

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

ANNUAL COMPLIANCE REPORT, 2008

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Docket No. ACR2008

**REPLY COMMENTS OF  
MAGAZINE PUBLISHERS OF AMERICA, INC.  
AND ALLIANCE OF NONPROFIT MAILERS**

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Mailers*

February 13, 2009

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Pursuant to Order No. 161, Magazine Publishers of America, Inc. (“MPA”) and Alliance of Nonprofit Mailers (“ANM”) respectfully submit these comments. These comments respond to the portions of the initial comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers Association, Inc. (“Valpak”) and the Public Representative concerning Periodicals Mail.

(1)

Both Valpak and the Public Representative contend, as they did in Docket No. ACR2007 and other past cases, that the failure of Periodicals Mail to achieve a cost coverage of 100 percent in FY 2008 violates 39 U.S.C. § 3622(c)(2). Valpak at 13-14; Public Representative at 16. Neither party, however, contends that this circumstance provides a legal basis for raising Periodicals rates above the limit imposed by the CPI cap established under 39 U.S.C. § 3622(d).

This reticence is warranted. As previously explained by the undersigned parties and others in previous comments to the Commission, PAEA does not allow the Commission to impose rate increases that exceed the CPI-based cap on rate adjustments imposed by 39 U.S.C. § 3622(d) merely because Periodicals rates would other-

wise fail to cover attributable costs. 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.<sup>1</sup> A summary of this statutory analysis, which appeared previously in MPA and ANM's reply comments in Docket No. RM2008-4 and earlier dockets, appears in Appendix A, *infra*.

The Commission has recently noted further evidence that Congress, when enacting PAEA, contemplated that Periodicals Mail could make a negative contribution to institutional costs in the post-PAEA environment:

Under the PAEA price cap, the losses in FY 2007 from the two subclasses that make up the Periodical class could not have been eliminated. Therefore, the FY 2007 loss of \$448 million by Periodicals was made necessary by current statutory obligations. Consequently, the negative contribution made by them should be included with the costs of the USO.

*Report on Universal Postal Service and the Postal Monopoly* (December 19, 2008) at 134.

To be sure, it would be reasonable for the Commission to require that a class of mail which fails to recover attributable cost take the full amount of the CPI-based and banked increase authority. As MPA and ANM noted in their April 6, 2007, comments in Docket No. RM2007-1, the Postal Service (or, under procedures authorized by the Act,

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<sup>1</sup> See Docket No. RM2007-1, Comments of ANM and MPA (April 6, 2007) at 2-12; *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; *id.*, Reply Comments of ANM and MPA (May 7, 2007) at 2-6; *id.*, ANM-MPA Reply Comments (July 3, 2007) at 6-7; *id.*, Reply Comments (Oct. 9, 2007) at 6-7; Docket No. ACR2007, ANM-MPA Comments (Jan. 30, 2008) at 9-10; *id.*, ANM-ABM-Dow Jones-MPA-McGraw Hill Reply Comments (February 13, 2008) at 9-23; Docket No. RM2008-4, Reply Comments of MPA, ANM and ABM (Nov. 14, 2008).

the Commission) may continue to increase the rates for a class that fails to cover attributable costs by the full amount of the CPI until full coverage of attributable costs is attained. This interpretation of the statute harmonizes the rate cap provisions of § 3622(d)(1) and the attributable cost factor of § 3622(c)(2) by giving effect to both, and without frustrating the intent of Congress.

(2)

Valpak proposes, as an alternative to imposing above-CPI rate increases for Periodicals Mail rates on average, that the Commission or the Postal Service implement “disproportionate rate increases focused especially on copies of publications that do not come close to paying the costs which they impose on the Postal Service” until Periodicals Mail as a whole covers 100 percent of its attributable costs. Valpak Comments at 24; see *generally id.* at 21-24. Valpak asserts that MPA and ANM have endorsed this approach. *Id.*

The position that Valpak imputes to MPA and ANM on rate differentials with Periodicals Mail is an exaggeration of the actual view of MPA and ANM. We certainly agree with Valpak that designing rates to give mailers reasonable signals about all relevant cost drivers is critical to controlling Periodicals costs. To this end, MPA and ANM have encouraged the Postal Service to adopt Periodicals rates that send more efficient price signals.<sup>2</sup> MPA and ANM have also devoted substantial resources to educating periodical publishers about the cost-effectiveness of co-mailing, co-palletization and other available techniques for reducing the costs of periodical mail. But MPA and ANM

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<sup>2</sup> See, e.g., Docket No. R2006-1, Brief Of Magazine Publishers Of America, Inc., And Alliance Of Nonprofit Mailers On Periodical Rates (Dec. 21, 2006) at 49-77.

have never asserted, and do not believe, that economic efficiency is an absolute value that trumps all other ratemaking goals—including the avoidance of undue economic dislocation in appropriate circumstances.<sup>3</sup>

(3)

The Public Representative devotes the bulk of its comments to a thought experiment about what would happen to the cost coverage of Periodicals Mail and other mail classes if financial trends over the past three years were to continue. The Public Representative concludes (unsurprisingly) that under this scenario the Postal Service generally, and Periodicals Mail particularly, would go deeper into the red.

