

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

**ANNUAL COMPLIANCE REPORT, 2010**

**Docket No. ACR2010**

**REPLY COMMENTS OF  
THE ASSOCIATION FOR POSTAL COMMERCE  
AND ALLIANCE OF NONPROFIT MAILERS  
IN RESPONSE TO ORDER NO. 636**

The Association for Postal Commerce ("PostCom") and Alliance of Nonprofit Mailers ("ANM") hereby submit these reply comments in response to Commission Order No. 636 and the comments filed by the Public Representative and Valpak Direct Marketing Systems, Inc./Valpak Dealers' Association, Inc. ("Valpak"). PostCom and ANM submit these comments to emphasize once again that it would be irresponsible for the Commission to take any action to adjust rates based on seemingly excessive workshare discounts or inadequate cost coverages reported by the Postal Service before it resolves the costing and workshare discount design issues being considered in other dockets. As Valpak and the Public Representative have recognized, the costs used by the Postal Service to develop workshare discounts are not reliable. Adjusting prices to align prices and cost coverages based on this faulty information—in addition to being unlawful in certain instances—would simply make a bad situation worse. PostCom and ANM therefore again urge the Commission to refrain from any substantive rulings on these

issues in this docket so as not to prejudge the outcome of the various rulemaking dockets in which workshare, costing, and reporting issues will be properly and thoroughly considered.

## **I. The Postal Service’s Cost Estimates Are Unreliable**

As PostCom explained in its initial comments, “[b]ecause the costing methodologies employed by the Postal Service do not accurately track the costs actually incurred by the Postal Service in providing services, a workshare discount that appears to pass through more than 100% of the Postal Service’s avoided costs may in fact pass through less than the full amount of avoided costs.” PostCom Comments at 3. Both the Public Representative and Valpak have recognized this problem in their comments.

The Public Representative explains that Management Operational Data System (“MODS”) data “is used to calculate the MODS productivities used in the Postal Service’s cost avoidance models” that in turn provide the avoided cost estimates that “form the floor for worksharing discounts.”<sup>1</sup> Public Representative Comments at 22. Consequently, “if MODS productivities are inaccurate due to errors in the underlying MODS data not being properly scrubbed out, then . . . costs avoided (mail processing, transportation, delivery, etc.), worksharing discounts, and passthroughs will be inaccurate.” *Id.* at 22-23. Since, as the Public Representative acknowledges, MODS “data suffers from certain flaws,”<sup>2</sup> including small sample sizes for certain data sets<sup>3</sup> and

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<sup>1</sup> MODS data is also used to develop cost coverages and to test for cross-subsidies. Public Representative Comments at 23; 39 C.F.R. § 3015.7(a).

<sup>2</sup> Public Representative Comments at 22.

<sup>3</sup> *Id.* at 24.

anomalous results from a large percentage of facilities in which the data is collected,<sup>4</sup> it follows that the worksharing discounts and passthroughs calculated by the Postal Service are in fact inaccurate.

Valpak, citing its belief that “accurate costing is the foundation for rational pricing,” also recognizes flaws in the data the Postal Service uses to develop workshare discounts and calculate passthroughs and cost coverages. Valpak Comments at 61. In particular, Valpak points to the anomalous costs of Standard Mail Saturation Letters and Standard Mail High Density Letters. *Id.* at 63. As Valpak explains, the Postal Service reports higher costs for Saturation letters than High Density letters when common sense and logic would indicate the opposite to be true. *Id.* Valpak then cautions that “[a]ny negative cost difference for letters with higher density is not only anomalous, it also raises issues concerning the accuracy of the Postal Service’s costing system.” *Id.* By Valpak’s own logic, then, there is doubt as to whether the Postal Service’s pricing can be “rational,” based as it is on inaccurate costing.

Yet neither Valpak nor the Public Representative follow these findings to their logical conclusion. Instead, they urge the Commission to raise rates for products such as Standard Mail Flats based solely on the Postal Service’s reported data indicating that these products do not cover their full attributable costs. How they can ask the Commission to raise these rates—in Valpak’s case, even to levels that would result in increases exceeding the price cap at the class level—while simultaneously acknowledging these costing issues is baffling. If the costs are inaccurate, the reported passthroughs and coverages cannot be relied on. Raising rates will not fix the underlying

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<sup>4</sup> *Id.* at 23-24.

cost issues, and the rates may in fact be raised unwittingly to unjust and unreasonable levels.

