

Before the  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Competitive Product Prices  
Priority Mail  
Priority Mail Contracts 6 through 10

Docket No. MC2009-25

Competitive Product Prices  
Priority Mail Contract 6 (CP2009-30)  
Through Priority Mail Contract 10 (CP2009-34)  
Negotiated Service Agreements

PUBLIC REPRESENTATIVE COMMENTS  
IN RESPONSE TO ORDER NO. 217

(June 5, 2009)

The Public Representative hereby offers comments on the United States Postal Service's request to add a new product, Priority Mail Contract Group, to the Competitive Product List.<sup>1</sup> These comments are filed in response to the Commission's notice and order requesting comment.<sup>2</sup>

**I. Overview**

This case is a proposal by the Postal Service to establish a category for Priority Mail contracts, and to place five individual contracts into that category.

The Public Representative has examined the materials filed under seal, and

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<sup>1</sup> Docket No. MC2009-25, Request of the United States Postal Service to Add Priority Mail Contract Group to Competitive Product List, May 19, 2009 (Request). The Postal Service also filed five contracts identified as Priority Mail Contracts 6 through 10, which the Commission has assigned the Docket Nos. CP2009-30 through CP2009-34.

<sup>2</sup> See PRC Order 217, Notice and Order Concerning Priority Mail Contracts 6 through 10 Negotiated Service Agreements, May 26, 2009, at 6.

believes that the individual contracts appear to satisfy the requisite statutory criteria. However, three problems exist: 1) the over-breadth of the proposed shell classification; and 2) the scope of the delegation of statutory authority by the Governors of the United States Postal Service to Postal Service management. The Public Representative also identifies 3) a concern about the lack of transparency and accountability in one aspect of the reporting of the Governors Decisions.

## **II. The Governors' Important Role and Responsibilities in Establishing Shell Classifications**

Public Representatives have on several occasions noted that the Commission's recognition of NSA shell classifications allows the Governors to exercise their authority in a measured fashion.<sup>3</sup> The Governors by this route are able to direct the establishment of categories encompassing a set of similar negotiated agreements, aggregated together as a single product, provided that the contracts are functionally equivalent. While this is a good idea, problems may arise when such grouping is carried out beyond the scope of what the Commission had envisioned.

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<sup>3</sup> In Order No. 43, the Commission issued regulations establishing a modern system of rate regulation, including a list of competitive products. Among other things, the Commission determined that each negotiated service agreement would initially be classified as a separate product. The Commission also acknowledged, however, the possibility of grouping functionally equivalent agreements as a single product if they exhibit similar cost and market characteristics. See ¶ 2177.

A shell classification is a collection of separately negotiated contracts considered together as a single product. As a result, it is possible that individual contracts within that product group might not individually satisfy the statutory criteria (*e.g.*, covering attributable costs and contributing to institutional costs, so as to avoid cross-subsidization by Market Dominant products).<sup>4</sup> The risks of establishing broad shell classification products (because a “product” that is a shell classification can contain a variety of NSA contracts with varying cost contribution profiles) highlight the importance of the Governors’ supervisory role and exercise of authority in rate-setting. Essentially, the Governors are the primary line of defense against establishing shell classification products that would harm the Postal Service.

### **III. The Risks of Overbroad Product Classification**

A wide open shell classification with essentially no boundaries masks a larger risk of bad contracts in at least four ways. First, as noted above, a shell classification may contain individual contracts that (by themselves) may not satisfy the statutory criteria and thus may impair the Postal Service’s financial position, lessening the value of that shell classification. Secondly, an overbroad shell classification permits a jumbled assemblage of contracts that are, in reality,

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<sup>4</sup> One or more contracts within a product could even end up losing money, but this is acceptable (to a degree) because taking reasonable risks with innovative products and contracts in the competitive products area is envisioned and encouraged under PAEA.

unrelated, contrary to the Commission's authorizing instructions. In another docket, the Public Representative wrote: "At some point in the future, the question will likely arise of how far the envelope of 'functionally equivalent' and 'substantially similar' can be stretched."<sup>5</sup>

Third, overbroad product classification combined with insufficient oversight can lead to problems resulting from individual incentives mismatched with organizational goals. Individual or departmental management incentives may not always be in accord with the priorities of the Governors, or coincide with the best interests of the Postal Service.<sup>6</sup>

Finally, the lack of time limits on broad shell classifications is also a concern because the transfer of statutory approval authority from the Governors to postal management can be extended (barring further action from the Governors) for periods perhaps longer than is wise.

