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

Consideration of Workshare Discount Rate Design	Docket No. RM2009-3

COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE CONCERNING ISSUES SPECIFIC TO STANDARD MAIL IN RESPONSE TO ORDER NO. 243

The Association for Postal Commerce ("PostCom") hereby submits these comments concerning issues specific to Standard Mail in response to Commission Order No. 243, comments provided during the Commission's public forum held on August 11, 2009, and the Commission's Notice of Inquiry No. 1 issued in this docket on August 27, 2009. PostCom is concurrently filing separate comments concerning issues specific to First Class Mail.

In PostCom's view, the very title of this docket, "Consideration of Workshare Discount Rate Design" is problematic: it is indicative of the resistance of both Commission and some segments of the mailing community to accepting the important principle that pursuant to the regulatory regime established by and under the PAEA, pricing, -- a more accurate term for "rate design", -- is a matter initially and principally within the Postal Service's purview.

With regard to Standard Mail, PostCom observes that the issues and ideas under consideration amount to dithering about cruise rates while the ship is pitching. The

specific concepts advanced are not only beyond the Commission's purview, they are divorced from the realities of the postal market place and, therefore, counterproductive. We respectfully suggest that the Commission return its focus to working with the Postal Service to address more fundamental questions. All postal stakeholders will benefit if the Postal Service is successful in smoothly restructuring its network of retail and processing facilities to meet demand and rapidly reduce its costs, and (of greatest importance) in developing products that respond to the modern marketplace.

I. IN THE FIRST INSTANCE, PRODUCTS ARE DESIGNED AND PRICES ARE PROPOSED BY THE POSTAL SERVICE; COMMISSION AUTHORITY IS LIMITED TO REVIEWING PRICES (AND TERMS AND CONDITIONS OF SERVICE) FOR STATUTORY COMPLIANCE

A. The Commission Does Not Set Prices.

A paramount objective of the PAEA is to provide the Postal Service with pricing flexibility. The PAEA set forth a modern system for regulating rates and classes for market dominant products in which the Commission's primary active roles are to review whether the rates comply with the price cap restrictions under the statute,[1] and to ensure that the Postal Service operates in conformance with its statutory requirements.[2]

This does not mean that the Postal Service has unfettered discretion in pricing and rate design matters. It does mean that the Commission's role is very different than it was

[1] 39 U.S.C. § 3622(d).

[2] 39 U.S.C. § 3662(a). In Order No. 243, in addition to proposing the idea of requiring the Postal Service to unbundle certain Standard Mail prices, the Commission also raised the question of whether cost coverages in Standard Mail should be reset. Order at 6. Provided the requirement is met at the class level, reassessing cost coverages within Standard Mail is simply beyond the Commission's jurisdiction and unlawful.

under former Title 39 and considerably narrower than Orders 243 and NO1-1 in this docket evidently contemplate.

1. Rigid Adherence to Formulaic Rules Is Not Likely to Yield PredictableRates, is Arbitrary and Unlawful

As the Postal Service has stated in response to Commission inquiries concerning the justifications for existing worksharing discounts, "absolute adherence to any strict 100 percent passthrough pricing rule could lead to a price structure whose incentives are constantly being jolted, to the detriment of mailers, and therefore, the efficient operation of the Postal Service."[3] This observation is particularly apt in the post-PAEA world of annual price adjustments, and in a period where, if the Postal Service is successful in restructuring its operations, its costs can be expected to change dramatically in a relatively short time frame. As the postal network itself changes and actual costs change, the goal of predictability of rates is not likely to be achieved through rigid adherence to past methodologies. As we further explain below, nor does the statute require application of past methodologies. Rather, the Postal Service must look to achieve the goal of predictability though balanced rate setting.[4]

Furthermore, ratemaking case law illustrates that formulaic approaches to price setting are arbitrary. Consider, for example, *Celanese Chemical Company, Inc. v. the United States,* 632 F. 2d 568 (5th Cir. 1980). In that case, a Celanese, a railroad shipper, petitioned for review of an Interstate Commerce Commission (ICC) order approving a

[3] *Response of the United States Postal Service to Commission Information Request No. 1,* at 5, PRC Docket No. R2008-1 (March 4, 2008).

