

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

ANNUAL COMPLIANCE REPORT, 2011

)
)

Docket No. ACR2011

REPLY COMMENTS OF
MAGAZINE PUBLISHERS OF AMERICA, INC.,
ALLIANCE OF NONPROFIT MAILERS
AND AMERICAN BUSINESS MEDIA

David M. Levy
Matthew D. Field
VENABLE LLP
575 Seventh Street, N.W.
Washington DC 20004
(202) 344-4732

*Counsel for Magazine Publishers of
America, Inc., and Alliance of Nonprofit
Mailers*

Clark Pettit
President/CEO
AMERICAN BUSINESS MEDIA
675 Third Avenue
New York, NY 10017-5704
(212) 661-6360

For American Business Media

February 17, 2012

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

ANNUAL COMPLIANCE REPORT, 2011

)
)

Docket No. ACR2011

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

Pursuant to Order No. 1095, Magazine Publishers of America, Inc. (“MPA”), Alliance of Nonprofit Mailers (“ANM”) and American Business Media (“ABM”) respectfully submit these reply comments. These comments respond to portions of the initial comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers Association, Inc. (“Valpak”) and the Public Representative.

Valpak repeats its perennial argument that the Commission should increase the cost coverage of Periodicals mail by raising Periodicals prices by more than the price cap established by 39 U.S.C. § 3622(d). Valpak at 60-82. This, outcome, Valpak contends, could be achieved by (1) ordering an above-inflation increase for Periodicals or (2) eliminating the Periodicals class, thereby forcing periodicals to be mailed in other, higher-priced mail classes. *Id.* at 80-81.

The Public Representative argues that the Postal Service should be allowed to increase prices by more than the price cap as an alternative to network/service changes, e.g., changes proposed in Docket No. N2010-1, *Six-Day to Five-Day Street Delivery and Related Service Changes*; Docket No. N2011-1, *Retail Access*

Optimization Initiative; Docket No. N2012-1, *Mail Processing Network Rationalization Service Changes, 2012*. Public Representative Comments at 11.

None of these proposals have merit. As the Commission has found, the Postal Accountability and Enhancement Act of 2006 (“PAEA”) does not allow the price increase for any class of mail (as defined in the Domestic Mail Classification Schedule on the date of enactment (see 39 U.S.C. § 3622(d)(2)(A)) to exceed inflation except as allowed under section 3622(d)(1)(E) (exigency) or section 3622(d)(2)(C) (unused rate authority). Neither of these exceptions applies here.

COMMENTS

I. THE REPORTED FAILURE OF PERIODICALS MAIL TO COVER ITS REPORTED COSTS GIVES THE COMMISSION NO AUTHORITY TO IMPOSE OR APPROVE ABOVE-CPI RATE INCREASES FOR THE CLASS.

The latest version of Valpak's arguments suffers from the same fundamental defect as its predecessors: the failure of a class of mail to cover its attributable costs does not give the Commission authority to impose or approve above-CPI rate increases for the class. The "requirement" of 39 U.S.C. § 3622(c)(2) that each class cover its attributable costs is codified only as one of the “factors” of section 3622(c), not as an absolute requirement. Like the other “factors” and “objectives” of sections 3622(b) and (c), section 3622(c)(2) is subordinate to the CPI-based price cap and the two other quantitative pricing requirements established by PAEA.¹

¹ Apart from the CPI cap of section 3622(d), the other two “quantitative pricing requirements” are the limit on workshare discounts (39 U.S.C. § 3622(e)), and the revenue ceilings for the various categories of preferred mail (39 U.S.C. § 3626).

The Commission squarely addressed this issue in its Annual Compliance Determination (“ACD”) for Fiscal Year 2010. Rejecting the Public Representative’s contention in Docket No. ACR2010 that the attributable cost provision of 39 U.S.C. § 3622(c) stood on equal footing with the CPI-based price cap of section 3622(d), the Commission specifically held that the price cap trumps the attributable cost floor:

The Public Representative reasons that the statutory price cap and the attributable cost floor provision in section 3622(c)(2) are on equal footing. This is based on the contention that section 3622(c)(2) is a quantitative requirement, notwithstanding its location with the cluster of statutory factors the Commission identified, in Order No. 536, as qualitative....

Section 3622 creates a hierarchy based on “requirements,” sections 3622(d) and (e), “objectives,” section 3622(b), and “factors,” section 3622(c). With the exception of an exigent rate request and use of banked pricing authority, the PAEA’s price cap mechanism in section 3622(d)(1)(A) takes precedence over the statutory pricing objectives and factors in sections 3622(b) and (c), even if some of these can be considered quantitative. Therefore, to the extent an objective or factor with a quantitative component can be seen as competing with the price cap, the price cap has primacy . . .

