

**BEFORE THE POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001**

Annual Compliance Report, 2007

Docket No. ACR2007-1

**REPLY COMMENTS OF PITNEY BOWES INC.
IN RESPONSE TO NOTICE OF FILING OF ANNUAL COMPLIANCE REPORT BY
THE POSTAL SERVICE AND SOLICITATION OF PUBLIC COMMENT**

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I. INTRODUCTION

In its January 30, 2008 comments in response to the Postal Regulatory Commission's (Commission) Notice of Filing of Annual Compliance Report (ACR) by the Postal Service and Solicitation of Public Comment (December 31, 2007) (Docket No. ACR2007-1), Pitney Bowes Inc. (Pitney Bowes) acknowledged that the Postal Service's ability to comply with the full data collection and reporting requirements contemplated under the Postal Accountability and Enhancement Act (PAEA)¹ was inhibited by the transitional nature of its filing, but urged the Postal Service and the Commission to pursue important modifications in reporting information relating to workshare discounts. These changes are necessary to improve the accuracy of the cost avoidance estimates and passthroughs as reported in this ACR.

The comments of numerous other parties in this docket confirm that there is a broad consensus within the mailing community regarding the need for accurate cost measurement and reporting. These reply comments address how the Postal Service's reporting can be improved to ensure that the annual compliance process satisfies the requirements of sections 3652 and 3653. *See* 39 U.S.C. §§ 3652 and 3653. These reply comments also address specific recommendations of other parties with respect to the Commission's anticipated reporting requirements in future rulemakings and ACR filings.

¹ Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

II. DISCUSSION

A. The Commission Should Assess Compliance for the Initial Annual Compliance Report Under the Postal Reorganization Act, Not the Postal Accountability and Enhancement Act

There is broad consensus among the commenters that the scope of this initial proceeding should be limited. While acknowledging that the ACR was filed by the Postal Service pursuant to section 3652 of the PAEA, the substantial majority of the commenters supported the Postal Service's assertion that because "FY 2007 Postal Service rates and fees were governed by the provisions of the [Postal Reorganization Act] rather than the PAEA. . . . the 'applicable requirements of title 39' that are relevant to the FY 2007 rates and fees are those of the PRA, not the PAEA." *See* ACR at 1; ANM / MPA Comments at 1-2; APWU Comments at 1; DMA/PSA Comments at 2; MMA Comments at 8; NPPC Comments at 1-5; Pitney Bowes Comments at 2; Time Warner Comments at 2-3.

Pitney Bowes concurs with the comments of NPPC that for purposes of this transitional ACR filing, any ambiguity with respect to the "applicable requirements of this title," *see* 39 U.S.C. § 3652(a)(1), or "applicable provisions of this chapter," *see* 39 U.S.C. § 3653(b)(1), is dispelled by reference to section 3622(f), which provides in pertinent part:

Transition rule. – For the 1-year period beginning on the date of enactment of this section, rates and classes for market-dominant products shall remain subject to modification in accordance with the provisions of this chapter and section 407, as such provisions were last in effect before the date of enactment of this section.

39 U.S.C. § 3622(f); NPPC Comments at 2-3. Accordingly, the Commission should assess compliance for this initial transitional ACR under the PRA, not the PAEA.

B. Future Annual Compliance Report Filings Must Be Substantially Improved to Ensure that the Commission’s Review of Workshare Discounts and Avoided Cost Estimates are Based on Accurate and Complete Information

Accurate cost measurement is essential for the Commission to meaningfully review “whether any rates or fees . . . were not in compliance with applicable provisions of [chapter 36].” 39 U.S.C. § 3653(b)(1). The necessity of accurate cost measurement is particularly important with respect to the Commission’s review of workshare discounts and avoided cost estimates. Numerous parties identified areas in which the workshare cost avoidance estimates presented in the Postal Service’s FY 2007 ACR should be improved for future ACR filings. *See* ANM / MPA Comments at 10-19 (Periodicals workshare discounts); DMA/PSA Comments at 2-4 (First-Class Mail workshare discounts); MMA Comments at 2-3 (same); NAPM Comments at 1-2 (same); NPPC Comments at 7 (same); Pitney Bowes Comments at 2-3 (same); Time Warner Comments at 4-5 (Periodicals workshare discounts); Val Pak Comments at 4-5 (Standard Mail workshare discounts). With respect to First-Class Mail workshare discounts, the Commission should require several important improvements:

1. The Commission should require the Postal Service to align the measurement periods for workshare discounts and cost avoidance estimates.

