

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

ANNUAL COMPLIANCE REPORT, 2007)

Docket No. ACR2007

**REPLY COMMENTS OF
ALLIANCE OF NONPROFIT MAILERS,
AMERICAN BUSINESS MEDIA,
DOW JONES & COMPANY, INC.,
MAGAZINE PUBLISHERS OF AMERICA, INC.,
THE MCGRAW-HILL COMPANIES, INC., AND
THE NATIONAL NEWSPAPER ASSOCIATION, INC.
(February 13, 2008)**

Alliance of Nonprofit Mailers (“ANM”), American Business Media (“ABM”), Dow Jones & Company, Inc. (“Dow Jones”), Magazine Publishers of America, Inc. (“MPA”), The McGraw-Hill Companies, Inc. (“McGraw-Hill”) and the National Newspaper Association, Inc. (“NNA”) respectfully submit these reply comments concerning the Postal Service’s Annual Compliance Report (“ACR”) for Fiscal Year 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 respond here to the contention of Valpak Direct Marketing Systems, Inc., and Valpak Dealers’ Association, Inc. (collectively “Valpak”) that (1) existing Periodicals rates violate the Postal Reorganization Act (“PRA”) or the Postal Accountability and Enhancement Act (“PAEA”) because revenue from the class fails to cover attributable costs, and (2) the Postal Service therefore should be required to increase Periodicals rates enough to eliminate

the shortfall, even if the increase violates the PAEA price cap, 39 U.S.C. § 3622(d). Valpak at 9, 21, 44-51.¹

Valpak's contentions provide no basis for finding that the Periodicals rates established by the Commission and the Governors less than a year ago are unlawfully low. First, the lawfulness of the Periodicals rates established during FY 2007 in Docket No. R2006-1 may not be relitigated in this docket. Second, even if the existing Periodicals rates could be relitigated, Valpak has failed to show that they do not cover the attributable costs of the class. Third, even if (contrary to fact) Valpak had surmounted the first two hurdles, PAEA does not authorize rate increases in excess of the limits imposed by 39 U.S.C. § 3622(d) even if forecasts show that a class of mail could otherwise fail to cover its attributable costs.

It is telling that the average rate increase filed for Periodicals mail by the Postal Service two days ago under 39 U.S.C. § 3622(d) is limited by the same CPI-based cap as the rate increases for other mail classes. This is entirely correct. As the Postal Service emphasized last year, "reading this factor [the attributable cost floor of 39 U.S.C. § 3622(c)(2)] as 'requiring' that every class of mail cover its costs, regardless of the ceiling imposed by the cap, would eviscerate the framework set forth by Congress." Docket No. RM2007-1, Initial Comments of USPS (April 6, 2007) at 22-23.

¹ See *also* Public Representative at 5-6 (stating that the cost coverage of Periodicals mail "raises questions of compliance" that the Postal Service should answer with a "narrative explanation").

I. THE LAWFULNESS OF THE PERIODICALS RATES ESTABLISHED IN DOCKET NO. R2006-1 MAY NOT BE RELITIGATED IN THIS DOCKET.

As most of the commenting parties have recognized, this proceeding has a much narrower scope than future compliance review proceedings will have. ANM-MPA at 1-3; *accord*, USPS Annual Compliance Report for FY 2007 (“ACR”) at 1; APWU at 1; DMA-PSA at 2; NPPC at 1-6; Pitney Bowes at 2.

(1) The relevant transition provision of PAEA, codified at 39 U.S.C. § 3622(f), effectively requires that the reasonableness of the rates established during FY 2007 be judged under the PRA, not the PAEA. The postal rates that took effect in FY 2007 were established in Docket No. R2006-1, a traditional omnibus rate case instituted under the PRA in May 2006, six months before the enactment of PAEA. Section 3622(f) provides that even 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).² Docket No. R2006-1 was “completed” under the provisions of the PRA 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, begun before the enactment of PAEA, beyond Commission review under 39 U.S.C. § 3653.

² Valpak’s claim that “PAEA does not specify that PRA or PAEA is the appropriate touchstone for evaluation of rates” (Valpak at 9) thus ignores the plain language of 39 U.S.C. § 3622(f).

(2) Even if 39 U.S.C. §§ 3622(f) did not foreclose collateral review in this proceeding of the rates established in R2006-1, the doctrines of res judicata and collateral estoppel would. 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. The Commission specifically found in Docket No. R2006-1 that the rates it was recommending satisfied the PRA:

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.

