis.

First, the Commission's "provision for an explanation . . . rather than an outright prohibition of such shortfall" does not, even taking OCA's point in the broadest sense, "negate long-standing Commission practice." Longstanding Commission practice under the PRA involved recommending rates on a *prospective* basis, using *estimates* of future costs and revenues. Under a Test Year mechanism,

the Commission recommended rates *estimated to recover each class's attributable in a specified future year*. Under the PRA, the Commission did not single out attributable-cost recovery and subject it to year-by-year (rather than test-year) analysis. Nor did it adopt a policy of "truing up" rates retrospectively in order to make up for previous failures to recover attributable costs. In essence, the Commission adopted the eminently practical view that rate regulation is not an exact science and that the authors of the attributable-cost requirement did not intend to commit the Commission to the pursuit of a delusive exactitude through a multiplication of regulatory checks and procedures. The Commission faithfully recommended rates that were calculated to recover attributable costs in the Test Year, but it did not interpret § 3622(b)(3) as requiring more.⁹

Second, as the OCA itself concedes immediately before the quoted passage:

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.

It is therefore self-evident that the attributable-cost recovery requirement, whatever it may have been under the PRA, is not "the bedrock of Commission ratemaking" under the PAEA. It is the PAEA itself, not the Commission, that has "diminish[ed]" the role played by that provision. Moreover, it follows that whatever degree of

⁹ See Reply Comments of Time Warner Inc. to Initial Comments in Response to Commission Order No. 2, at 31: "In considering what weight or status to accord to the attributable-cost recovery requirement under the PAEA, the Commission should take into consideration: (1) the provision's distinctly lesser place in the hierarchy of statutory policies; (2) the fact that even under the PRA periods when costs of a subclass exceeded its revenues were tolerated; (3) the fact that the "test year" mechanism established under the PRA is now obsolete; and (4) the fact that the provision itself contains no indication that it must be applied to the rates for each individual year rather than over a longer period of time (unlike, for example, the 'annual limitation' of § 3622(d) or the limitations on workshare discounts of § 3622(e)(4), which apply '[w]henver the Postal Service establishes a workshare discount rate')."

flexibility the Commission legitimately possessed in interpreting and applying the attributable-cost recovery requirement under the PRA is not *diminished* but *enhanced* under the PAEA, which makes the requirement merely one among a number of subordinate policy provisions.¹⁰

Since what OCA describes as "the apparent dichotomy between the proposed rule §3010.14(b)(4) and the long standing practice of requiring rates to cover attributable costs" is *no more than* "apparent," and since the Commission evidently does not share OCA's view of the continued paramountcy of the attributable-cost recovery provision under the PAEA, there is no reason that the Commission should feel impelled to address this issue on a pre-emptive, categorical basis.¹¹

¹⁰ See Reply Comments of Time Warner Inc. to Initial Comments in Response to Commission Order No. 2, at 30: "In the PRA, the attributable-cost recovery requirement represented, along with the break-even requirement, one of the two most central or fundamental policies of the Act. Plainly, it does not have a similar primacy under the PAEA, where it is relegated to a list of 'factors' that are subordinate both to the stated 'objectives' of the Act and to the annual limitation."

¹¹ In an effort to demonstrate the urgency of this issue, OCA (at 21) approvingly quotes the following statement by the Association of Priority Mail Users (APMU) in comments filed in this docket:

[I]t 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.

It is obviously hyperbolic to describe any losses experienced by the relatively small Periodicals class in recent years as "causing a hemorrhage in Postal Service revenues." Moreover, unlike the cost-of-service regime of the PRA, it is not the case that the failure of one class to recover its attributable costs will necessarily have a "push-up" effect on rates in other classes. The price-cap regime of the PAEA does not permit losses incurred on one class of mail to be recovered by higher rates for other classes than would be allowable in any event under the statutory price caps.

Time Warner, alone among Periodicals mailers in this proceeding, has argued that a sufficiently severe or chronic failure of a class to recover its attributable costs could rise to the level of a situation constituting exigent circumstances under § 3622(e). But to categorically define all instances where a class's "actual revenues and costs demonstrate a loss" as rising to that level would make the attributable-cost recovery requirement the dog and the price caps the tail. That is, it would reverse the one principle on which all commenters (including OCA) seem to be in agreement: that the PAEA "unequivocally establish[es] subsection 3622(d) as the administrative cornerstone of the new rate setting system for market dominant products." Order No. 26, ¶ 2009.