Several parties recognized that the reported passthroughs for many First-Class Mail workshare letters categories appear larger than they should because avoided costs and discounts are measured and reported for different time periods. *See* DMA/PSA Comments at 2-4; MMA Comments at 6; Pitney Bowes Comments at 3-5. Specifically, these parties pointed out that measuring and reporting workshare cost avoidance estimates for the period of October 1, 2006 through September 30, 2007 (FY 2007),

while reporting workshare discounts that reflect rates for the period of May 15, 2007 through September 30, 2007, creates a “temporal mismatch” that distorts the rates and frustrates the Commission’s ability to undertake a meaningful compliance review. *See* DMA/PSA Comments at 2-3; Pitney Bowes Comments at 3-5. The failure to align these measurement periods distorts the passthroughs as reported in the ACR and, as a result, “any comparison of . . . workshare discounts with cost savings . . . is, of necessity, an apples to oranges comparison.” MMA Comments at 6.

As stated in Pitney Bowes’ initial comments, the distortion of the apparent passthrough from 3-Digit to 5-Digit First-Class Mail Automation Letters is particularly acute because the workshare discounts were substantially lower in the portion of FY 2007 that was excluded from the measurement period (October 1, 2006 to May 14, 2007). *See* Pitney Bowes Comments at 4. As a result, the apparent passthrough, as reported in the ACR, is over 100 percent, when in fact, measured and reported correctly this workshare discount did not exceed avoided costs. *See id.*

The Postal Service’s failure to align the measurement periods for workshare discounts and cost avoidance estimates is arbitrary and makes it impossible to meaningfully assess observance of the limitations imposed by section 3622(e). *See* 39 U.S.C. § 3622(e). As several parties recommended, this deficiency could be addressed by deriving a weighted average (by volume) of the discounts in effect for the entire measurement period. *See* DMA/PSA Comments at 3; Pitney Bowes Comments at 4-5.

2. The Commission should require an inflationary adjustment to the Postal Service's cost avoidance estimates for reasonably foreseeable cost increases for use in the notice of rate adjustment.

Several parties also recognized that workshare-related cost avoidance estimates presented in the ACR were systematically understated because the Postal Service failed to account for reasonably foreseeable changes in costs. *See* DMA/PSA Comments at 4; Pitney Bowes Comments at 5. As underlying costs increase, so should avoided costs, all else being equal. Thus, cost avoidance estimates reported in the ACR, if used in the Notice of Rate Adjustment, should be adjusted to take into account inflationary cost increases. This would keep the cost avoidance estimates in a proper relationship with Postal Service unit cost increases resulting from increases in labor, transportation and other reasonably foreseeable inflated costs. *See* DMA/PSA Comments at 4; Pitney Bowes Comments at 5. A straightforward inflationary adjustment is the preferred approach because it would improve the accuracy of the cost avoidance estimates presented in the ACR without imposing the complexity, costs, and administrative burden of requiring full-blown “roll-forward” modeling.

3. The Commission should adopt rules regarding changes in cost methodologies / data updates to mitigate unintended distortions among the existing rate relationships.

Numerous parties commented on the effects on existing rate relationships that selective data updates and changes in costing methodologies on existing rate can have. *See* MMA Comments at 8; NAPM Comments at 3-4; Pitney Bowes Comments at 6; Time Warner Comments at 6; Val Pak Comments at 35. As noted by the Commission, although the majority of the costing methodologies and data inputs presented in the ACR are consistent with established precedent, “some are new and have not been subjected to

critical evaluation by the Commission or the public either in a formal evidentiary hearing or an informal rulemaking.” Notice at 3. The changes to the Periodicals model were the most substantial, but other less public data input changes also had significant effects on existing rate relationships.

For example, updated read / accept data developed in PRC Docket No. MC2007-1 had a significant effect on the cost avoidance estimates for First-Class Mail Automation Letters. Other selective updates to the In Office Cost System (IOCS), wage rates, productivities by cost pool, and piggyback factors partially off-set the impact, but the cost avoidance estimates presented in the ACR remain incomplete because many other inputs have not been updated. Moreover, as pointed out by several commenters, the ACR itself suggests that selective updating has degraded the accuracy of the models used to measure avoided costs because the “CRA Adjustment” is larger in the ACR filing than it was in the last rate case. *See* Pitney Bowes Comments at 7; Time Warner Comments at 11-14 (calculating an implied CRA adjustment factor for Periodicals piece-sorting costs).

In addition to the concerns regarding accurate cost measurement, Pitney Bowes shares the concerns raised by MMA and NAPM regarding procedural fairness: “[t]he use of untested, partial data updates inhibits the transparency of the rate system and frustrates rate predictability and stability by disturbing existing rate relationships.” NAPM Comments at 3; MMA Comments at 8 (“procedural and substantive due process requires that interested parties must be given an adequate opportunity to test the proposed changes and present their views for consideration by the Commission”). Experience under this initial ACR suggests that data input and cost methodology changes can have significant impacts on existing rate relationships. Accordingly, Pitney Bowes concurs with NAPM’s

suggestion that the Commission “adopt rules to ensure that interested parties are afforded the opportunity for meaningful, advanced review of any significant data input changes to the workshare cost calculations.” *See id.*, at 4.