PRC Op. & Rec. Decis. (Feb. 26, 2007) at 1; *accord*, Rec. Decis. on Reconsideration (April 27, 2007) at 1; Second Rec. Decis. on Reconsideration (May 25, 2007) at 1. For Periodicals Mail, the Commission specifically found that the recommended rates were projected to “exceed attributable costs by a small margin” in the FY 2008 test year, “and thus are consistent with the requirement that rates cover costs.” R2006-1 Op. & Rec. Decis. (Feb. 26, 2007) ¶ 5776; *accord, id.*, Appendix G, Schedule 1.

The Governors implemented as consistent with the Act all of the rate changes recommended by the Commission for Periodicals Mail. Decision of the Governors dated March 19, 2007. 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) in Docket No. R2006-1 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 beyond challenge through direct review.

Moreover, the findings may not be challenged collaterally in this docket. 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 Periodicals rates at issue here took effect less than a year ago under the same ratemaking standards that govern the Commission’s review in this docket—i.e., the ratemaking standards of the PRA—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.

(3) Valpak gains nothing by citing CRA data purporting to show in hindsight that Periodicals revenue did not cover attributable costs in FY 2007. Valpak at 21 & 46. The PRA required the Commission and the Governors to establish rates based on a reasonable projection that revenues would cover costs in the rate case test year. The Commission and the Governors used a test year of FY 2008, not FY 2007—a choice that Valpak did not challenge. The Commission and the Governors had no obligation to project that revenues would cover costs in FY2007, or to revise the FY2008 projections in light of subsequent developments. See *UPS v. USPS*, 184 F.3d 827, 831-34 (D.C. Cir. 1999) (minimum cost coverages prescribed by PRA are satisfied by test year projections, which “may or may not come to pass”); *id.* at 836 (PRA did not require that rates be “continually updated to reflect the latest, most accurate data”).³

II. VALPAK HAS FAILED TO ESTABLISH THAT PERIODICALS REVENUE FAILS TO COVER ATTRIBUTABLE COSTS.

Even if (contrary to fact) the cost coverage of existing Periodicals rates were an issue properly before the Commission in this docket, Valpak has failed to establish that existing Periodicals rates are in fact noncompensatory. Valpak bases this claim on CRA reports purporting to show that Periodicals revenue covered only about 83 percent of attributable costs in FY 2007. Valpak at 21 & 46. As noted above, the legally relevant period for determine the adequacy of cost coverage is the FY2008 test year, not FY2007. In any event, for the reasons noted by ANM-MPA in their initial comments,

³ Valpak concedes that, under the PRA, “the Commission’s responsibility in a rate case was to issue a recommended decision to the Postal Service Board of Governors in compliance with PRA. *The process was forward-looking to a prospective test year. . . . [A]fter-the-fact accountability . . . did not exist under the PRA.*” Valpak at 9 & 21 (emphasis added).

the CRA data significantly understate the cost coverage of Periodicals mail under existing rates in FY 2007 .

First, the CRA calculates coverage ratios by reference to the aggregate revenue earning during the entire fiscal year at issue. The current set of Periodicals rates, which represented an average increase of 11.8 percent over the prior rates, did not take effect until July 15, 2007, more than nine months into FY 2007. For the portion of FY 2007 when the R2006-1 rates were in effect, the same CRA data would show that the coverage ratio exceeded 90 percent—even assuming no change in mailer behavior or the CRA methodology. ANM-MPA at 4. Valpak, while offering the unexceptionable observation that this one correction alone would not eliminate the entire coverage shortfall reported by the CRA, does not dispute that the correction is warranted. Valpak at 47-48.

Second, the accuracy of the attributable cost data on which Valpak relies has been seriously questioned. See, e.g., PRC R97-1 Op. & Rec. Decis. (May 11, 1998) at ¶ 3148 (acknowledging that the automation refugee issue “warrants systematic investigation”); PRC R2000-1 Op. & Rec. Decis. (Nov. 13, 2000) at ¶¶ 3011-3015, 3076, 5592-93. In recognition of this fact, Section 708(a) of the PAEA specifically directs the Postal Service and the Commission to conduct a joint study of, *inter alia*, “the quality, accuracy and completeness of the information used by the Postal Service in determining the direct and indirect postal costs attributable to periodicals.”

Third, as the Commission specifically found in R2006-1, the stronger worksharing incentives incorporated into the R2006-1 rate design for Periodicals are inducing major changes in mailer behavior that should further close the reported gap between revenues

and costs in FY 2008 and future years. R2006-1 Op. & Rec. Decis. at iv; ANM-MPA at 5-6 (providing several examples of changes in publisher and printer behavior that have already occurred).⁴ Valpak does not even mention this effect.