The conclusion that Time Warner draws from proposed rule 3010.14(b)(4) is that the Commission, unlike Valpak and OCA, has attended to the arguments against a mechanical or literalistic interpretation of the attributable-cost recovery requirement and opted in favor of a more practical, flexible, and realistic approach to remedying the problem in Periodicals class. We urge the Commission to stand by its prudent refusal to impose a peremptory solution via regulation at this early stage of implementing the new law.

III. NEGOTIATED SERVICE AGREEMENTS SHOULD NOT BE TREATED AS SEPARATE PRODUCTS

Paragraphs 3023 and 3079 of Order No. 26 state the Commission's intention to treat negotiated service agreements (NSAs) within both the competitive and market-dominant categories as separate products. The Initial Comments of the Postal Service (at 2), noting that this "leads to an ambiguity" as to whether NSAs will be subject to "the use of § 3642 procedures," urge the Commission "to not consider each customized agreement to be a separate 'product'." "Instead," states the Postal Service,

the Commission should generally consider such agreements through proposed rules 3010.40 *et seq.* and 3015.5, which set forth procedures that are consistent with the statutory provisions of the Act dealing specifically with customized agreements. Taking such an approach would allow the Commission to exercise fully its oversight role over customized agreements, while preserving the flexibility intended by the Act. In contrast, the § 3642 procedures are unsuitable for the review of customized agreements, and would also likely constitute a significant hindrance to postal customers and the Postal Service entering into customized agreements, on both the competitive and market-dominant sides of the business, in contravention of the Act.

Id. at 2-3 (footnote omitted).

For the same reasons, Parcel Shippers Association (PSA) assumes that it was not the Commission's intention to "trigger the application of §3642, related to the introduction of *new* products" to NSAs. "Such a result," says PSA,

would lead to an absurd situation where contract rates which require only 15 days notice under §3632(b)(3) could be subject to time-unlimited procedures under §3642. Congress could not have intended this.

Comments of PSA at 11, n. 11.

Advo, Inc. and DFS Services LLC also argue that NSAs should not be treated as separate products. They point out that if the Commission's concern is to require that competitive NSAs recover their attributable costs, it can do so by "insert[ing] an appropriate provision into the regulations that states that competitive NSAs must cover their attributable costs." DFS Services Comments at 3-4; *accord* Advo Comments at 2-3.

Time Warner agrees with these comments and joins in urging the Commission not to treat NSAs as separate products. We share the assumption of PSA that the Commission did not intend to create the "absurd situation" in which NSAs would be subject to both the streamlined procedures of rules 3010.40 *et seq.* and 3015.5 and the elaborate, time-unlimited procedures of rule 3020.30-76. Given that assumption, the only apparent effect of treating NSAs as separate products would be to subject competitive NSAs to § 3633(a)(2)'s requirement that "each competitive product cover its costs attributable," a result that could be achieved more simply by inserting such a requirement into the regulations governing implementation of competitive NSAs.

If the commenting parties have failed to understand the Commission's rationale for treating NSAs as separate products, Time Warner respectfully urges the Commission to provide a fuller explanation of its reasoning and to provide an opportunity for further responsive comments on this subject.

IV. THE COMMISSION SHOULD TAKE NOTE OF OCA's PERSISTENT, EGREGIOUS MISCHARACTERIZATIONS OF THE TEXT OF THE PAEA AND OF ORDER NO. 26

Substantial portions of OCA's Comments in Response to Order No. 26 transgress the boundaries of legitimate argument and amount to nothing less than a systematic mischaracterization of (1) the plain language of the Act, (2) the plain language of the proposed regulations, and (3) the plain language of the Commission's explanation of its proposed regulations. This is not a statement that Time Warner takes pleasure in making. However, two examples will amply substantiate its accuracy: OCA's discussion of negotiated service agreements at pp. 3-9 of its Comments; and its discussion of "product list description alterations" at pp. 15-17.