[T]he objectives and factors, including those that can be regarded as quantitative operate within the context of the price cap; they are not on an equal footing with it. However, giving precedence to the price cap does not render the attributable cost floor provision inconsequential. It advances the section 3622(b)(5) objective of assuring adequate revenues to maintain financial stability and promotes the recognition of other objectives and factors. Consequently, the Commission will continue to press for meaningful cost-reduction efforts, examination of costs, and use of pricing flexibility to promote PAEA policies.

FY 2010 ACD (March 29, 2011) at 18-19 (footnotes omitted).² Hence, the failure of Periodicals rates to satisfy the attributable cost factor of 39 U.S.C. § 3622(c)(2) does

² *Accord*, Docket No. RM2009-3, Order No. 536 at 36:

These differences necessarily lead to differences in how the quantitative and the qualitative standards are to be applied in the modern system of ratemaking. Quantitative pricing standards are at the top of the statutory

not, without more, make Periodicals mail out of “compliance with” the Act as a whole. As the Commission explained in denying Valpak’s request for a finding of noncompliance in Docket No. ACR2010,

The Commission concludes that the rates for Periodicals do not satisfy section 3622(c)(2), but it does not find FY 2010 Periodicals rates out of compliance with applicable provisions of chapter 36 or regulations promulgated thereunder. A finding that a product (either individually or collectively) fails to satisfy a provision of title 39 does not compel a finding of non-compliance. In making its determination, the Commission must take into account numerous sometimes conflicting considerations.

FY 2010 ACD (March 29, 2011) at 17.

Valpak tries to circumvent the Commission’s holding on the theory that Periodicals rates violate not just one, but “at least 11” of the “objectives” and “factors” of 39 U.S.C. §§ 3622(b) and (c). Valpak at 71-78. Valpak gains nothing, however, by loading more objectives and factors onto the scales: the CPI-based price cap of section 3622(d) outweighs all of the objectives and factors combined. As the Commission made clear in its ACD for 2010, in the hierarchy of Section 3622, *none* of the “objectives” and “factors” of 39 U.S.C. §§ 3622(b) and (c), alone or in combination, override section 3622(d). FY 2010 ACD (March 29, 2011) at 17-19. Valpak itself acknowledged this in its recent brief to the Court of Appeals on review of the FY 2010 ACD: “The Commission has found that Periodicals prices cannot lawfully be raised to full cost coverage levels without violating the class-wide price cap.” Brief of Intervenors

hierarchy. Next in the hierarchy are the qualitative “objectives” listed in section 3622(b), followed by the qualitative “factors” listed in section 3622(c). Under this hierarchy, violations of the three quantitative pricing requirements are “out of bounds.” The Postal Service has broad flexibility to develop prices to achieve the qualitative objectives and factors of sections 3622(b) and (c) so long as its prices are “in bounds” because they satisfy these quantitative requirements.

L.L. Bean, Inc., and Valpak in *USPS v. PRC*, No. 11-1117 (D.C. Cir., filed Dec. 7, 2011) at 25 n. 16.

Equally infirm is Valpak's effort to bootstrap a substantive ratemaking standard from the remedial provisions of 39 U.S.C. §§ 3653 and 3662 (*cf.* Valpak at 80-81). Section 3653 is merely an enforcement mechanism, and does not establish substantive ratemaking standards in its own right. The Commission may take action against a rate under section 3653 only if the rate was in noncompliance with the "applicable provisions of this chapter [i.e., chapter 36 of Title 39] (or regulations promulgated thereunder)." 39 U.S.C. § 3653(b)(1) (emphasis added). The remedial provisions of 39 U.S.C. § 3662 in turn may be invoked in an annual compliance review proceeding only upon such a finding of noncompliance. *Id.*, § 3653(c). Without any independent basis for a finding of noncompliance, no remedial action by the Commission under § 3653 or 3662 is "appropriate" under § 3653(c). See FY 2010 ACD (March 29, 2011) at 17 ("Given these considerations, the Commission need not address the scope of remedial powers under section 3653.").

Valpak's reliance on 39 U.S.C. § 101(d) is equally misplaced. *Cf.* Valpak at 80. Section 101(d), which was added to Title 39 by the Postal Reorganization Act of 1970, establishes a "policy" that postal rates "shall be established to apportion of the costs of all postal operations to all users of the mail on a fair and equitable basis." Whatever the meaning and significance of this general policy statement vis-à-vis the more specific provisions of section 3622,³ section 101(d) is part of chapter 1 of Title 39, not chapter

³ See *Mail Order Ass'n of America v. USPS*, 986 F.2d 509, 515 (D.C. Cir. 1993) (specific provision preferred over general one).

