

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

ANNUAL COMPLIANCE REPORT, 2007

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Docket No. ACR2007

**COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
(January 30, 2008)**

The National Postal Policy Council (“NPPC”) respectfully submits these comments on the Annual Compliance Report (“ACR”) for Fiscal Year 2007, filed by the Postal Service on December 28, 2007. See Docket No. ACR2007, *Annual Compliance Report*, Notice of Filing of Annual Compliance Report By The Postal Service And Solicitation of Public Comment (December 31, 2007), published at 73 Fed. Reg. 1234 (2008). We discuss here: (1) the appropriateness of the rate design established in R2006-1 for Presort First-Class Mail; (2) the letter-flat rate differentials established in R2006-1 for Standard Mail; and (3) Confirm pricing. We begin, however, by noting the unique statutory context of this case, the first annual review proceeding under the Postal Accountability and Enhancement Act (“PAEA”).

I. THE LIMITED SCOPE OF THIS INITIAL PROCEEDING

The annual compliance report and Commission determination of compliance prescribed by 39 U.S.C. §§ 3652 and 3653 were established by Congress to provide a mechanism for after-the-fact Commission review of rates previously implemented by the Postal Service through the index mechanism established by PAEA and codified at 39

U.S.C. § 3622(e). As the Commission has noted, pre-implementation review of rate changes proposed by the Postal Service under Section 3622(e) is limited:

The Commission concludes that one of Congress's main motives in enacting the PAEA was to simplify and expedite the setting of postal rates. It further concludes that Congress intended to give the Postal Service wide latitude in designing specific rates and rate relationships, expecting that the Commission would alter those decisions only where disregard of particular statutory standards is clear. Consequently, the Commission now plays a different role in reviewing proposed rates prior to their implementation than it has in the past.

Docket No. RM2007-1, *Regulations Establishing System Of Ratemaking*, Order No. 43, 72 Fed. Reg. 63662, 63665 col. 1 (Nov. 9, 2007). Hence, because "Congress expected that a modern system for regulating rates and classes would afford the public and the Commission only a limited period of pre-implementation comment and review . . . the inference is strong that Congress contemplated that complicated or subjective compliance issues would be addressed during the annual compliance review, or through the complaint procedures of [39 U.S.C.] section 3662." *Id.*, cols. 1-2.

The rates that took effect in FY 2006, however, were not set through an index-based adjustment under PAEA. Rather, they were established in Docket No. R2006-1, a traditional omnibus rate case instituted under the Postal Reorganization Act ("PRA") in May 2006, six months before the enactment of PAEA, and completed in mid-2007. Section 201(a) of PAEA enacted a transition provision, codified at 39 U.S.C. § 3622(f), which provides that rate cases begun within one year after enactment of PAEA "shall be *completed* in accordance with subchapter II of chapter 36 of [Title 39] and implementing regulations, *as in effect before the date of enactment of this section*"—i.e., under the standards and procedures of the Postal Reorganization Act (emphasis added). Docket

No. R2006-1 was “completed” under the provisions of the old law on or about July 9, 2007, 15 days after the publication by the Government Printing Office of the Governors’ June 19, 2007, decision on the Postal Service’s third and last opinion and recommended decision. See former 39 U.S.C. § 3628 (establishing 15-day window for seeking judicial review of Governors’ decisions). Hence, 39 U.S.C. § 3622(f) clearly places the rates established in R2006-1 beyond Commission review under 39 U.S.C. § 3653.¹

Moreover, even if the Commission had jurisdiction under Section 3653 to review the rates set in R2006-1, the “applicable provisions” of Title 39 against which the rates implemented during FY 2007 would need to be judged would be the provisions of the PRA, not the PAEA. *Accord*, ACR at 1 & n. 1. Both the Commission and the Governors found, based on the evidentiary record of a full-blown adjudicative proceeding, that the R2006-1 rates satisfied the traditional ratemaking standards of the PRA. Sound considerations of judicial economy, reflected in the doctrines of *res judicata* and *collateral estoppel*, would argue against reopening these findings even if the Commission had jurisdiction under Sections 3622(f) and 3653 to do so.

At the conclusion of the record in Docket No. R2006-1, the Commission specifically found in its opinions and recommended decisions that the rates it was recommending satisfied the PRA. See, e.g., Recommended Decision (issued February 26, 2007) at 1:

¹ It should be emphasized that Section 3653 does not authorize the Commission to embark upon a full-blown traditional rate case even for rates originally set through the Section 3622(d) adjustment mechanism. Nothing in Section 3652 or Section 3653 suggests that Congress intended the annual compliance review process as a vehicle for resurrecting traditional cost-of-service rate regulation.

The rates of postage and fees for postal services set forth in Appendix One hereof are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.

The Commission reiterated this holding in its further recommended decision concerning the nonmachinable surcharge for First-Class letters and the rate for the Priority Mail Flat Rate Box:

The rates of postage and fees for postal services set forth in Appendix One hereof are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.