The Public Representative's analysis illustrates the hazards of attempting to extrapolate long term trends from short term data. Financial trends during the past three years were skewed by the dramatic decline in volume (particularly of flats volumes) in all mail classes, and the inability of the Postal Service until now to reduce its labor capacity fast enough to keep pace with the decline in volume. The disguised underemployment that resulted has appeared in the Postal Service's costing systems as a decline in labor productivity:

In 2008, despite the reduction of 50 million workhours, TFP declined primarily due to volume declines so rapid and so large (4.5 percent) that it was impossible to adjust resources with sufficient speed to maintain positive TFP.

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<sup>3</sup> The MPA/ANM comments from which Valpak selectively cites concerned proposed changes in *costing* methods that would allow more precise estimates of worksharing-related cost avoidances. Docket No. RM2009-1, *Modification Of Costing Methods 2008—Postal Service Proposal Twelve*, Comments of MPA and ANM (December 1, 2008), at 4. The comments did not discuss the optimal balance in rate design between cost recognition and avoidance of rate shock.

FY 2008 Comprehensive Statement on Postal Operations at 54.<sup>4</sup> The costs of this underemployed capacity, however, are clearly short-term (and thus not a reliable proxy for long-term costing trends after the American economy emerges from its current downturn). Moreover, for FY 2009 the Postal Service “has very aggressive cost reduction strategies, doubling the 50 million workhour savings achieved in the prior year to a goal of 100 million workhours—or the equivalent of 50,000 full-time employees.” FY 2008 Comprehensive Statement on Postal Operations at 54.

In fact, the Postal Service’s senior executives have made clear that they are committed to achieving these savings and more. Two weeks ago, for example, Postmaster General Potter testified before a Senate oversight committee that the Postal Service has recently taken, or intends to take, the following cost saving steps:

- A halt in the construction of new postal facilities in 2008.
- A collectively-bargained increase in the share of health care benefit costs paid by employees.
- An accelerated procedure for adjusting delivery routes in response to workload loss.
- A salary freeze for all Postal Service officers and executives, and a 15-percent reduction in management head count.
- Accelerated consolidation of redundant mail processing facilities.

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<sup>4</sup> The decline in volume was especially severe for flat-shaped mail, particularly Standard Mail catalogs. The volume of both Standard Mail flats and Carrier Route Standard Mail (which consists almost entirely of flats) declined by more than 20 percent. FY 2008 Quarter 4 Year-To-Date Revenue, Pieces, and Weight Report.

- Elimination of 58 Airport Mail Centers and substitution of ground transportation for air carriage.
- Legislative authorization to fund retiree health benefits costs over a less front-end loaded payment schedule.

Statement of PMG/CEO John E. Potter before the Subcom. On Federal Financial Management, etc., of the Senate Com. on Homeland Security and Government Affairs (Jan. 28, 2009).

For these reasons, the Commission's finding in ACR2007 that a "definitive pronouncement" about Periodicals cost coverage based on short-run coverage ratios would be "premature" (USPS *FY 2008 Annual Compliance Report* (December 29, 2008) at 33) remains equally valid this year:

The Postal Service, Periodicals publishers and mailers, and the Commission have recognized the special role and current situation of Periodicals. Significant efforts are underway to try to improve Periodicals, such as the joint PRC/USPS review of Periodicals. It would be premature to make any definitive pronouncement on the future actions necessary to improve the current situation while such work is in progress. The Postal Service will continue to pursue these efforts, as well as use the annual price change mechanism to fine-tune prices that lead to cost-reducing behavior.

*Id.*

## CONCLUSION

For the foregoing reasons, it “would be premature to make any definitive pronouncement on the future actions necessary to improve the current situation” for Periodicals Mail while “significant efforts are underway” to improve the contribution from the class. *USPS FY 2008 Annual Compliance Report* (December 29, 2008) at 33.

Respectfully submitted,

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February 13, 2009

**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. 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.

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.

**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).<sup>5</sup> This provision, like Sections 3622(d)(1)(A) and (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

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<sup>5</sup> 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).

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 (5<sup>th</sup> 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 attributable,” § 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 has never attempted to explain these provisions in its pleadings and comments in other proceedings since the enactment of PAEA. Instead, Valpak has relied 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). 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. Without any basis for a finding of noncompliance, no remedial action by the Commission under § 3662(c) is “appropriate” under § 3653(c).

## **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 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 Repre-*

sentatives, 106<sup>th</sup> Cong., 1<sup>st</sup> Sess. at 374 (testimony of Jerry Cerasale, Senior Vice President, Direct Marketing Association).<sup>6</sup>

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 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.