C. The Postal Service’s Decision to Delink Single-Piece First-Class Mail from Presort First-Class Mail is Appropriate and Consistent with the Proposed Mail Classification Schedule

The Postal Service’s proposal to “delink” the rates for Presort First-Class Mail and Single-Piece First-Class Mail is appropriate and consistent with proposed Mail Classification Schedule under the modern rate system.²

In its Order Proposing Regulations to Establish a System of Ratemaking (PRC Order No. 26)(Aug. 15, 2007), the Commission called for a more “nuanced approach” to “product” classification which balances the business need for flexibility with the regulatory need for transparency and accountability. The Commission stated:

The revamped ratemaking under the PAEA is designed to achieve various goals, principal among them are to afford the Postal Service enhanced pricing flexibility, while at the same time providing accountability through greater transparency. These joint goals will best be achieved if they are balanced with one another. Transparency cannot be achieved if the term “product” is applied too broadly, *e.g.*, solely at the subclass level. Aggregating postal services into only a few products, a result urged by several parties, forfeits transparency and serves no legitimate business or regulatory need. Stated differently, it will not provide for accountability, a bedrock principle underlying the PAEA. By the same token, pricing flexibility is illusory if the term “product” is applied too narrowly, *e.g.*, at the rate cell level. Disaggregating postal services into too many products would impose unwarranted administrative burdens on the Postal Service, thwart pricing flexibility, and serve no legitimate business or regulatory need. It would not, in short, lead to any enhancement in postal service, which, too, is a central principle underlying the PAEA.

Order 26, at 75.

² A similar proposal to delink Single-Piece and Presort First-Class Mail was at issue in the last omnibus rate case under the PRA (R2006-1). In that context, the Commission rejected the Postal Service’s proposal. But that system has expired. In its place the Commission has established a modern system of ratemaking.

In response to the Commission's charge, the Postal Service, in its proposed Mail Classification Schedule, disaggregates Presort First-Class Mail Letters and Cards from Single-Piece First-Class Mail Letters and Cards, stating:

The costs are clearly different for those letters/postcards that are entered in bulk and meet the many eligibility characteristics for bulk prices, as opposed to those pieces that are entered individually; indeed, the costs for bulk First-Class Mail have been separately reported in the CRA for many years. Also, on a broad level, the nature of the communication and its purpose differ between bulk and single piece letters/postcards, with the former generally used for business applications involving groups such as customers and the latter generally used for individual correspondence or transactions. Thus, from both a cost and a market perspective, bulk letters and postcards are a much different product than are single piece letters and postcards.

USPS Submission of Draft Mail Classification Schedule in Response to Order No. 26, at 11-12.

Presort First-Class Mail and Single-Piece First-Class Mail are thus two separate products under the Mail Classification Schedule and, therefore, they should be priced separately. *See* NPPC Comments at 6. As separate products within the same class, their relationship is analogous to separate "subclasses" under the prior nomenclature. Accordingly, delinking Single-Piece First-Class Mail and Presort First-Class Mail is consistent with the Commission's long-standing practice of pricing and measuring workshare-related cost avoidances within a product (subclass), but not among or across different products (subclasses).

Delinking Single-Piece First-Class Mail will also enhance the Postal Service's pricing flexibility, while promoting cost-reflective rates and enhanced transparency. Deaveraging Single-Piece rates would allow the Postal Service to establish prices (through discounts or surcharges) that better reflect costs and promote efficient behaviors

within the Single-Piece segment of the mailstream. For example, deaveraging Single-Piece rates would create opportunities for the Postal Service to use its pricing flexibility to promote: enhanced address hygiene, more widespread adoption of intelligent mail barcodes and information-based indicia for smaller volume mailers, improved costs savings through the use of alternative retail sales channels, and enhanced mailstream security via sender-identified mail.

D. The Commission Should Require the Postal Service to File Sufficient Information with the Annual Compliance Report to Allow the Commission to Assess Compliance with the Objectives and Factors of the Act

Section 3652(a)(1) provides that the Postal Service shall prepare and submit a report “which shall analyze costs, revenues, rates, and quality of service . . . in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title; . . .” 39 U.S.C. § 3652(a)(1). Several commenters observe that the “applicable requirements” language of section 3652 is properly read to encompass the statutory objectives and factors of section 3622(b)-(c). *See* 39 U.S.C. §§ 3622(b)-(c); OCA Comments at 3-4; Val Pak Comments at 6-8. Pitney Bowes concurs with these comments. The Commission should require that the Postal Service include in its ACR a discussion that demonstrates how the rates and quality of service for the covered period promote and achieve the statutory objectives listed in section 3622(b) and properly take into account the statutory factors listed in section 3622(c). *See* 39 U.S.C. §§ 3622(b)-(c).

As stated in the OCA Comments:

The Postal Service should provide a narrative explanation . . . describing how market dominant products comply with the policies and provisions of the PAEA. In cases where products fail to comply, the Postal Service should describe the steps it is taking to ensure future compliance. This will reduce the burden on the Commission in preparing its determination