The prudent course, then, is that laid out by PostCom in its Initial Comments. The Commission should refrain from a finding of noncompliance in this docket while turning its attention to other dockets in which it can assist the Postal Service in developing costing methodologies and designing workshare discounts that will accurately reflect the costs the Postal Service incurs and avoids in providing particular products.

## **II. The Remedies Proposed by Valpak and the Public Representative Are Not Permitted by the PAEA**

Perhaps more troubling than the logical deficiencies in the Public Representative's and Valpak's Comments are the remedies they propose to correct the perceived deficiencies in rates. In addition to being impractical and ill-advised, the proposed remedies are not permitted by the PAEA.

### A. "Underwater" Rates Are Not Necessarily Noncompliant

Valpak, in particular, grossly misinterprets the PAEA in asking the Commission to implement an 8% increase in Standard Mail Flats prices. Valpak Comments at 54. First, it elevates one factor prescribed by the law—"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" in 39 U.S.C. § 3622(c)(2)—above all of the other objectives and factors listed in section 3622, including the need for pricing flexibility, the effect of rate increases on the general public, and the relative value to the public of different types of mail. Valpak Comments at 23. It does so solely on the basis of the word "requirement." *Id.* at 23 n.6. The statute must be read as a whole, however, and the fact

that a product within a particular class of mail<sup>5</sup> does not cover its attributable costs—assuming, contrary to fact, that those costs have been reliably determined—does not necessitate or support a finding of noncompliance under section 3652. While the statute does speak of the “requirement” that each class of mail or type of mail service cover its attributable costs, it still lists that “requirement” as only one of fourteen factors for the Commission to consider in regulating rates. If this factor were meant to trump all the others, it would have been given prominence in the statute, not relegated to a list of considerations to weigh.<sup>6</sup> Moreover, treating this factor as the ultimate standard by which rates must be judged would defeat Congress’s intent to move the Postal Service away from cost-based ratemaking and toward “a modern system for regulating rates and classes for market-dominant products.” 39 U.S.C. § 3622(a).

But perhaps more importantly, even § 3622(c)(2) itself does not support a finding of noncompliance, at least not as Valpak would suggest. *See* Valpak Comments at 23-26 (arguing that “underwater” products violate the PAEA because they do not cover their attributable costs). While this factor speaks of the “requirement” that types of mail bear their direct and indirect attributable costs, it also requires that these attributable costs be determined “through reliably identified causal relationships.” 39 U.S.C. § 3622(c)(2). If

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<sup>5</sup> Further, it is unclear that a product, such as Standard Mail Flats, qualifies as a “class of mail or type of mail service.” It is certainly not a class of mail unto itself, and the meaning of “type of mail service” is ambiguous. As other PAEA requirements, such as the price cap, apply at the class level, it is reasonable to conclude that cost coverage should be determined at the class level as well, consistent with the need to allow the Postal Service pricing flexibility. The Commission recognized this distinction in Order No. 536, explaining that “[i]t is not plausible to contend that . . . the attributable cost floor applies at the product level and no higher.” Order No. 536 at 32.

<sup>6</sup> *See* Order No. 536 at 36 (explaining that the “factors” of section § 3622(c) are subordinate to the “objectives” of § 3622(b) and the quantitative pricing standards set forth in separate sections of the statute in evaluating the lawfulness of rates).

the Postal Service is noncompliant with any part of this factor, it is the direction to develop “reliably identified causal relationships” that can be used to determine the costs that should be attributed to individual products. Without such “reliably identified” relationships, the requirement that each class of mail or type of mail service bear its attributable costs becomes meaningless. The need for reliably identified causal relationships is logically prior to the requirement that each type of mail service cover its costs. As the Commission is in the process of addressing this issue in other dockets, there is no need for the Commission to reach the issue in this docket.