Fourth, both the anticipated deployment of the Flats Sequencing System (“FSS”) and a number of other Postal Service cost reduction initiatives should further reduce Periodicals costs in FY2008 or soon thereafter, as the Commission found. ANM-MPA 6-8. Valpak derides these initiatives on the ground that past cost savings initiatives have “consistently failed” to produce full cost coverage for Periodicals mail during the past 11 years. Valpak 21, 45-46. But the track record of the Postal Service’s cost saving initiatives under the cost-plus ratemaking regime of the PRA clearly sheds no light on how the Postal Service will perform now that the regulatory rate ceiling has been decoupled from the Postal Service’s actual costs of service. Under the old law, the Postal Service could always come back to the Commission and ask for more money if the anticipated cost savings did not come to pass. Under the new law, the Postal Service’s inability to raise rates faster than overall inflation provides a much stronger incentives to make sure that the savings are actually realized. That change in incentives is the very point of incentive ratemaking.⁵

⁴ Although Periodicals mailers may disagree about the extent or timing of these changes, none dispute that the changes have occurred, are occurring, and will continue to occur in the future.

⁵ See *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. ¶ 30,985 (1993) (“*Order No. 561*”) at 30,948-49 & n. 37, *aff’d*, *Ass’n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

III. PAEA DOES NOT AUTHORIZE RATE INCREASES IN EXCESS OF THE LIMITS IMPOSED BY 39 U.S.C. § 3622(d) MERELY BECAUSE A CLASS OF MAIL WOULD OTHERWISE FAIL TO COVER ATTRIBUTABLE COSTS.

The notion that PAEA imposes an absolute requirement that rates for each class cover attributable costs suffers from an insurmountable defect. While 39 U.S.C. § 3622(c)(2) specifies the coverage of attributable costs as a ratemaking “factor,” the law does not authorize the Commission or the Postal Service to impose rate increases that exceed the CPI-based adjustment index established by 39 U.S.C. § 3622(d) merely because Periodicals rates would otherwise fail to satisfy this factor. As previously explained by ANM, MPA and other parties in Docket No. RM2007-1, the language, legislative history, and economic policies of Section 3622(d) preclude the Commission from allowing the attributable cost floor to trump the rate cap for individual classes of mail.⁶

If a particular class or service is not bearing its attributable costs, the Postal Service (or, under procedures authorized by the Act, the Commission) certainly may continue to increase the rates for that class or service by the full amount of the CPI, even if rates for other classes are increased by smaller amounts, until full coverage of attributable costs is attained. This interpretation of the statute gives effect to both the rate cap provisions of Section 3622(d)(1) and the attributable cost factor set forth in Section 3622(c)(2), without frustrating the intent of Congress.⁷

⁶ Docket No. RM2007-1, ANM-MPA comments (April 6, 2007) at 2-10; *id.*, ANM-MPA comments (May 7, 2007) at 2-3; *accord, id.*, ABM comments (April 6, 2007) at 3-4; *id.*, NNA comments (April 6, 2007) at 3-10; USPS comments (April 6, 2007) at 22-23.

⁷ Valpak objects to this remedy on the ground that CPI-compliant rate increases could take “at least a decade—and perhaps far longer” to eliminate a coverage shortfall. Valpak 50. For the reasons noted at pp. 6-8 above, the factual premise of this objection is unfounded: Periodicals mail is almost certainly far more compensatory than Valpak

A. The Language of PAEA

39 U.S.C. § 3622, the cornerstone of PAEA, imposes an absolute limit on overall percentage increases in rates for a class, with only narrow exceptions. Section 3622(d)(1)(A) specifically provides that “The system for regulating rates and classes for market dominant products *shall . . . include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date on which the Postal Service files notice of its intention to increase rates.*” 36 U.S.C. § 3622(d)(1)(A) (emphasis added). Similarly, Section 3622(d)(1)(D) specifically directs the Commission to “establish procedures whereby the Postal Service may adjust rates *not in excess of the annual limitations under subparagraph (A).*” *Id.* § 3622(d)(1)(D) (emphasis added). Neither provision creates any exception for mail that would otherwise fail to cover attributable costs.

Section 3622(d) also specifies that changes to the CPI shall constrain rate increases separately for each class of mail. Section 3622(d)(2)(A) provides that “the annual limitations under paragraph (1)(A) *shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of*” PAEA. *Id.*, § 3622(d)(2)(A) (emphasis added).⁸ This provision, like Sections 3622(d)(1)(A) and

has assumed. In any event, Valpak’s objection to the statutory balance struck by Congress is one properly addressed to Congress, not the Commission.

⁸ The intent of Congress to make the CPI cap a limit on each class of mail is also evidenced by Section 3622(d)(2)(B), which allows the Postal Service to round rates and fees to the nearest whole integer, “if the effect of rounding *does not cause the overall rate increase for any class to exceed the Consumer Price Index for All Urban Consumers.*” 36 U.S.C. § 3622(d)(2)(B) (emphasis added).

