

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Review of Commission's)
Price Cap Rules)

Docket No. RM2013-2

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
REPLY COMMENTS ON NOTICE OF
PROPOSED RULEMAKING
(May 31, 2013)**

Order No. 1678, "Notice of Proposed Rulemaking Requesting Comments on Proposed Commission Rules for Determining and Applying the Maximum Amount of Rate Adjustments," set May 31, 2013 as the deadline for Reply Comments. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") jointly filed Initial Comments, and now jointly submit the following Reply Comments.

REPLY COMMENTS

I. Initial Comments Confirm that the Price Cap Should Not Be Increased by Temporary Promotions and Incentives.

Proposed rule 3010.23(e) would permit the price cap to be increased above CPI to help recoup the cost of temporary promotions. Four sets of initial comments (including Valpak's) addressed the proposed rule; none supported it as written.

The Association of Postal Commerce ("PostCom") stated:

The underlying principle that should guide the Commission in developing rules for promotional programs is that the Postal Service should not be able to create new price adjustment authority simply by implementing promotional pricing in-between regular price changes. [PostCom Initial Comments, p. 2.]

Valpak agrees generally with PostCom’s comments, but also believes that the Postal Service should not be able to create new price adjustment authority by implementing promotional pricing no matter when it makes the proposal, not just when it does so “in-between regular price changes.”

PostCom proposes two alternatives which would satisfy the principle it stated. First, temporary promotions should be excluded from price cap calculations by default. PostCom suggests changing proposed rule 3010.23(e) from “may exclude temporary promotional rates and incentive programs ...” to “shall exclude....” *Id.*, p. 5. The second alternative is to require a full calculation of unused rate authority (not merely for that revenue forgone by the temporary promotion), properly banking all pricing authority not used up to that point. *Id.*, pp. 5-6. Valpak discussed these issues in its Comments in Docket No. R2013-6 (pp. 10-19), and urges adoption of the first alternative.

The National Association of Presort Mailers (“NAPM”) correctly pointed out an inconsistency in Order No. 1678:

Paragraphs (e) and (f) of proposed rule 3010.23 reflect **past Postal Service practice** concerning the **inclusion** of temporary promotional rates and incentive programs in the calculation of percentage change in rates. In past rate cases, the Postal Service chose **not to include** temporary promotional rates and incentive programs in the calculation of percentage change in rates when those rates and programs resulted in overall rate decreases. Order No. 1541 at 18. Proposed rule 3010.23(e) states the **Commission’s approval** of this practice. [Order No. 1678, pp. 10-11 (emphasis added).]

NAPM points out that “established practice of the Postal Service and the Commission **prior to Docket No. R2013-1**, was to **exclude** promotional pricing incentives from the cap calculation.” NAPM Initial Comments, p. 3 (emphasis added). NAPM explains that in the

seven price adjustment dockets addressing this issue prior to Docket No. R2013-1, “the Commission consistently held that promotional programs should be treated as analogous to negotiated service agreements ... having no impact on the price cap calculations.” *Id.*, p. 4.

In Order No. 1678, the Commission cites to Order No. 1541, page 18, for its statement that “[i]n past rates cases, the Postal Service chose not to include temporary promotional rates ... in the [price cap] calculation....” Order No. 1678, p. 11. In addition to being inconsistent, the Commission misstates what it actually did in Order No. 1541. Certainly, on page 16 of that Order, it noted that “Valpak urges the Commission to keep with the established practice of not allowing inclusion of revenue forgone in the price cap calculation at this time.” But then the Commission never substantively addressed that argument, instead approving the Postal Service proposal to include revenue forgone due to promotional pricing. *See* Order No. 1541, pp. 17-18. As NAPM noted, this “was a substantial departure from past practice.”

Like PostCom’s first alternative, NAPM suggested that proposed rule 3010.23(e) be changed from “may” to “shall.” Valpak agrees with this proposed change.

Pitney Bowes Inc. (“Pitney Bowes”) states that proposed rule 3010.23(e) “raise[s] a number of concerns” and “represents a significant change.” *See* Pitney Bowes Initial Comments, p. 3. Pitney Bowes notes that, under the proposed rule, “the Postal Service is held harmless for a failed promotional program; but the nonparticipating mailers pay” and “[t]his is inequitable and diminishes the incentive for the Postal Service to ensure that its promotional programs improve its financial condition.” *Id.*, pp. 3-4. Pitney Bowes’ recommendation is to conform proposed rule 3010.23(e) to the rule for the effect of NSAs on the price cap. As an alternative to the proposals suggested by PostCom and NAPM, and to the extent that this

would prevent the Postal Service from including temporary promotions in the price cap calculation, Valpak agrees with Pitney Bowes' recommendation.