[4] Under the PAEA, the goal of transparency is largely achieved through annual compliance reporting. PostCom also recognizes that the Commission's administrative preference for vetting new metholodological approaches in advance of the Postal Service's price adjustment filings furthers the goal of transparency.

capital incentive rate for a shipment of coal along a particular railroad route. Celanese had embarked on a plan to convert its plant to coal use at a time when the ICC itself had acknowledged that it was national energy policy to encourage both the conservation of petroleum (e.g., oil and natural gas) resources and the development of coal reserves. The capital incentive rate was, essentially, a surcharge on the rate based on fully allocated costs which the ICC permitted by rule whenever the schedule would require a million dollar capital investment to implement. The ICC authorized a formulaic rate that required one set of customers to pay a surcharge to make up for other customers who paid rates that did not reflect fully allocated costs. Among other errors, the court found that the ICC failed to weigh federal energy policy as required by its statutory mandate. In the Energy Policy and Conservation Act, Congress had specifically ordered the ICC to consider the impact of its regulatory actions on national energy policy.

Here, as in *Celanese*, the Commission cannot lawfully impose a formulaic approach to price setting. Rather the Commission must recognize and evaluate the many factors – and most importantly the strictures of Section 403(c) -- in its review of Postal Service prices. The Commission cannot arbitrarily order unbundling or repricing based merely out of adherence to a rule or rate design that defines what costs or cost pools are within the realm of a particular definition of worksharing.[5]

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[5] *See also, System Fuels, Inc. v. United States,* 642 F. 2d 112 (Fifth Cir. 1981) (where the Commission was ordered to reconsider its approval of the differential pricing a railroad carrier prescribed for a utility shipping coal for failure to evaluate the impact of the price on the cost or quality of the resulting electrical service, which the court characterized as a public interest consideration, despite a more specific provision of the statute which the Court acknowledged gave the Commission the power to accept differential pricing); *Union Pacific Railroad Company et al. v. United States,* 637 F.2d 764 (10th Cir. 1980)

2. Section 3622(e) does not establish an absolute prohibition on workshare discounts that exceed avoided costs.

Section 3622(e) sets forth several circumstances under which it is plainly permissible for an existing discount for presorting, prebarcoding, handling or transportation to exceed the cost that the Postal Service avoids as a result of that activity. These circumstances include where the "reduction or elimination of the discount would impede the efficient operation of the Postal Service." Congress even further limited the applicability of the requirement to existing discounts through the following provision (Section 3622(e)(3)):

> ''(3) LIMITATION.—Nothing in this subsection shall require that a work share discount be reduced or eliminated if the reduction or elimination of the discount would— ''(A) lead to a loss of volume in the affected category or subclass of mail and reduce the aggregate contribution to the institutional costs of the Postal Service from the category or subclass subject to the discount below what it otherwise would have been if the discount had not been reduced or eliminated; or '(B) result in a further increase in the rates paid by mailers not able to take advantage of the discount.

Further, the statute specifically permits worksharing "discounts" –where "reduction or elimination of the discount would impede the efficient operation of the Postal Service." These statutory limitations on *reducing* worksharing discounts were not specifically addressed by Order No. 243, nor were they addressed to any significant extent, by any of the comments submitted to date. Even assuming that the Commission were empowered to set prices under the PAEA – and it is not – the Commission still would be required to be governed by Congress's express intent to continue discounts that exceed avoided costs under the circumstances it identified.

Nor can the Commission simply isolate a truncated version of Section 3622(e) in carrying out its review functions under the PAEA. Although this docket singularly – and as we will show inappropriately – focuses on workshare discounts that may exceed 100% of avoided costs, the statute and Section 3622 do not. Nor did Congress intend such a narrow approach. Workshare discounts are nothing more than pricing of products that entail and require certain functions to be performed by mailers. They are a part – important but only a part – of the mosaic of services and functions the Postal Service should tailor to meet mailer's needs.