(D), contains no restriction or exception for mail that would otherwise fail to cover attributable costs.

Section 3622(c)(2), which directs the Commission, “in establishing or revising” a “modern system” of ratemaking, to “take into account . . . the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to each such class or type,” does not support a contrary result. The structure and organization of Section 3622 make clear that the factors of § 3622(c) do not and cannot trump the CPI cap established by § 3622(d). Language much more direct and precise than “take into account” would have been necessary to support the conclusion that Congress meant to allow the attributable cost floor to override the price cap,

Section 3622 establishes a hierarchy of regulatory authority. At the bottom are Section 3622(c)(2) and the thirteen other factors enumerated in § 3622(c)(1) through (14). Section 3622(c) merely requires that the Commission, in establishing and revising a system of ratemaking for market-dominant products, “take” these factors “into account.” Above the factors enumerated in § 3622(c) are the nine “objectives” enumerated in § 3622(b): the Commission is directed to design the ratemaking system “to achieve” those objectives. *Id.*

At the top of the hierarchy, however, is the CPI-based cap established by § 3622(d)(1). This is the only ratemaking standard that the legislation requires the Commission to enforce as an absolute command (“shall . . . include”). Moreover, § 3622(d)(2)(A) specifically states that, “except as provided under” § 3622(d)(2)(C)—

i.e., the provision authorizing catch-up recovery of previously unused index authority—“the annual limitations under paragraph (1)(A)”—*i.e.*, the annual cap on increases established by reference to the CPI under § 3622(d)(1)—“*shall apply to a class of mail*” (emphasis added). Section 3622(d)(1)(E) establishes a separate exception for exigent circumstances. By establishing the CPI cap as a mandatory constraint on each rate class (“shall apply”), § 3622(d)(2)(A), enumerating only two exceptions to it, §§ 3622(d)(2)(C) and 3622(d)(1)(E), and directing that the CPI cap shall be binding “except as provided” by those exceptions, § 3622(d)(2)(A), Congress has foreclosed any exception to the CPI cap based on any other “objective,” “factor” or other provision of PAEA.

Allowing Section 3622(c)(2) to override the *specific* provisions of Section 3622(d) limiting annual rate increases to the CPI (§ 3622(d)(1)(A)) and applying the annual limitation separately to each class of mail (§ 3622(d)(2)(A)) would invert this clear statutory hierarchy. Such an expansive reading of § 3622(c)(2) would also violate the “fundamental rule of statutory construction” that, when two statutory provisions are arguably in conflict, “specific provisions trump general provisions.” *Navarro-Miranda v. Ashcroft*, 330 F.3d 672, 676 (5th Cir. 2003).

Our reading of the statute finds further support in Section 3622(d)(1)(D), which directs the Commission to “establish procedures whereby the Postal Service may adjust rates *not in excess of the annual limitations under subparagraph (A).*” 36 U.S.C. § 3622(d)(1)(D) (emphasis added). Allowing the attributable cost factor of § 3622(c)(2) to trump the CPI cap on classwide rate increases would effectively read the qualifying

phrase “not in excess of the annual limitations under subparagraph (A)” out of § 3622(d)(1)(D).

Moreover, the absence of any exception to the CPI cap for classes that do not cover attributable cost contrasts starkly with the explicit and unambiguous wording of the handful of provisions of PAEA creating exceptions to the CPI cap or imposing an attributable cost floor on rates:

- (1) The exigent circumstances provision, Section 3622(d)(1)(E), authorizes rates to be increased by more than the CPI in “extraordinary or exceptional circumstances” within the meaning of that provision. The existence of the exception, and the procedures required for invoking it, are explicitly stated in Section 3622(d)(1)(E).
- (2) The banking provision, Section 3622(d)(2)(C), allows rate increases to exceed the annual CPI increase in certain circumstances when the Postal Service has not increased rates by the full amount of the CPI in previous years. The existence of this exception is expressly stated in Section 3622(d)(2)(C). So are the limits on use of this catch-up provision: “the rate increase may not exceed the annual CPI cap “for *any class or service* . . . by more than 2 percentage points.” 39 U.S.C. § 3622(d)(2)(C)(iii)(IV) (emphasis added).
- (3) Section 3633(a)(2) states that the Commission “shall” promulgate regulations to “ensure” that “each competitive product covers its costs attribut-

able,” § 3633(a)(2). There is no comparable provision in PAEA for market dominant products.