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<sup>6</sup> 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, 108<sup>th</sup> Cong., 2d Sess. 63 (2004) (“2004 Joint Hearings”).

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.<sup>7</sup>

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

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<sup>7</sup> 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, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. 3-4, 46-48 (2005).

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 (9<sup>th</sup> Cir. 2006); *City of Jacksonville v. Dept. of Navy*, 348 F.3d 1307, 1312-1313 (11<sup>th</sup> Cir. 2003); *State of Rhode Island v. Narragansett Indian Tribe*, 19 F.3d 685, 700 (1<sup>st</sup> Cir. 1994).

**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.<sup>8</sup> 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.<sup>9</sup>

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.

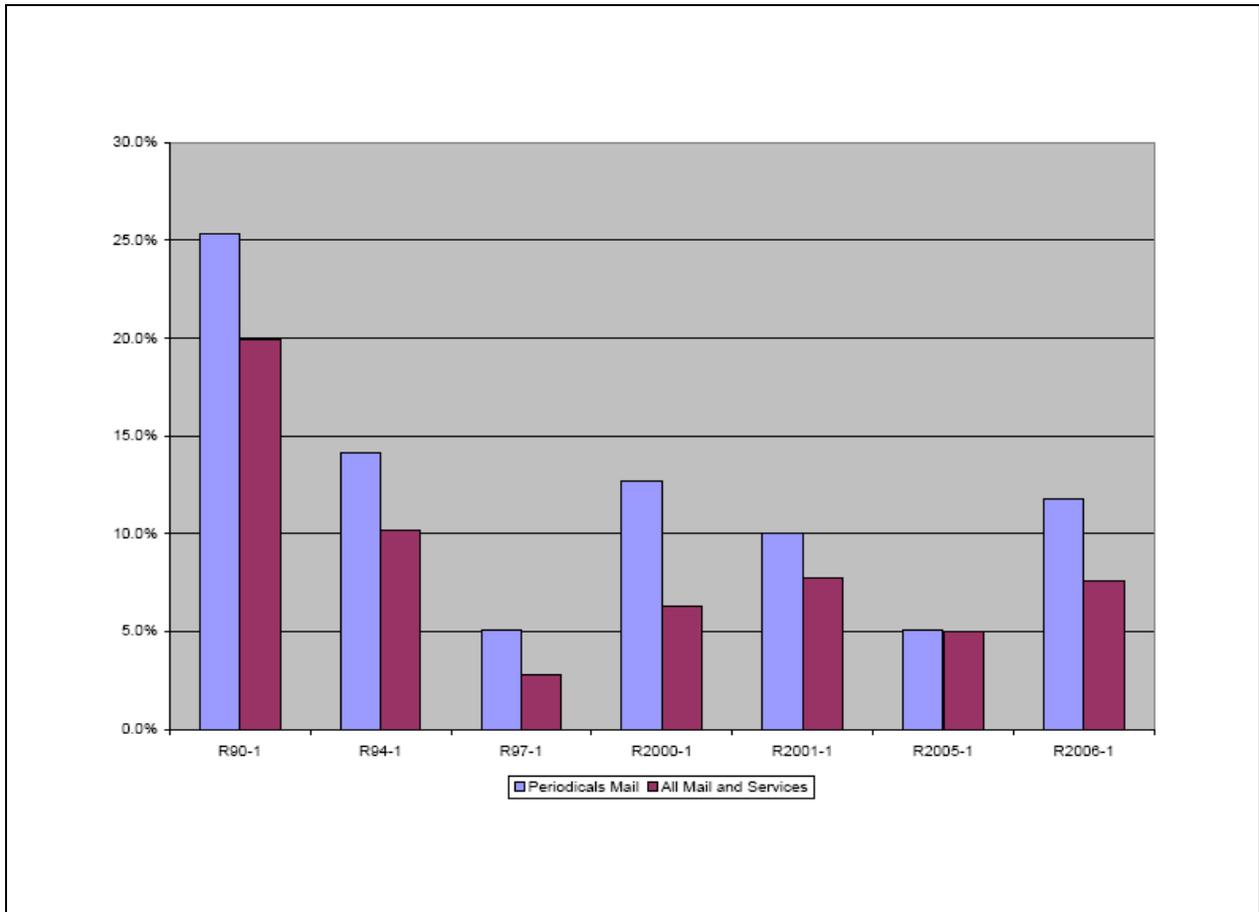
The history of Periodicals rates since 1990 confirms that this is not a frivolous concern. Despite the rapid growth of worksharing (and related cost-saving efforts such

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<sup>8</sup> *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).

<sup>9</sup> 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) (a “chorus of economists” has focused on “regulatory commitment as the Achilles heel of” price cap regulation).

as barcoding) by periodical publishers in recent years, Periodicals rates have suffered above-average increases in every rate case from R90-1 through R2006-1, except for the largely across-the-board increase of R2005-1:



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 not be borne by 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.