36, and thus cannot provide the basis for a finding of noncompliance under section 3653. *Id.*, § 3653(b)(1). Nor may the Commission circumvent this problem on the theory that section 101(d) is incorporated into the catch-all “factor” of section 3622(c)(14) (“the policies of this title as well as such other factors as the Commission determines appropriate”). Because Periodicals mail is a class, the price cap provision of section 3622(d) trumps section 3622(c)(14), along with section 3622(c)(2) and every other factor listed in section 3622(c), in setting prices for the class.

The one new wrinkle in Valpak’s February 3 comments is a suggestion that 39 U.S.C. § 3662(c) authorizes the Commission to circumvent the CPI-based price cap of 39 U.S.C. § 3622 by discontinuing all of the products within the Periodicals rate class. Valpak, citing a “longer-term recommendation” presented in the Periodicals Mail Study by the USPS (but not the Commission),⁴ argues that the Commission may implement an above-inflation increase on Periodicals mail by eliminating the class, thereby forcing publishers of Periodicals rates to migrate to other, costlier rate classes. Valpak at 81-82. Valpak appears to be referring to 39 U.S.C. § 3662(c), which authorizes the Commission, upon finding that existing rates fail to comply with Title 39, to “order[] the Postal Service to discontinue providing loss-making products . . .” Valpak’s reliance on section 3662(c) fails on several grounds.

First, the Commission’s remedial authority under section 3622(c) requires a finding that the rates in question are out of “compliance with the applicable requirements” of Title 39. *Id.* As explained above, the failure of Periodicals rates to

⁴ Contrary to Valpak’s suggestion, the Commission did not join in this recommendation. See Periodicals Mail Study at 93 (“The *Postal Service* has a longer-term recommendation.”) (emphasis added).

cover the attributable cost factor of 39 U.S.C. § 3622(c)(2) does not, without more, put Periodicals mail out of “compliance with” the Act as a whole. Docket No. ACR2010, FY 2010 ACD (March 29, 2011) at 17.

Second, the CPI-based cap would continue to constrain price increases on the mail matter now sent at Periodicals rates *even if* the Commission somehow found a basis in section 3662(c) for ordering the discontinuation of *every* product within the Periodicals class. Section 3622(d) defines the CPI-based price cap not in terms of the “products” or classes that are in effect today or in the future, but in terms of the Periodicals rate *class* as it was defined *when the PAEA was enacted*—i.e., on December 20, 2006. See 39 U.S.C. § 3622(d)(2) (“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 the Postal Accountability and Enhancement Act.*”) (emphasis added). This grandfather clause means that eliminating the individual product categories within Periodicals mail would not abrogate the price protection given by 39 U.S.C. § 3622(d) to the class. If the Commission were to force periodicals to migrate to other products of mail by eliminating the Periodicals product categories, the average rates paid by the former Periodicals class volume would still need to be limited to the levels previously established for Periodicals mail, as escalated by subsequent changes in the CPI cap.

Third, the notion that 39 U.S.C. § 3622(c) was intended to authorize the Commission to eliminate the entire Periodicals rate class is also inconsistent with 39 U.S.C. § 3621(a)(3), which provides that the “modern system for regulating rates and classes” established by the Commission under 39 U.S.C. § 3622 must continue to apply

to “periodicals” unless the Commission reclassifies Periodicals mail as a competitive product under 39 U.S.C. § 3642. Allowing the Commission to remove Periodicals mail from the system of rate regulation established under Section 3622 by ordering the “discontinuation” of the entire class would allow the Commission to render Section 3621(a)(3) a nullity.

II. THE COMMISSION HAS NO AUTHORITY TO CIRCUMVENT THE CPI-BASED PRICE CAP OF 39 U.S.C. § 3622(d) ON THE THEORY THAT NETWORK OR SERVICE CHANGES WOULD OTHERWISE RESULT.

The suggestion of the Public Representative that the Commission “perhaps” might allow above-CPI price increases to avoid the elimination of six-day mail delivery or the consolidation of the retail post offices and mail processing network proposed by the Postal Service (Public Representative at 11) is likewise beyond the Commission’s authority. The Public Representative cites no provision of Title 39 that allows the Commission to breach the CPI cap on these grounds, and no such authority exists. The only provision of PAEA that allows the Postal Service to breach the CPI cap when needed to enable the continuation of postal services of an appropriate “kind and quality” is the exigency provision, 39 U.S.C. § 3622(d)(1)(E). As the Commission knows, however, it may not approve an exigent rate increase unless the Postal Service (1) has requested the increase and (2) satisfied a host of specific statutory preconditions for it. *Id.*; Docket No. R2010-4, *Rate Adjustment Due to Extraordinary or Exceptional Circumstances* (Sept. 30, 2010), remanded in part, *USPS v. PRC*, 640 F.3d 1263 (D.C. Cir. 2011), on remand, Order No. 864, *Order Resolving Issues on Remand* (Sept. 20, 2011). The Postal Service has not made such a showing. Order No. 1059, *Order Addressing Motion to Supplement and Related Filing* (December 20, 2011).