Recommended Decision on Reconsideration (issued April 27, 2007) at 1.

And the Commission reiterated this holding in its further recommended decision concerning letter-flat rate differentials for Standard Mail:

The rates of postage and fees for postal services set forth in Appendix One hereof are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.

Second Recommended Decision on Reconsideration (issued May 25, 2007) at 1.

Except for the temporary changes to Standard Mail rates recommended by the Commission in its May 25 Second Recommended Decision, the Governors ultimately implemented as consistent with the Act all of the rate changes recommended by the Commission. Decisions of the Governors dated March 19, May 1 and June 20, 2007. As noted above, no party sought judicial review of the Governors' decisions before the expiration of the statutory period prescribed by former 39 U.S.C. § 3628. Accordingly,

the Commission's explicit findings (and the Governors' implicit findings) that the rates established in Docket No. R2006-1 comply with "all applicable requirements of this title," 39 U.S.C. §§ 3652(a)(1) and 3653(b)(1), are final and unreviewable.

As a general rule, the courts "have long favored application of the common-law doctrines of collateral estoppel (as to issues) and res judicata (as to claims) to those determinations of administrative bodies that have attained finality." *Astoria Federal Savings & Loan Ass'n v. Solimino*, 501 U.S. 104, 107-08 (1991); *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 422 (1966). Enforcement of repose in these circumstances "is justified on the sound and obvious principle of judicial policy that a losing litigant deserves no rematch after a defeat fairly suffered, in adversarial proceedings, on an issue identical in substance to the one he subsequently seeks to raise. To hold otherwise would, as a general matter, impose unjustifiably upon those who have already shouldered their burdens, and drain the resources of an adjudicatory system with disputes resisting resolution." *Astoria Federal Savings*, *supra*, at 107-08 (citing *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979)).

While the Commission has discretion to waive application of collateral estoppel and res judicata where enforcement of repose would result in injustice, no such circumstances are present here. The rates at issue here took effect less than a year ago (and, for Standard Mail, barely six months ago) under the same legal standards that govern here, and at the culmination of a fully litigated traditional rate case. Under the unique circumstances of this docket, the Commission should devote its resources not to relitigating the lawfulness of the particular rates established in Docket No. R2006-1, but

to developing general policy guidance on issues that are likely to arise in FY 2008 and future years.

II. RATES FOR PRESORT FIRST-CLASS MAIL

The data reported by the Postal Service for Presort First-Class Mail reveal mixed progress toward an appropriate rate design. On the one hand, the Postal Service has properly delinked rates for Presort First-Class Mail from Single Piece First-Class Mail. The two are separate products under the recently implemented Mail Classification Schedule, and should be priced separately.

On the other hand, the rate preference for Single-Piece Mail is still excessive. According to the Postal Service's data, the average Presort letter still pays approximately 3.4 cents more in unit contribution than the average Single-Piece letter, a relationship contrary to the Efficient Component Pricing Rule. See FY 2007 CRA (PRC version) at 2. The same CRA data show that Presort letters have only 38 percent of the unit attributable cost of Single-Piece letters (11.8 cents vs. 31.2 cents), and that the cost coverages of the two kinds of First-Class Mail are 279 percent and 157 percent, respectively. *Id.* These cost coverages equate to percentage markups of 179 percent and 57 percent, respectively.

Even Ramsey pricing theory cannot justify these disparities. Not even the most ardent advocates of low Single-Piece rates have contended that the demand for Single-Piece First-Class Mail is three times more price-elastic than the demand for Presort First-Class Mail. To the contrary, the demand elasticity data submitted by the Postal Service two weeks ago indicate that the long-run own-price elasticities of the two

categories of First-Class letters are virtually identical: -0.232 for Single-Piece letters vs. -0.246 for Workshared letters.² In future rate adjustments under 39 U.S.C. § 3622(d), the Postal Service should move to eliminate the rate preference enjoyed by Single-Piece Mail.

The Postal Service also should give careful attention in future compliance review proceedings to improving the accuracy of the cost data used to estimate worksharing-related cost differences *within* Presort First-Class Mail. Both the Postal Service and the Commission have recognized that the efficient component pricing rule (“ECPR”)—“the principle that workshare discounts should be set equal, on a per-unit basis, to the costs avoided by the Postal Service when the mailer performs the workshare activity”—should be used as a “guiding principle in establishing and maintaining workshare discounts.” Docket No. RM2007-1, *Regulations Establishing System Of Ratemaking*, Order Nos. 26 and 27, 72 Fed. Reg. 50744, 50749 (Sept. 4, 2007). ECPR-compliant rates “reflect cost differences fully,” and thus “send proper price signals,” thereby resulting in “more efficient processing and transportation practices, which in turn reduce costs, thereby allowing smaller rate increases, and less volume losses.” R2006-1 PRC Op. & Rec. Decis. (Feb. 26, 2007) at ii. Determining whether rate differentials comply with the ECPR, however, obviously requires accurate data on “the costs avoided by the Postal Service” from worksharing. Order Nos. 26 and 27, *supra*, 72 Fed. Reg. at 50749.