II. The Postal Service's Request, Supported by PostCom, for Authority to Tinker with Billing Determinants Should Be Rejected.

Initial Comments of the Postal Service propose that rule 3010.23 be amended as follows:

The Postal Service recommends that the Commission modify proposed Rule 3010.23 to grant the Commission the discretion to use projections where it believes using historical volumes would either understate volumes or otherwise be inappropriate. [USPS Initial Comments, p. 5.]

Valpak opposes this recommendation.

In support of its recommendation, the Postal Service cites two examples:

(1) Docket No. R2009-2, where it proposed the Full-Service Intelligent Mail barcode (IMb) discounts; and

(2) Docket No. R2013-1, where data for the Mail to Mobile category were at issue.

Both of these examples would be covered by the requirement in proposed rule 3010.23 to "make reasonable adjustments to the billing determinants to account for the effects of classification changes such as the introduction, deletion, or redefinition of rate cells." Neither requires the Postal Service to be vested with broad authority to tinker with billing determinants.

The Postal Service Initial Comments also note that:

Proposed Rule 3010.23 codifies the Commission's preference for using known (historical) mail characteristics for adjusting billing determinants for classification changes, rather than using projections of anticipated changes in mailer behavior. [USPS Initial Comments, p. 4.]

In general, the Commission also has expressed a preference for actual data, which help avoid speculation and controversy, whereas projections are prone to the opposite. Projections should be avoided unless absolutely necessary. Speculation concerning data — whether the data be volumes used for billing determinants, mailer behavior, rates, or costs — leads to assertions that are unprovable (and often unsupported), disagreements, and other problems that PAEA was supposed to avoid, or at least minimize.

Nevertheless, wishful thinking concerning future cost reductions and speculation about possible cost savings continue to intrude into price adjustment dockets which were intended to be delinked from such cost projections. By way of illustration, following are some quotes from Order No. 1541 in Docket No. R2013-1:

The Commission is not persuaded that the rationale offered by the Postal Service justifies a waiver of the directive that cost coverage for Standard Mail Flats be increased through a combination of above-average price increases and **cost reductions**. [*Id.*, p. 34 (emphasis added).]

In this proceeding, the Postal Service neither proposes an above-average rate adjustment nor convincingly demonstrates that **cost reductions** will result in an increase in the cost coverage of the Standard Mail Flats product. [*Id.*, p. 36 (emphasis added).]

[T]he Postal Service states that it anticipates the cost coverage for Standard Mail Flats to increase to 83 percent in FY 2012 and 86 percent in FY 2013 due, in part, to **estimated decreases in the average unit cost** for Standard Mail Flats. [*Id.*, p. 36 (emphasis added).]

These model outputs do not contain sufficient data for the Commission to substantiate the **expected cost savings**.... In short, the Postal Service fails to

demonstrate that Standard Mail Flats **average unit costs are likely to decrease.** [*Id.*, p. 37 (emphasis added).]

The Postal Service's failure to rely on the actual, most recent data — in lieu of wishful thinking and pie-in-the-sky speculation about future costs — led the National Postal Policy Council to comment correctly in Docket No. R2013-1 that it:

is rather concerned that the Postal Service is relying upon **unproven future cost savings** ... as a justification for below-cost rates for Standard Flats. It would be preferable to set prices on the **basis of known, current costs**, and moderate future prices in the future should **anticipated cost savings, in fact, be realized.** [Order No. 1541, p. 37 (emphasis added).]

Order No. 1541 (Docket No. R2013-1) includes a chart (on p. 38) which illustrates well that certain much-discussed and long-awaited cost reductions have yet to materialize. The Postal Service and the Commission both should rely more on actual data and cease trying to rationalize decisions that actual data cannot and do not support.

Similar to the Postal Service proposal, PostCom would have the Commission amend proposed rule 3010.23 in a manner designed to open the door to speculation about the impact of future mailer behavior on billing determinants, in PostCom's continued, single-minded dedication to perpetuate subsidies to users of Standard Mail Flats, at the expense of all other Standard Mail users:

[Proposed rule 3010.23(d)] further states, however, that “[a]djustments to billing determinants may not be based on **anticipated changes in mailer behavior.**” This complete prohibition on relying on anticipated changes in mailer behavior is **too restrictive.** In certain instances, there may be well-defined trends in mailer behavior that clearly demonstrate that it is improper to use the most recent available 12 months of billing determinants as the rate cell volume. [PostCom Initial Comments, p. 8 (emphasis added).]