1. OCA comments on NSAs

In its discussion of the proposed NSA regulations, OCA latches onto a single phrase in Order No. 26 (at 38)--"must improve the net finances of the Postal Service"--and builds on that foundation the astonishing conclusion that the PAEA adopts "a significantly more stringent standard" for NSAs than applied under the PRA. On this basis, OCA proposes a mountain of additional procedural and substantive hurdles for NSAs. If the Commission had in fact stated that NSAs "must improve the net finances of the Postal Service," OCA's conclusions would be merely

debatable. But the Commission said no such thing. Following is a chart that compares OCA's assertions with the actual passages from Order No. 26, the proposed regulations, and the PAEA to which OCA refers. Boldface is, in all cases, added for emphasis:

A.

<u>OCA Comments at 4</u>
<p>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.</p>
<p>³ Docket No. RM2007-1, Order No. 26, “Order Proposing Regulations to Establish a System of Ratemaking,” (herein “Order No. 26”), at 38.</p>
<u>Order No. 26 at 38</u>
<p>Subsections 3622(c)(10)(A) and (B) mandate that such agreements must improve the net finances of the Postal Service or enhance operational performance while not causing unreasonable harm to the marketplace.</p>
<u>PAEA, § 3622(c)(10)</u>
<p>(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—</p> <p>(A) either—</p> <p>(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</p> <p>(ii) enhance the performance of mail preparation, processing, transportation, or other functions; and</p> <p>(B) do not cause unreasonable harm to the marketplace.</p>

B.

OCA Comments at 4

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.

⁴ *Id.* [Order No. 26] at 115, **proposed § 3010.40(a) (emphasis added).**

Proposed rule 3010.40(a)

(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)).

C.

OCA Comments at 8

. . . 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.**

PAEA, § 3622(c)(10)

(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—

(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.

OCA's obvious distortion of both the PAEA and the Commission's draft proposed rules indicates that its conclusions should be regarded with considerable skepticism.

2. OCA comments on changes to the Mail Classification Schedule

In the same way that OCA latches onto a single phrase in Order No. 26, grossly mischaracterizes the import of the phrase, and then makes that mischaracterization the springboard for its entire discussion of NSAs, OCA seizes on a single casually employed word in the proposed regulations governing changes to the MCS--"correction"--and treats that word as if it were the defining concept of § 3020.90 of the proposed rules.

According to OCA, the Commission's rules for making changes to the lists of market-dominant products in the new Mail Classification Schedule (MCS) provide for "two types of changes," (1) "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,' " and (2) "'corrections' to product descriptions 'that do not constitute a proposal to modify the market dominant product list.'" On this basis, OCA argues that the Commission has failed to make any provision for changes in the product lists that are substantive in nature but "that are neither changes in products nor corrections to the lists." Consequently, OCA argues, the regulations "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." OCA states (at 16):

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 [emphasis added].

So it might. But only by studiously disregarding the fact that the Commission uses the terms "update," "correction," and "modification" interchangeably to describe the amendments that are subject to "minimal review" under proposed rule 3020.90, and the fact that the Commission has expressly indicated that substantive changes fall within the scope of rule 3020.90, is OCA able to gin up its imaginary "gap." Order No. 26 (¶¶ 4041-42) delineates carefully the "limits on the scope or magnitude of any update allowable under" proposed rule 3020.90:

Specifically excluded are updates that would modify the market dominant or the competitive product lists. Implicitly excluded are updates that might be governed by other rules such as changes to rates and fees. A proposed update may not change the nature of a service to such an extent that it effectively creates a new product or eliminates an existing product. This subpart is not intended for such changes. . . .

Within these limitations, however, this subpart allows the Postal Service the flexibility to update provisions of the Mail Classification Schedule with minimal review [emphasis added]. To prevent abuse, other checks and balances always are available such as the compliant process. This is consistent with both allowing the Postal Service flexibility and providing after-the-fact review where appropriate.

CONCLUSION

Wherefore, Time Warner respectfully submits these reply comments to Order No. 26 and expresses its appreciation for the full opportunity for comment afforded by the Commission in developing proposed regulations for implementing the PAEA.

Respectfully submitted,

s/

John M. Burzio
Timothy L. Keegan

COUNSEL FOR
TIME WARNER INC.

Burzio McLaughlin & Keegan
Canal Square, Suite 540
1054 31st Street, N. W.
Washington, D. C. 20007-4403
Telephone: (202) 965-4555
Fax: (202) 965-4432
E-mail: burziomclaughlin@covad.net