Collectively, the statutory objectives and factors of the PAEA are indicative of Congress's recognition of the important role workshared mail plays in the modern era in supporting our postal system, enhancing operational efficiency, and reducing Postal Service costs.[6] It may be helpful to recall that the Postal Service took into account many of these statutory objectives and factors when it first presented its pricing proposals to this Commission.[7] This Commission apparently initiated this proceeding largely because of the abridged schedule that the PAEA imposed on Commission review[8] – not because of any specified legal deficiency in the Postal Service's prices.

The formulaic proposals with respect to Standard Mail described in Order No. 243 take no account of the statutory limitations on reducing worksharing discounts, nor

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[6] The Commission's consideration of workshare discount rate design would not be complete without examining how the PAEA objectives would be served by any changes it might order. See, in particular, 39 U.S.C. §§ 3622(b)(1-4). We also draw attention to the factors, and in particular those described in 39 U.S.C. §§ 3622(b)(1-4)3622(c)(1), (3-5), (7), (12-14), which the Commission is required to consider before revising its "system of regulation".

[7] United States Postal Service Notice of Market Dominant Price Adjustment, PRC Docket No. R2009-2 (February 10, 2009).

[8] *See* Order No. 192.

do they articulate the balancing of statutory factors that influence Postal Service pricing. The apparent preference for regulatory definition of functions comprising workshare discounts, and for prescribing workshare rate design should not be pursued at the expense of these qualitative considerations that the PAEA compels the Postal Service and this Commission to consider.

B. Under Section 403(c), the Postal Service Is Prohibited From Engaging In Predatory Pricing

The Commission's role defined by the PAEA does not mean that the Commission must simply rubber stamp any and all workshare proposals advanced by the Postal Service. Section 403(c) strictly prohibits the Postal Service from making any undue or unreasonable discrimination among users of the mails, and Section 404a(1) prohibits the Postal Service from establishing "any rule or regulation (including any standard) the effect of which is to preclude competition or establish the terms of competition unless the Postal Service demonstrates that the regulation does not create an unfair competitive advantage for itself...."

Mailers are concerned that the Postal Service not be permitted to use its new pricing flexibility simply as a vehicle for shifting costs from the Postal Service to the mailing industry. Over the past several years, mailers have seen their costs go up significantly as the Postal Service has imposed more and more eligibility rules, more design and preparation constraints on Standard Mail,[9] ostensibly to reduce the costs the

[9] Incremental requirements imposed on Standard Mail have included, *inter alia*, address placement, paper quality, tabbing, address quality, and bundling and palletization requirements.

Postal Service incurs in processing this type of mail, but which raise the costs of mailers and mail service providers, or reduce the value of the mailpiece to mailers.

By increasing costs to mailers and mail service providers, the Postal Service can effectively preclude the private sector from competing against the Postal Service in the provision of certain worksharing functions such as presort and drop entry. For example, if the eligibility criteria for bulk mail become so much more restrictive than eligibility for single piece mail, promotions that could be designed for bulk mail may yield a lower return on investment. Since many organizations select marketing campaigns based on ROI, the combination of restrictive eligibility criteria and reduced workshare incentives could result in greater loss of mail volume, and/or increasingly targeted (smaller amounts of) non-workshared mail. The risk that the Postal Service may use its prices, terms and conditions of service to preclude competition in sortation and transportation counsels that, in the exercise of its authority under §403(c), the Commission must diligently assure that the prices the Postal Service sets for products or services that reflect workshare activity at least closely approximate 100% of real avoided costs. By truncating Section 262(e) and ignoring qualitative considerations, the Commission's focus is misplaced. It should have equal, or even greater concern with discounts that pass through less than 100% of avoided costs.

As mailers have pointed out in the past,[10] fully passing through costs avoided by the Postal Service serves to advance Postal Service operational and financial objectives. As Anita Pursley observed on behalf of PostCom and MFSA (in R2006-1), a decline in workshared mail would result in added Postal Service costs and unplanned-for changes in mail flows. The goal should be to encourage mailers to presort, palletize and drop ship to the farthest extent possible so that the Postal Service can achieve maximum efficiencies and cost avoidance. As Ms. Pursley stated: "Mailers' choices regarding the level of presort, containerization, and drop entry of a given mailing or set of mailings are intertwined: the level of presorted pallets that can be prepared also determines the depth of entry that is feasible or permitted. Where discounts are below 100% of avoided cost, the Postal Service may be using its prices to preclude efficient competition."

