

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

ANNUAL COMPLIANCE REPORT, 2007

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Docket No. ACR2007

**REPLY COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
(February 13, 2008)**

The National Postal Policy Council (“NPPC”) respectfully submits these reply comments concerning the Annual Compliance Report (“ACR”) of the Postal Service 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). These comments discuss an issue raised by the initial comments of several parties: the relationship between changes in the quality of service (including changes in mail preparation requirements and other worksharing requirements imposed by the Postal Service) and the CPI-based cap on rate increases established by 39 U.S.C. § 3622(d). DMA-PSA at 1; Valpak at 12-14.

For the reasons noted by most of the commenting parties, this issue is beyond the scope of this proceeding, which concerns rates recently established by the Commission and the Governors as compliant with the Postal Reorganization Act (“PRA”) in Docket No. R2006-1.¹ Because the issue is likely to arise in future cases,

¹ NPPC at 1-6; *accord*, USPS Annual Compliance Report for FY 2007 (“ACR”) at 1; ANM-MPA at 1-3; APWU at 1; DMA-PSA at 2; Pitney Bowes at 2.

however—including, in all likelihood, the annual compliance review for FY 2008—the issue is worth noting for the Commission.

The significance of the issue is underscored by the Postal Service's recent proposal to mandate the use of Intelligent Mail barcodes ("IMBs") effective January 2009 as a condition for eligibility for automation rates for letters and flats. See *Implementation of Intelligent Mail® Barcodes*, 73 Fed. Reg. 1158 (Jan. 7, 2008). IMB technology, if managed properly, offers great potentially great cost savings for both the Postal Service and its customers, including NPPC's members. At the same time, however, rules mandating adoption of technology can impose large costs on mailers, who must acquire and install the hardware, software and systems needed to satisfy the Postal Service's mandates. The costs are compounded when the affected mailers and their vendors cannot do so within the deadlines imposed by the Postal Service.

The comments filed with the Commission last year in Docket No. RM2007-1 revealed a broad consensus among mailers that an adjustment to the index prescribed by 39 U.S.C. § 3622(d) for significant changes in the quality of service (including changes in the level of uncompensated mail preparation and worksharing mandated by the Postal Service) is necessary to carry out its purposes.² This consensus is also

² See, e.g., Docket No. RM2007-1, ANM-NAPM-NPPC Comments (April 6, 2007) at 7-9; DMA Comments (April 6, 2007) at 6; Mulford Associates (April 6, 2007) at 3; NNA Comments (April 6, 2007) at 10-12; OCA Comments (April 6, 2007) at 18-20; Pitney Bowes Comments (April 6, 2007) at 9; McGraw-Hill Reply Comments (July 30, 2007) at 6-7; Transcript of Kansas City field hearing (June 22, 2007) at 40 (Randy Stumbo testimony for Meredith Corporation); Transcript of Los Angeles field hearing (June 28, 2007) at 38 (John Carper testimony for Pepperdine University); Transcript of Wilmington field hearing (July 9, 2007) at 19-20 (testimony of Sr. Georgette Lehmutz for National Catholic Development Conference); *id.* at 30 (testimony of Daniel C. Emens for J.P. Morgan Chase); NPPC Comments on Order No. 26 (Sept. 24, 2007) at 7-9.

supported by the scholarly economic literature. “In contrast to cost-of-service regulation, a price-cap regulated firm has an incentive to reduce quality of service in an effort to reduce costs and increase profits.”³ Attention to quality of service is particularly important in rate indexing for regulated industries that are not experiencing rapid productivity gains.⁴

The Commission, while stating that it was “sympathetic to these concerns,” announced in Order No. 26 that it would defer consideration of a quality adjustment until after the promulgation of rules for the collection of data on service performance. Order No. 26 ¶ 2067. In the interim, the Commission stated that it “expects that the Postal Service will operate within both the letter and the spirit of the PAEA.” *Id.* ¶ 2068. Given the further technology mandates now proposed by the Postal Service, development of more concrete standards and procedures for this issue is likely to be necessary this year.

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

³ Michael A. Crew and Paul R. Kleindorfer, “Pricing, Entry, Service Quality, and Innovation under a Commercialized Postal Service,” in J.G. Sidak, ed., *Governing the Postal Service* 164-165 (1994); *accord*, Jean-Jacques Laffont and Jean Tirole, *A Theory of Incentives in Procurement and Regulation* 212, 233 (1993). This basic problem is the reason why Pentagon contract managers tend to “favor performance over cost. They often feel that fixed-price contracts encourage contractors to make ‘uneconomic’ reliability trade-offs and be reluctant to make design improvements.” *Id.* at 233 n. 13.

⁴ Michael A. Crew and Paul R. Kleindorfer, “A Critique of the Theory of Incentive Regulation: Implications for the Design of Performance Based Regulation for Postal Service,” in Crew and Kleindorfer, eds., *Future Directions in Postal Reform* (2001).

applicable requirements of Title 39, and (2) consider in an appropriate docket or dockets the issues raised above and in sections II through IV of NPPC's initial comments.

Respectfully submitted,

/s/

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