PostCom's Comments (at 8) acknowledge that a similar proposal was previously rejected in Docket Nos. R2013-1 and ACR2012 when "the Commission declined to account for mailer behavior with respect to Standard Mail Flats in Order No. 1541."

As proposed, rule 3010.23(d) already allows the Postal Service to "make reasonable adjustments to the billing determinants to account for the effects of classification changes such as the introduction, deletion, or redefinition of rate cells." In the absence of classification changes, for which the rule makes adequate allowance, it is neither necessary nor wise to invite the Postal Service to engage in speculative projections and alterations to the billing determinants. The proposed rule is sufficient.

Every postal product has some kind of trend, even where it appears to be flat. At the same time, trends in mailer behavior are not "well-defined," notwithstanding PostCom's assertions to the contrary. Rather than being well-defined, any projection of anticipated changes in mailer behavior necessarily involves assumptions, speculation, and uncertainty. As such, any projection of anticipated changes in mailer behavior should be open to challenge. However, market dominant price adjustment reviews are conducted under an accelerated timetable which leaves no time for Reply Comments or review of assumptions and challenges to projections of mailer behavior.

The Commission explained in Order No. 1678 that it "has repeatedly emphasized that ... adjustments to billing determinants should not be based on anticipated changes in mailer behavior." The Commission is correct and should reject PostCom's and the Postal Service's proposals, instead confirming "the Commission's preference for using historical data in the

calculation of percentage change in rates by prohibiting the use of data based on anticipated changes in mailer behavior.” Order No. 1678, p. 10.

Further, by definition, the volume of mail recorded in the billing determinants for every product reflects mailer behavior. Introducing speculative trends and forecasts into the billing determinants, although perhaps only a small step, could be the first step down the path towards a more comprehensive review rate of adjustments in a more forward-looking manner — *i.e.*, a roll-forward approach to billing determinants. That, clearly, would open the kind of Pandora’s box that PAEA was supposed to avoid.

We already have arbitrary Postal Service pricing. The Postal Service should not now be permitted to engage in the creation of arbitrary costs, volumes, and revenues. PAEA may mention pricing flexibility, but it does not grant the Postal Service flexibility in manipulating mail data.

III. Postal Service Comments on Price Adjustments Filed more than 12 Months Apart Misreads Order No. 1678.

The Postal Service opposes the proposed change to rule 3010.21. That proposed rule would require a calculation of the cap for the last 12 months, with that amount being the annual limitation. If the time since the last adjustment has been more than 12 months, then the months between the last price adjustment and the immediately preceding 12 months results in “interim unused rate adjustment authority.”

The Postal Service appears to believe that the proposed rule would require it to forgo use of the interim authority until after it had used all previous unused authority (as required by

39 U.S.C. § 3622(d)(2)(C)(iii)(III)). The Postal Service complains that “the Commission’s approach would effectively force the Postal Service to raise prices at least every twelve months...” and that it “would be **penalized for delaying rate adjustments.**” USPS Initial Comments, pp. 2-3 (emphasis added). It proposes that “the Commission could allow the Postal Service to use the full rate adjustment authority associated with the period since the previous notice.” *Id.*, pp. 3-4.

Apparently, the Postal Service did not grasp the entirety of Commission Order No. 1678. Proposed rule 3010.26(c)-(d) defines “interim unused rate adjustment authority” and states that it “**may be used** to make a rate adjustment pursuant to the second of two notices of rate adjustment filed more than 12 months apart.” (Emphasis added.) The Commission even explained: “The proposed rule also specifies that interim rate adjustment authority **may be used** in the same case in which it is generated....”¹ *Id.*, p. 9 (emphasis added).

However, it is not clear that the Commission’s proposal is correct under PAEA. Section 3622(d) indeed sets up an “annual limitation,” which is based on the CPI-U “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). Furthermore, “the Postal Service may adjust rates not in excess of the **annual limitations,**” except for unused rate authority under section 3622(d)(2)(C). 39 U.S.C. § 3622(d)(1)(D) (emphasis added). Thus, it is not at all obvious that PAEA allows the Postal Service to use more than 12 months of CPI increase plus the earliest available banked authority. This price cap, said to be at the heart of PAEA,

¹ This was permitted in Docket No. R2011-2.

remains problematic in implementation. It is based on an **annual limitation**, and it appears that any unused authority that exists from before the most recent 12-month period must be used on a first-in, first-out basis. 39 U.S.C. § 3622(d)(2)(C)(iii)(III).