It is these considerations that lead PostCom to conclude that Efficient Component Pricing (ECP) remains relevant to the consideration of whether the Postal Service's pricing of workshared mail is within the bounds of law or is anti-competitive. ECP does not, however, justify mechanical approaches to the implementation of §3622(e).[11] The Commission's analytical difficulties with evaluating whether the Postal Service's proposed prices meet statutory requirements by law cannot dictate Postal Service pricing (such as to require the actual unbundling or decomposition of discounts), or otherwise override the overarching PAEA price cap regime which provides the Postal Service with considerable pricing authority. Rather, the Commission is limited to using its best

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[10] *Direct Testimony of Anita Pursley on Behalf of the Association for Postal Commerce and the Mailing and Fulfillment Service Association,* PRC Docket No. R2006-1 (September 6, 2006).

[11] Nor does the concept necessarily apply to the Saturation/High-Density Rate Differentials. *See Comments of Valassis Direct Mail, Inc. and the Saturation Mailers Coalition,* PRC Docket RM2009-3 (May 26, 2009).

judgment as to whether the Postal Service's proposes prices satisfy statutory requirements, including but not limited to 3622(e), based on the information the Postal Service is required by law to provide, and weighing all other statutory directives.

II. FORMULAIC APPROACHES ARE DIVORCED FROM REALITY

The idea that this Commission's review of Postal Service pricing should be governed by strict adherence to quantitative approaches that have been accepted by this Commission in the past overlooks economic and technological realities.

First, the Commission should take notice that at least under recent economic conditions, the mailer's response to rate increases – the losses of volume -- appear to be considerably greater than that anticipated by the demand functions in the models used. Therefore, it seems more likely than not that an attempt to regulate and reduce or eliminate those workshare discounts that reportedly exceed avoided costs, in the current economic climate would lead to further unmodeled volume losses, and consequentially deeper losses of contribution to institutional costs, putting the Postal Service even deeper in the red.

Second, the statute allows prices for worksharing activities to exceed measured avoidable costs precisely because there are certain costs that may not be captured or may not be quantifiable. The fact that such quantification was not achieved does not mean it should be ignored, particularly as changes to the network and the introduction of new

technology alter the significance of the term worksharing as it is historically been understood.

Third, and most importantly, the results of any attempts to both (i) further define the term "workshare discount" by rule beyond the definition already prescribed by statute and (ii) unbundle or decompose pricing or costing, are likely to be overtaken by impending operational changes. This is because these changes – if successful – are likely to significantly alter historically recognized cost relationships, and also because – hopefully – such changes will usher in a new array of postal products and prices.

Thus, even if the Commission were to require the Postal Service to analytically unbundle or decompose the costing to identify workshare and non-workshare discount components, given all the qualitative factors, objectives, and circumstances that the Commission is required to consider, the unbundling exercise would not be likely to alter the Commission's conclusions regarding the legality of the existing pricing.

III. THE COMMISSION SHOULD ENCOURAGE INNOVATION

The Chair of this Commission stated in her testimony to the Senate:

> The Postal Service is at a very uncertain moment in its history. It is contending with historic mail losses driven by an exceptionally difficult economic environment. There is no question, however, that the increased transparency, accountability and flexibility provided by the PAEA have been beneficial. Within the current law, there remains considerable room for innovation. Postal products continue to be shaped by historic class differences, largely in place since the 1920's that may not make sense today. Potentially new markets could be developed around hybrid products

> that combine characteristics between classes – for example, a standard mail product with guaranteed date of delivery. Opportunities to better use its existing facilities have yet to be explored.[12]

PostCom agrees. Further, this Commission stands in a unique position to use its regulatory authority to foster innovation. It can do so by broadening its inquiry to encourage industry participants -- mailers and the Postal Service -- to put forward ideas for new products and pricing.

The Postal Service as an institution is slow to change. In part, this may be attributable to risk averse tendencies appropriate to a government agency with a public mandate. However, this may also be because key decision makers are dubious of whether new pricing ideas or methodologies will be accepted by its regulator, this Commission. The Postal Service may well be disinclined to present new products or pricing concepts to the Commission unless it has reasonable assurances that such ideas are likely to be approved. As evidenced by recent summer and fall incentive sales, there is undoubtedly great institutional potential for innovation. However, the Postal Service must be emboldened by evidence that the role of the Commission, too, is changing.