The point is that by delegating its authority, the Governors must be even more vigilant to ensure that its managerial incentives are appropriate and produce results that coincide with the interests of the Service (and, per the provisions of 39 U.S.C. 101, the interests of the public).

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<sup>5</sup> Docket Nos. CP2008-18 *et seq.*, Public Representative Comments... (September 2, 2008) at 3, n. 7.

<sup>6</sup> For example, if bonuses are tied to the number of contractual agreements signed, rather than their likely value to the Postal Service, the end result may not be optimal. The Public Representative does not wish to minimize the timeless and ultimately crucial challenge of aligning management compensation schemes with corporate objectives, a problem that has, as we know all too well, has of late bedeviled American business and thus our society.

These concerns are not limited to the Priority Mail shell classification product in the instant case. Should blanket-style shell products be proposed for other Competitive Product areas, such as for Express Mail contracts, Bulk Parcel Post, or Bulk International Mail, the result of adding such overbroad products would be to reinforce and exacerbate the same “delegation of authority” concerns.

#### **IV. The Statutory Oversight Role of the Governors**

The Governors hold an important responsibility under 39 U.S.C. 3632, their authority to establish rates and classes for competitive products of mail. While the Postal Accountability and Enhancement Act (PAEA) directs the Postal Service to have more flexibility in pricing and product innovation, the law did not envision that this authority would be handed over entirely to postal management. The Governors were meant to assume an integral and ongoing role in the process. In fact, PAEA added requirements for the qualifications and skills for the Governors, highlighting their oversight functions.<sup>7</sup> In that role, it is of crucial importance that the Governors are kept fully informed and receive balanced, objective briefings on all the relevant considerations and facts associated with Postal Service rate and classification actions.

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<sup>7</sup> See § 202 (a)(1).

With the number of matters demanding the Governors' time and attention, it makes sense to gather together similar negotiated contracts for the Governors' consideration. The Public Representative favors transactional efficiency of this sort. But creating an overbroad shell classification that appears to remove the Governors from the loop begs the question of whether this arrangement exceeds common sense boundaries.

The requirement that postal management must justify special deals to the Governors serves an important function – it aids in discouraging nascent deals that are not good for the Postal Service, and in preventing “sweetheart” deals that are not in accord with accepted business conditions and practices.

The public relies on the Governors to exercise their statutory role in setting proposed postal rates to ensure that the rates will benefit rather than detriment the Postal Service.<sup>8</sup> This is particularly true for Competitive Products Rates Not of General Applicability, because for those rates, there is less time and opportunity for public participation in the process to help surface areas of concern. A broad transfer of authority of the sort that this entails seems inconsistent with the PAEA and the provisions of Title 39.

In this docket, the Public Representative has been unable to ascertain if the decision was unanimous or if any Governors dissented or abstained.

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<sup>8</sup> For example, when one or more Governors takes exception to a Decision or declines to vote, the public (and the regulator) benefits from awareness of the reservations expressed by the dissenting Governor or Governors.

Following an informal inquiry, counsel for the Postal Service has informed the Public Representative that it is not the practice of the Governors' office to identify when any Governors either voted against a Decision or abstained.

The Public Representative believes the public should know if and when any Governors object to a Decision, or if any governors abstain or recuse themselves. The Governors (as Presidentially-appointed and Senate-confirmed positions held for a period of years) are appointed to represent the public interest generally.<sup>9</sup> They serve as custodians of the public trust in a way that is fundamentally different from the role performed by an ordinary corporation's Board of Directors. The transparency and accountability identified as paramount in the PAEA are not furthered if the public cannot know when Governors object to a decision or decide not to participate in a vote. This does not mean to suggest that the names of individual Governors need be identified, just the overall tally of aye's and nay's, and abstentions.

#### **V. Delegation of Authority by the Governors**

In the proposed shell classification MC2009-25, the Governors are in effect delegating to postal management in one fell swoop their authority over rate-setting across the entire sector of Priority Mail NSAs. (Some may argue that this is a speculative or hypothetical problem because the Governors always oversee postal actions and can take corrective action, but the Public

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<sup>9</sup> 39 U.S.C. 202(a)(1).

Representative believes it is a very real difficulty because the Governors would be managing rates and classifications “after the fact” rather than beforehand, contrary to their clear statutory mandate.)