Furthermore, the premise of the Public Representative's proposal—that the mailers may properly be forced to elect between above-CPI rate increases and substantially degraded quality of service—is at odds with the fundamental policy of PAEA. As the Commission has recognized, PAEA does not allow the Postal Service to obtain de facto above-CPI price increases by providing less costly, inferior service:

Under the PAEA, the Commission is tasked with reviewing the Postal Service's quality of service for all market dominant products, including speed of delivery, reliability, and the level of customer satisfaction. The review is undertaken to *ensure that the quality of service does not deteriorate under the CPI price cap system because of the potential to cut costs by way of service reductions to comply with price cap requirements.*

PRC ACD Fiscal Year 2010 (March 29, 2011) at 57 (emphasis added). The dual obligations to limit price increases to inflation, and to do so without substantially degrading quality, are the primary means by which the authors of PAEA sought to induce the Postal Service to operate more efficiently. As the Commission found in Docket No. R2010-4, the

modern system of regulation adopted by the PAEA . . . imposes a price cap on rates tied to inflation. It is designed to incent the Postal Service to reduce its costs and improve efficiency, while creating predictable and stable rates.

Order No. 547, *supra*, Docket No. R2010-4 (Sept. 30, 2010) at 64. The undersigned parties strongly support the Postal Service's recent (and overdue) initiatives to rationalize its network and operations as warranted by recent and projected declines in mail volume and Postal Service workload. Allowing the Postal Service to cut costs by substantially degrading the quality of service, however, would sabotage the incentives for efficiency created by PAEA.

III. THE COMMENTS OF ACMA AND TIME INC. UNDERSCORE THE URGENCY OF DEALING WITH THE REAL PROBLEM: THE POSTAL SERVICE'S FAILURE TO CONTROL ITS COSTS.

As noted above, the Commission reemphasized in its ACD for Fiscal Year 2010 the Commission's determination to "continue to press for meaningful cost-reduction efforts, examination of costs, and use of pricing flexibility to promote PAEA policies." FY 2010 ACD (March 29, 2011) at 19. The passage of another year has made meaningful cost control efforts even more urgent.

The lack of effective cost control is the reason why Periodicals revenues failed to cover reported attributable costs. As we explained last year, despite significant USPS investments in flats automation and mailer worksharing, "the Postal Service's unit cost for the Periodicals class increased by 85 percent from FY 1996 to FY 2010. This rate of growth was more than double the rate of inflation during the same period. Had the Postal Service simply held the increase in Periodicals unit costs to the rate of inflation during these periods, FY 2010 Periodicals revenues would have covered reported costs." Docket No. ACR 2010, Comments of MPA, ANM, and ABM (Feb. 2, 2010) at 8.

The comments of the American Catalog Mailers Association ("ACMA") in the present case provide further confirmation of the huge increases in Periodicals costs that have occurred over the last 15 years. ACMA's comments present a cost index (which, according to ACMA, quantifies "cost changes not due to changes in worksharing") for Periodicals. ACMA Comments at 2. ACMA shows that the overall increase in the Periodicals cost index between FY 1997 and FY 2011 (109 percent) was about twice the 56 percent increase in USPS Factor Input prices over the same period. *Id.* at 11.

The undersigned parties are also increasingly concerned that the Flats Sequencing System (“FSS”)—long touted as the savior of flats—will only continue the Postal Service’s miserable record in controlling the costs of handling flat-shaped mail. We, like Time Inc., hope that the problems with FSS are the temporary effects of the transition to a new system. So far, however, FSS has been a failure—driving up both Periodicals costs (see Time Inc. comments, Attachment B (Stralberg Statement) at 8-10) *and* customer complaints about service performance (see Time Inc. comments, Attachment A (O’Brien Statement) at 4 (chart)).

This issue is not just one of fairness or equity, but goes to the very crux of what is an attributable cost. The added costs of excess capacity and needlessly inefficient operations are not, in any meaningful sense, caused by Periodicals mail, and cannot properly be attributed to it.

CONCLUSION

The Commission should deny the relief proposed by Valpak and the Public Representative.

Respectfully submitted,

David M. Levy
Matthew D. Field
VENABLE LLP
575 Seventh Street, N.W.
Washington DC 20004
(202) 344-4732

*Counsel for Magazine Publishers of
America, Inc., and Alliance of Nonprofit
Mailers*

Clark Pettit
President/CEO
AMERICAN BUSINESS MEDIA
675 Third Avenue
New York, NY 10017-5704
(212) 661-6360

For American Business Media

February 17, 2012