The enactment of these explicit exceptions to the CPI, and the absence of any comparable exception for the failure of a market-dominant mail class to cover attributable costs, argue against inferring the existence of the latter exception. “When Congress provides exceptions to a statute,” the “proper inference . . . is that Congress considered the issue of exceptions and, in the end, limited the statute to the ones set forth.” *United States v. Johnson*, 529 U.S. 53, 58 (2000); *accord, TRW Inc. v. Andrews*, 534 U.S. 19, 28-29 (2001).

In short, the language and structure of PAEA demonstrate that when Congress intended to create an exception to the CPI cap, or to make recovery of attributable costs a requirement in ratemaking, Congress did so expressly. The absence of any such provision in Section 3622(d) requires the inference that Congress intended the CPI cap to be binding, irrespective of the level of the attributable costs of a particular class of mail.

Valpak makes no attempt to reconcile its position with these provisions. Valpak relies instead on 39 U.S.C. §§ 3653(c) and 3622(c), which direct the Commission to take “appropriate action” to “achieve compliance with the applicable requirements,” as evidence that the attributable cost floor of 39 U.S.C. § 3622(c)(2) trumps the index-based cap of § 3622(d). Valpak at 48-49. This approach, however, simply begs the question. Sections 3653(c) and 3662(c) are enforcement mechanisms, not independent sources of substantive ratemaking standards. If rates for a class of mail are at the maximum level permitted by 39 U.S.C. § 3622(d), they are “in compliance with the

applicable provisions of this chapter” within the meaning of § 3653(b)(1) whether or not the resulting revenue covers attributable costs. See pp. 10-14, *supra*. Without any basis for a finding of noncompliance, no remedial action by the Commission under § 3662(c) is “appropriate” under § 3653(c).⁹

B. Legislative History

The legislative history of the PAEA provides further confirmation that Congress intended the index mechanism set forth in Section 3622(d)(1) to impose an absolute limit on overall increases in rates for market-dominant mail classes in any given year, with no exceptions other than the two specified for exigent circumstances and the catch-up recovery of previously unused CPI authority. The legislative history reveals that Congress (1) was aware that a CPI-based cap increases could result in the failure of some mail classes to cover attributable costs, and (2) considered creating an exception to the cap in this circumstance, but (3) ultimately declined to do so.

Congress was well aware during the deliberations leading to the enactment of PAEA that a CPI cap on rate increases might result over time in the failure of one or more classes of mail to cover attributable costs. For example, at a 1999 hearing on the proposed “Postal Modernization Act of 1999” (H.R. 22), a prominent industry witness

⁹ The Public Representative cites a smattering of general policies scattered throughout Title 39 for the proposition that failure to cover attributable costs “raises questions of compliance.” Public Representative at 6 n. 14 (citing 39 U.S.C. § 101(a), 101(d), 403(a), 403(c), 404(b), 3622(c)(2), 3622(c)(5) and 3622(c)(12)). None of the cited provisions, however, concerns the relative priority to be given to the index-based cap and the attributable floor. Indeed, except for § 3622(c)(2), discussed above, none of the cited provisions even mentions attributable costs at all.

specifically proposed that the legislation allow above-index rate increases when “the Postal Service is not covering its costs in a class of mail”:

The third area when there could be some circumstances to go beyond the index, would be when a specific rate is too low, the Postal Service is not covering its costs in a class of mail. We think the Postal Service should have to go to the Regulatory Commission and adjust, one time, the index, make an adjustment in the index, to increase the rates for that class on a one-time basis and then go on, under the current provisions, with the index previously set by the Regulatory Commission for the remainder of the 5 years.

See *H.R. 22, The Postal Modernization Act of 1999*, Hearings Before the Subcommittee on the Postal Service of the Committee on Government Reform, U.S. House of Representatives, 106th Cong., 1st Sess. at 374 (testimony of Jerry Cerasale, Senior Vice President, Direct Marketing Association).¹⁰

Reflecting these concerns, early drafts of the legislation that culminated in PAEA would relieved the Postal Service from the CPI cap for particular classes of mail that failed to cover attributable costs, either at the outset of the new ratemaking regime or later on. The predecessor of PAEA introduced by Congressman McHugh in 1996, for example, would have established an attributable cost floor with priority over the other factors specified in Section 3622(c). H.R. 3717, the proposed “Postal Reform Act of 1996,” would have required the Commission, in establishing “baseline rates” for future

¹⁰ Likewise, Postmaster General Potter testified in 2004 that, because an imperfectly crafted price cap could be harmful “given the volatility of today’s marketplace,” the price cap should “be constructed to recognize the many cost factors which enter into the ratemaking process, many of which are beyond our control.” *The Postal Service in Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform*, Joint Hearing Before the Committee on Government Reform, U.S. House of Representatives, and Committee on Governmental Affairs, U.S. Senate, 108th Cong., 2d Sess. 63 (2004) (“2004 Joint Hearings”).