² USPS, *Econometric Demand Equation Tables for Market Dominant Products as of November, 2007* (filed January 16, 2008), at 2-3.

III. RATES FOR STANDARD MAIL

The Commission deserved praise for its decision in R2006-1 to recognize in Standard Mail rates a larger share of the shape-related differences between letters and flats,³ and for adhering to that decision in the face of pressure from certain users of flat-shaped mail.⁴ Progress toward full recognition of the cost effects of shape is still incomplete, however.

In its ACR, the Postal Service estimates that the unit attributable cost of processing and delivering an average Standard Regular flat was 21.3 cents greater in FY 2007 than for a comparable Standard letter.⁵ This disparity exceeds by almost four cents the letter/flat cost differential estimated in Docket R2006-1 for Standard Regular mail in FY 2008.⁶ Moreover, the 21.3 cent differential exceeds by approximately 20 percent the difference in unit revenue between Standard Regular letters and flats produced by the R2006-1 rates.⁷

³ PRC R2006-1 Op. & Rec. Decis. ¶ 5593 (February 26, 2007).

⁴ PRC R2006-1 Second Op. & Rec. Decis. on Reconsideration (May 25, 2007).

⁵ Mail processing costs are reported in USPS-LR-FY07-26, shp07prc.xls, "PAGE I-3", cells B30 and C30. Delivery costs are reported in USPS-LR-FY07-19, UDCmodel071211.xls, "1.Table 1", cells C71 and C72.

⁶ See R2006-1, PRC-LR-9, shp08prc PRCFinal.xls, "Page I-3", cells B30 and C30 (mail processing costs); *id.*, PRC-LR-11, UDCmodel.PRC.xls, "1.Table1", cells C71 and C72 (delivery costs).

⁷ Average revenues per piece under Docket No. R2006-1 rates for Standard Regular (including Nonprofit) letters (18.5 cents) and flats (36.1 cents) were derived from Tables 2-A and 2-B of the Postal Service's FY 2007, Quarter 4, Quarterly Statistics Report. http://www.usps.com/financials/gsr/QSR_Quarter_4.pdf. Note that R2006-1 rates were in effect for all of FY 2007, Quarter 4. Further, the 21.3 cent figure does not include differences in transportation costs.

The defenders of rate preferences for flat-shaped Standard Regular Mail have asserted that rate preferences for flat-shaped mail are justified by the assertedly more elastic demand for this mail. This claim is unfounded. Even assuming *arguendo* that Ramsey pricing theory were to establish the benchmark for setting markups under PAEA, the disparities in markups between the two mail categories far exceed their differences (if any) in demand elasticities. The R2006-1 rates produce an average percentage markup over mail processing and delivery costs for Standard letters that is approximately 5.6 times the markup for Standard Regular flats.⁸ No evidence has been offered that the demand for Standard Regular flats is substantially more price elastic than the demand for Standard Regular letters—let alone that the former is 5.6 times more elastic than the latter.

IV. CONFIRM PRICING

The Postal Service has provided no revenue or cost data for Confirm, on the ground that the “CRA does not isolate the FY 2007 costs, revenues, or volumes for this product.” ACR at 12. This omission should be corrected in future ACR proceedings. Confirm has become an important ancillary service for customers that generate a large share of the Postal Service’s mail volume, as the intense controversy over Confirm pricing in Docket No. R2006-1 underscored. See R2006-1 PRC Op. & Rec. Decis. (Feb. 26, 2007) at ¶¶ 6166-6229. Accurate and timely data on the costs of providing Confirm are necessary to preserve a rate structure for Confirm that is reasonable and

⁸ The markups for Standard Regular flats and letters were calculated using the mail processing and delivery cost per piece data cited in footnote 3 and the revenue per piece data cited in footnote 5. Including the remaining attributable cost segments would reduce somewhat the average percentage markup of each category, but the wide disparity in markups between the two categories would remain.

allows efficient third-party vendors to compete effectively in offering value-added services based on Confirm, at price levels that remain affordable and do not needlessly deter mailers from using those Confirm-based services.

CONCLUSION

NPPC respectfully requests that the Commission (1) reaffirm that the rates established in R2006-1 for Presort First-Class Mail and Standard Mail satisfy all applicable requirements of Title 39, and (2) consider the issues raised in sections II through IV in future compliance review proceedings.

Respectfully submitted,

Arthur B. Sackler
Executive Director
NATIONAL POSTAL POLICY COUNCIL
1156 15th St., NW, Suite 900
Washington DC 20005
(202) 955-0097

David M. Levy
Richard E. Young
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington DC 20005
(202) 736-8000

Counsel for National Postal Policy Council

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