Without a finding of noncompliance, the remedies specified in 39 U.S.C. §§ 3653(c) and 3662(c) are unavailable. There are no “unlawful” rates to be adjusted to lawful levels, no “loss-making products” to be discontinued. Thus, there is no statutory authority for raising rates for Standard Mail Flats.

B. The Commission Must Respect the Price Cap

The argument that the Commission must determine that the rate for a product is noncompliant with the PAEA if that product does not cover its attributable costs is deficient on its own. Yet Valpak further distorts the statute in arguing for its preferred remedy, a 8% increase in the Standard Mail Flats rate. Valpak Comments at 54.

Valpak’s request rests on the unjustifiable contention that the Commission has the authority to order the Postal Service to adjust rates above the price cap in the context of an Annual Compliance Determination. Valpak Comments at 29-30. Valpak, in fact, contends that “the authority of the Commission to increase rates over the cap appears so clear that Valpak cannot identify any plausible reading of the statute to deny that power

to the Commission.” *Id.* at 30. PostCom and ANM have looked at the statute a little closer and have identified at least one such reading.

Assuming a finding of noncompliance, the statute permits the Commission to “order unlawful rates to be adjusted to lawful levels.” 39 U.S.C. § 3662(c). By law, increases in rates must comply with the price cap. That is, the statute requires that the system of rate regulation “include an annual limitation on the percentage changes in rates . . . 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 the Postal Service files notice of its intention to increase rates.” 39 U.S.C. § 3622(d)(1)(A). This provision does not admit of any exceptions for rates ordered adjusted by the Commission. Rather, it unequivocally limits the annual percentage change in rates to the CPI-U. Any rate increases above that level are unlawful. Thus, the Commission cannot order rates adjusted above the price cap, as it would be ordering rates adjusted to unlawful, not lawful, levels.

The statute admits of only one instance in which rates may be adjusted such that the increase in rates exceeds the price cap: an exigent rate case under 39 U.S.C. § 3622(d)(1)(E).<sup>7</sup> There is nothing in this provision, or anywhere else in the statute, that authorizes the Commission to unilaterally raise rates above the price cap in the context of an Annual Compliance Determination. The “clear” authority Valpak cites is so clear as

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<sup>7</sup> Further, even in an exigency case, the persistent failure (or persistent reported failure) of a class to cover attributable costs is insufficient to justify an above-CPI increase. *See* Order No. 547 at 64 (September 30, 2010) (“The exigent rate provision . . . may not be invoked simply by demonstrating a need for revenues.”); *accord* Brief for Respondent PRC in *USPS v. PRC*, No. 10-1334 (D.C. Cir.; filed Jan. 14, 2011) at 35-36 (“[T]he authority to raise prices due to either extraordinary or exceptional circumstances was not designed to provide a unique opportunity to address [cost coverage] problems that have persisted for years.” (internal quotations omitted)).

to be invisible. Because the Commission lacks the authority to order rates increased to a level that would exceed that permitted by the price cap, Valpak's request to raise rates for Standard Mail Flats must be denied.

The Public Representative, at least, acknowledges the strictures of the price cap provisions of the PAEA. Thus, in asking the Commission to raise rates on Standard Mail Flats by 5% rather than the 0.835% proposed by the Postal Service in Docket No. RM2011-2, the Public Representative recognizes that such an action would require "rate decreases for standard products that are covering costs." Public Representative Comments at 6. Nevertheless, the Public Representative's remedy is not consistent with the PAEA. As discussed above, the reported failure of this product to cover its attributable costs does not mean that the rate for this product violates the PAEA, especially in light of the Postal Service's deficient mechanisms for determining cost coverage. As the rate cannot be shown not to comply with the PAEA as a whole, the Commission has no grounds to make a finding of noncompliance and order a remedy.

### **III. Conclusion**

It is essentially uncontested that there are fundamental problems with the Postal Service's costing methodologies. Until these methodologies are corrected, the Commission should refrain from taking any action based on reported cost coverages or passthroughs. The figures are simply too unreliable. Instead, the Commission should use Docket Nos. RM2010-13 and RM2011-13, among others, to ensure that the Postal Service's costing methodologies and workshare discount designs are thoroughly and comprehensively reviewed and modernized.

Respectfully submitted,

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