index adjustments, to give weight to the factors and policies of the legislation in a “descending order of priority” enumerated in the draft legislation. The very first factor listed in the bill—and thus the factor to be given the highest priority—was the requirement that each class of mail or type of mail service bear its attributable costs. See H.R. 3717, 104th Cong., 2d Sess. (1997), § 1001 (proposed revisions of 39 U.S.C. § 3622(b)). This hierarchy was omitted, however, from the version of the legislation that ultimately became law. In the law as ultimately enacted, attributable cost coverage was relegated to a factor to be considered by the Commission in establishing the ratemaking system, rather than an absolute requirement directly governing the rates themselves.

Congress also considered—but did not enact—provisions authorizing special index adjustments when a class of mail subsequently fails to cover its attributable costs. For example, the Senate bill (S. 662), as reported by the Senate Committee on Homeland Security and Governmental Affairs to the full Senate in 2005, included a provision that would have allowed the Postal Service to apply unused rate increase authority in two specified circumstances, one of which would have allowed the use of previously unused pricing authority when a class failed to cover its attributable costs. As proposed in the reported version of S. 662, 39 U.S.C. § 3622(d)(2)(C) would have provided:

(C) BANKING UNUSED PRICING AUTHORITY – Notwithstanding paragraph (1), *for any class or service that failed to recover its attributable costs in the previous fiscal year, or for any classes and services when the Postal Service has operated at a loss for the last 2 years, rate increases may exceed the Consumer Price Index for all Urban Consumers by the amount increases in the previous year were less than Consumer Price Index for All Urban Consumers.*

See S. 662, § 201 (proposed § 3622(d)(2)(C)) (July 14, 2005); *Congressional Record*, Feb. 9, 2006, at S913. That provision, however, was deleted before S. 662 passed the Senate. See *Congressional Record*, Feb. 9, 2005, at S926, S929; *Congressional Record*, Dec. 8, 2006, at H9162. Neither that bill nor the legislation that Congress ultimately enacted in December 2006 contained any provision authorizing (let alone requiring) above-index rate increases for classes that failed to cover attributable costs.¹¹

The omission from PAEA of limiting language in the earlier draft bills that would have allowed above-CPI rate increases for mail classes that fail to cover their attributable costs warrants the conclusion that the omission was intentional. “Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language.” *Benjamin v. Fraser*, 343 F.3d 46-47 (2d Cir. 2003) (quoting *INS v. Cardoza-Fonseca*, 480 U.S. 421, 442-43 (1987)); accord, *Nuclear Information and Resource Service v. U.S Dept. of Transportation Research and Special Programs Administration*, 457 F.3d 956, 962 (9th Cir. 2006); *City of Jacksonville v. Dept. of Navy*, 348 F.3d 1307, 1312-1313 (11th Cir. 2003); *State of Rhode Island v. Narragansett Indian Tribe*, 19 F.3d 685, 700 (1st Cir. 1994).

¹¹ The bill enacted by the House, H.R. 22, did not contain any provision regarding unused rate authority. See, e.g., H. Rep. No. 109-66, Part I, 109th Cong., 1st Sess. 3-4, 46-48 (2005).

C. Allowing An Attributable Cost Floor To Trump The Rate Cap For Individual Classes Would Undermine The Incentive For Efficiency That Congress Intended The Index To Create.

The decision of Congress to omit any exception to the CPI cap for market dominant mail classes that fail to cover attributable costs was entirely rational. Allowing an attributable cost floor to trump the Section 3622(d) rate cap would undermine one of the central purposes of the index mechanism: creating an incentive for the Postal Service to control its costs. As the Postal Service has noted:

A price cap system . . . provides greater incentives for efficiency due to the fact that it fundamentally changes the relationship between cost and price. Thus, reading this factor [§ 3622(c)(2)] as “requiring” that every class of mail cover its costs, regardless of the ceiling imposed by the cap, would eviscerate the framework set forth by Congress.

Docket No. RM2007-1, Initial Comments of the USPS (April 6, 2007) at 22-23.