Issuing more prescriptive definitions and regulation would not serve to embolden the innovation that will be essential to the Postal Service's survival in this modern era of electronic communication. Rather than immediately undertaking more rulemaking, the

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[12] *Testimony of the Honorable Ruth Y. Goldway, Commissioner, On Behalf of the Postal Regulatory Commission, Before the U.S. Senate Committee on Homeland Security and Government Affairs, Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security* (August 6, 2009) at 7. http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=deeb3cbd-c284-4321-bf5a-64c0b21cf38a.

Commission should look for ways to foster innovation, to get the Postal Service, the mailing industry, public representatives, and the Commission itself to develop ideas for new products and services that are attractive to the mailing industry.[13]

If the Commission routinely rejects new methodologies, and evaluates the pricing of new products and rate designs by benchmarking the pricing of such products against existing products, the Commission is likely to stifle the Postal Service's institutional creativity, and obstruct the development of innovative products and pricing that would have the potential of reviving demand for services. Instead, PostCom suggests Commission provide a forum for stakeholders to discuss and vet new product ideas, and to consider how it can free the Postal Service from perceived regulatory constraints in order to enable it to capture new market segments.

For example, a new product in Standard Mail that demands some level of mail preparation in its eligibility requirements need not be priced in terms of a worksharing discount from an existing product, or based on a cost avoidance model. The Postal Service should not be required to price based on benchmarking from existing products. Where a product's eligibility requirements include requirements in connection with "presorting, prebarcoding, handling or transportation of mail"[14] it does not automatically follow that the price for the product is a "workshare discount," particularly where there is no reasonable rate at which that type of mailpiece can be entered without performing such activities. Rather, the Postal Service can apply another appropriate model to price

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[13] *See, e.g., Revised Sunshine Notice, Commission Meeting Agenda,* Federal Communications Commission (August 26, 2009), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-293077A1.pdf.
[14] 39 U.S.C. 33622(e)(1).

the product, while separately providing the empirical and qualitative support for that price as may be required by statute and Commission. Such an approach does not turn the language of Section 3622(e) into mere window dressing. The provision plainly does not require the Postal Service or this Commission to continue to price either existing or new products in terms of discounts from other products, or lock the Postal Service or this Commission into any historic pricing or costing methodology.

What the Standard Mail community needs is not more regulation or microscopic attempts to measure cost causation. What Standard mailers need is a forum in which the dynamics (both economic and technology) of the modern marketplace can be explored, and in which ideas for new and improved products can be broadly vetted. The Commission plainly has the power to issue Notices of Inquiry. There is nothing in the PAEA or in the APA which mandates that Notices of Inquiry must lead to rules. The Notice can, instead, provide a forum though which mailers identify what works and does not work in the current service offering system, what the mailers need and want and for the Postal Service to explain in general terms how it intends to redesign its current offerings in light of the economic and technological changes that it is implementing and that it is contemplating. In short, the Commission can, without overstepping its legal authority, provide the forum in which transparency and therefore a smooth transition to a changed world can be achieved.

CONCLUSION

For the above-described reasons, the Standard Mail pricing proposals raised by the Commission in Order No. 243 and NO1-1 must be rejected on legal and economic

grounds. These proposals impinge upon the pricing flexibility that the statute plainly conferred upon the Postal Service, and promote arbitrary, formulaic solutions that fail to take into consideration the full range of policy objectives, factors, requirements and circumstances established and recognized by Congress.

PostCom is confident that the Commission will step back and consider the whole of its statutory mandate before it orders any rule-based restructuring of a price for workshared Standard Mail charged by the Postal Service. It is our hope that the Commission will, as a result, issue a Notice of Inquiry that establishes a forum in which innovation in pricing and products can be accomplished not through rules but through the combined efforts of the Postal Service, the mailers and the Commission. In short, this is the proper role for the Commission in the face of what is plainly an urgent need for the Postal Service to exercise the powers it has been given to address its current crisis and its long range prospects.

Respectfully submitted,

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