The MC2009-25 product description on its face provides so few distinguishing elements for the contracts that it establishes a product bin that could hold nearly every Priority Mail contract, past, present and future.<sup>10</sup> This is magnified by the fact that Priority Mail is an important and lucrative segment of negotiated agreements (rates not of general applicability), and to date, Priority Mail has provided a large measure of the financial contribution of the overall Competitive Products.<sup>11</sup>

Delegation in and of itself is not a bad thing. It makes sense to do some grouping and bundling to reduce the transactional costs of handling large numbers of negotiated Competitive Products contracts, and to focus the attention of the Commission and the Governors on the most important substantive and policy matters. As the Commission has noted, there is tension in the PAEA between its goals of facilitating rapid and flexible adjustments to rates and

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<sup>10</sup> The Public Representative’s comments do not touch on a number of distinctive differences of a technical nature amongst the contracts. The Commission will likely consider whether the differences do or do not affect their functional equivalency for assessing whether they should be placed into the same Product, which is another question entirely. The Postal Service did not in its filing provide much explanation of their functional equivalence. The Public Representative believes that the differences would not, by themselves, forestall approval of a Product containing contracts that had some overarching commonality other than simply that they used Priority Mail. The Commission is instead asked to consider the broader and more significant question (of an overbroad Product description and unilateral delegation of rate-setting authority) raised herein.

<sup>11</sup> Other Competitive Products include Express Mail, Bulk Parcel Post, Bulk International and certain Special Services.

classifications, and increasing the transparency and accountability of those processes.<sup>12</sup> And certainly the Postal Service management can be more agile if the Governors' approval is not required for numerous similar contracts. But it is important not to overlook the transparency and accountability portion of the equation when promoting flexibility and agility.

An overbroad delegation action causes the products to be lumped together to such a degree so as to frustrate sufficient scrutiny by the Governors and the Commission alike. Such aggregation of contracts in effect allows postal management a mechanism to change rates without the Governors' approval, (certainly without their explicit approval) and in some circumstances, provides for automatic pre-approval of rates sight unseen.

## **VI. The Public Representative's Recommendations**

The Public Representative offers two recommendations.

- 1) The Commission should work with the Postal Service to define shell classifications in a somewhat narrower fashion so that there is some common element among the included contracts.**

In this instance, for example, rather than a product which could easily encompass all possible Priority Mail contracts, a shell classification should be established that uses some categorization parameter linked to an aspect of the mail or the mailer(s). Examples of such limits might include mail piece shape, volumetric characteristics (such as flat-rated

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<sup>12</sup> PRC Order No. 43, ¶ 2006 and n.3, *reiterating* PRC Order No. 26, ¶¶ 3070, 3074. ("This tension is readily apparent from 39 U.S.C. 3622(b)(6), which simultaneously calls for reducing the administrative burden and increasing transparency relative to the system that prevailed under the Postal Reorganization Act.")

versus pound-weighted packages), pricing style, or even mailer volume (such as the use of volume bands). Alternatively, the products could simply be aggregated in batches.

In unique circumstances, where the Postal Service seeks (and the Commission grants) approval for such broadly encompassing product categories, the Governors should expect to be provided by postal management a periodic report (such as after two or three years), assessing the contracts within the broad category against the statutory requirements and corporate objectives.

**2) Broad shell classifications should be set to expire after a specified period of time.**

A renewal request and Governors' decision would be expected for any such shell classification renewal at the appropriate time if the Postal Service wished to continue that product.

## **VII. Summary**

The Public Representative believes that creating such a broad product category seemingly without functional constraint is contrary to the public interest and to the intent of PAEA and Title 39. Such a broad product category could interfere with suitable oversight by the Governors.

This is not to suggest any misdirection or ill-intent. Such a situation is a natural and understandable tug-of-war between two considerations outlined in the PAEA, and is certainly to be expected as the new regulatory scheme works its course.

The Commission should take the opportunity to discuss with the Postal Service how to reach a good middle ground between the transactional efficiency

and marketing flexibility of shell classifications, and the need for adequate oversight by the Governors. In general, it is recommended that shell classifications include contracts linked by some appropriate common element, that shell classifications should require periodic renewal by the Governors. It is also recommended that it would be sound practice for the Governors disclose the voting tally when issuing rate or classification Decisions.

The Public Representative respectfully submits the preceding Comments for the Commission's consideration.

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