The fundamental logic of incentive ratemaking is to provide incentives for a regulated carrier to hold its cost increases below the level of the index, by “severing the linkage under traditional cost-of-service ratemaking” between a regulated company’s costs and rates.¹² To create the desired incentive, however, the commitment not to allow an above-index rate increase if the regulated entity fails to control its costs must be credible; if that entity believes that nonrecovery of actual costs may plausibly cause the regulator to relent, the index mechanism loses its effectiveness as a control on costs.¹³

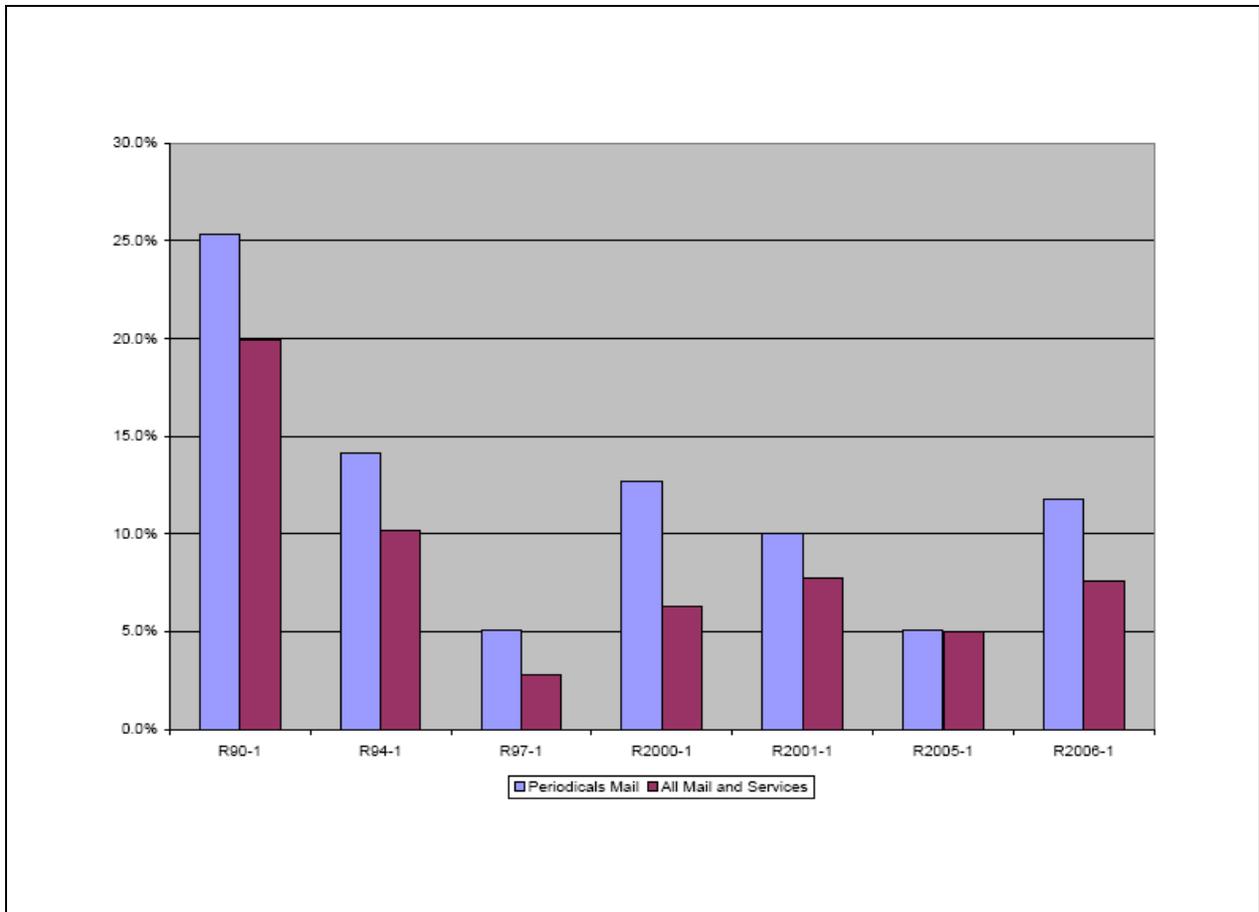
¹² *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. ¶ 30,985 (1993) (“*Order No. 561*”) at 30,948-49 & n. 37, *aff’d*, *Ass’n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

¹³ Michael A. Crew and Paul R. Kleindorfer, “A Critique of the Theory of Incentive Regulation: Implications for the Design of Performance Based Regulation for Postal

Allowing the Postal Service to breach the rate cap on the theory that one or more mail classes would fail otherwise to cover attributable costs would have this very effect. Allowing above-index rate increases on this ground would restore the link between Postal Service rates and costs—first for relatively low markup classes such as Periodicals Mail and Media and Library Mail, and then for other classes with progressively higher markups. At the extreme, the Postal Service could allow its reported costs to increase by such a wide margin in a single year (perhaps by recognizing in a single year costs otherwise reported in multiple years, or by increasing significantly the percentage of total costs that are treated as attributable) to justify a breach of the rate cap for every major class of mail.