Finally, the Postal Service complains of being forced “to raise prices at least every twelve months ... even when waiting would be more efficient and customer-friendly,” arguing that such an interpretation would jeopardize its beloved “pricing flexibility.” In nearly every docket, the Postal Service and at least some mailers who supported enactment of PAEA repeat the mantra that the price cap in section 3622(d) “trumps” all of the objectives and factors of section 3622(b) and (c). Assuming, *arguendo*, that to be true, then “pricing flexibility,” which is set out in the factors and objectives, certainly would not trump the price cap of section 3622(d) — the veritable “cornerstone” of PAEA — a central part of which is achieving price changes at “regular intervals by predictable amounts.” The Postal Service cannot have it both ways.

IV. MPA’s Proposal to Modify the Definition of Class Is Unwise.

MPA urges the Commission to revise its proposed regulatory definition of “Class.” Its proposal should be rejected.

The Commission’s proposed definition of “Class” appears in the very first section of Subpart A (“General Provisions”) and, hence, is designed to apply to all of Part 3010 (“Regulation of Rates for Market Dominant Products”). Part 3010 governs every aspect of rate adjustments for Market Dominant products — including Negotiated Service Agreements (Subpart D), and Rate Adjustments in Extraordinary and Exceptional Circumstances (Subpart

E). In essence, MPA urges the Commission to pluck a phrase from 39 U.S.C. § 3622(2)(A) defining “Class” for certain purposes regarding the rate cap, and have that definition apply to all types of rate adjustments, even where the rate cap does not apply.

Congress did not set out a general definition of the word “Class” in Chapter 36 of Title 39. It is not necessary for the Commission to parrot every word of a statute in every regulation for the statute to govern — when it applies.

Although the statutory provision from which MPA wants the Commission to pluck words is binding when it applies, there could well be other uses of the word “Class” (or that same concept) in Chapter 36 and in Part 3010 of the regulations where a different meaning of the word “Class” would be more faithful to what Congress intended. These commenters do not have the resources to do a comprehensive review of each word of Chapter 36 and Part 3010 to see what mischief this proposal might accomplish. Indeed, there could well be other instances where the word “Class” (or that same concept) was not frozen in time by Congress and a regulatory definition would result in a meaning exactly opposite of what Congress wanted. However, MPA’s proposal is certainly not a technical, non-substantive change. At worst, it could undermine Congressional intent, and, at best, is unnecessary.

Lastly, the MPA proposal may be part of an effort to implement MPA’s belief that PAEA prohibits the lineal descendants of all types of mail pieces that were entered in the Periodicals class (as defined in 2006) from ever having an above-CPI price increase, even if those types of mail are entered years later as First-Class Mail or Standard Mail. *See* Reply Comments of MPA, etc., Docket No. ACR2011 (Feb. 17, 2012) (“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.”) This rather incredible reading of what MPA calls “the grandfather clause” does violence to the text of PAEA, and demonstrates the need for great care in adopting MPA’s overly broad application of a few words in 39 U.S.C. § 3622(d)(2).

V. PostCom’s “in the Alternative” Proposal that Authority Related to Promotional Prices Should Be Tied to Products, Not Classes, Is Unworkable.

PostCom suggests that if the Commission were still to allow the Postal Service “to create additional price adjustment authority through ... promotional and incentive programs, the rules should clarify that any cap authority created should be applied only to those products which were eligible for the promotional or incentive rates.” PostCom Initial Comments, p. 6. Valpak is certainly sympathetic with this point, and also sees the unfairness of a product which does not benefit from a promotion being required to help pay the cost of that promotion. Valpak Initial Comments, p. 4. However, PostCom’s alternative proposal reveals that PostCom’s proposed remedy is an impossibility.

In a world where market dominant postal prices are plucked from thin air by the Postal Service monopoly, without regard to underlying costs, without regard to demand factors such as elasticity, and deferred to by the Commission as an exercise of virtually unreviewed and unregulated “pricing flexibility,”² how could the PostCom Rule ever be enforced? Under the Commission’s prior decisions, with a handful of exceptions, the Commission plays no

² See, e.g., Valpak Initial Comments, Docket No. ACR2012, pp. 107-122.

meaningful role in pricing. The Postal Service sets rates for monopoly products as it pleases, without providing any meaningful explanation or justification, based on any factors it chooses, or no factors at all. Accordingly, what the PostCom Initial Comments really confirm is that no “in the alternative” position would work, and the Postal Service simply cannot be allowed to recoup the cost of promotions.

Respectfully submitted,

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