The history of Periodicals rates since 1990 confirms that this is not a frivolous concern. Despite the rapid growth of worksharing (and related cost-saving efforts such as barcoding) by periodical publishers in recent years, Periodicals rates have suffered above-average increases in every rate case since R90-1, except for the largely across-the-board increase of R2005-1:

Service,” in Crew and Kleindorfer, eds., *Future Directions in Postal Reform* (2001) (a “chorus of economists” has focused on “regulatory commitment as the Achilles heel of” price cap regulation).



The cause of any revenue shortfall for Periodicals mail is not the inadequacy of the rate increases allowed by the Commission since 1990, but the Postal Service's failure to control its costs. The consequences of this failure should be borne by the Postal Service, not the Periodical mailers, who have already experienced outsized rate increases for the past decades. Such an outcome is hardly unfair to the Postal Service. To the contrary, it is precisely the outcome that index-based ratemaking is intended to achieve.

D. The Purported Failure Of Periodicals Revenue To Cover Attributable Costs Does Not Constitute An Exigent Circumstance Under 39 U.S.C. § 3622(d)(1)(E).

Valpak, apparently recognizing that failure to cover attributable costs may be insufficient legal justification for rate increases in excess of the CPI cap in a “conventional rate case” under 39 U.S.C. § 3622(d), suggests in the alternative that the Postal Service would be “compelled by PAEA” in this circumstance to file an “exigent rate increase” under 39 U.S.C. § 3622(d)(1)(E). Valpak at 51 n. 22. Here again, Valpak misreads the statute.

The exigency clause allows the Postal Service to increase rates faster than the CPI if Commission finds that (1) “extraordinary or exceptional” circumstances have rendered index-based rate increases inadequate to cover the Postal Service’s costs, *and* (2) an additional increase is “reasonable and equitable and 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). The circumstances that the drafters had in mind as sufficiently extraordinary to constitute exigent circumstances were national emergencies comparable in scale and severity to the “terrorist attacks of September 11, 2001, and the subsequent use of the mail to transmit anthrax . . .” H. R. Rep. No. 108-31, 108th Cong., 2d Sess. 11, 43 (2004).

Even a moment’s thought makes clear that the failure of Periodicals revenue to cover attributable costs (as computed by the CRA) satisfies neither requirement of the exigency clause. First, this circumstance can hardly be described, even on Valpak’s terms, as “extraordinary or exceptional.” Valpak’s own comments acknowledge that

Periodicals mail (according to the CRA methodology cited by Valpak) has had a cost coverage of less than 100 percent “consistently . . . over a period of many years . . . repeated over a decade.” Valpak at 21, 45-46; *id.* at 46 (table summarizing CRA data for 1997 through 2007). Whether the shortfall calculated in the CRA reflects economic reality or is merely an artifact of the CRA methodology, a situation that has persisted for 11 years in a row is neither “extraordinary” nor “exceptional.”

Second, Valpak has failed to show that raising Periodicals revenue to 100 percent of attributable costs (again, according to the CRA methodology relied on by Valpak) 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.” Even the asserted FY 2007 revenue shortfall of \$447.7 million,¹⁴ as inflated as that figure is,¹⁵ amounts to only about ½ of one percent of the Postal Service’s total revenue in the same year.

CONCLUSION

For the foregoing reasons, the undersigned parties respectfully request that the Commission: (1) find that the Periodicals rates established in R2006-1 were and are in compliance with “all applicable requirements” of Title 39 in Fiscal Year 2007; and (2)

¹⁴ Valpak at 46.

¹⁵ See pp. 6-8, *supra*.

consider the other points raised in these reply comments in future compliance review cases or other proceedings.

Respectfully submitted,

/s/

Timothy W. Bergin
HALL, ESTILL, HARDWICK, GABLE,
GOLDEN & NELSON
1120 20th Street, N.W.
Suite 700, North Building
Washington DC 20036-3406
(202) 973-1224

*Counsel for The McGraw-Hill
Companies, Inc.*

David R. Straus
THOMPSON COBURN LLP
Suite 600
1909 K Street, N.W.
Washington DC 20006-1167
(202) 585-6921

Counsel for American Business Media

Tonda F. Rush
KING & BALLOW
P.O. Box 50301
Arlington VA 22205-5301
(703) 812-8989

*Counsel for the National Newspaper
Association, Inc.*

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David M. Levy
Richard E. Young
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington DC 20005-1401
(202) 736-8000

*Counsel for Alliance of Nonprofit Mailers
and Magazine Publishers of America, Inc.*

Michael F. McBride
DEWEY & LEBOEUF LLP
1101 New York Avenue, N.W.
Suite 1100
Washington DC 20005-4213
(202) 986-8050

Counsel for Dow Jones & Company, Inc.