

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

NOTICE OF MARKET-DOMINANT PRICE)
ADJUSTMENT)

Docket No. R2013-10

**COMMENTS OF
MPA—THE ASSOCIATION OF MAGAZINE MEDIA,
ASSOCIATION FOR POSTAL COMMERCE,
DIRECT MARKETING ASSOCIATION, INC.,
ALLIANCE OF NONPROFIT MAILERS,
ASSOCIATION OF MARKETING SERVICE PROVIDERS,
MAJOR MAILERS ASSOCIATION,
NATIONAL NEWSPAPER ASSOCIATION,
PRINTING INDUSTRIES OF AMERICA,
QUAD/GRAPHICS, INC., R.R. DONNELLEY, AND
SOFTWARE & INFORMATION INDUSTRY ASSOCIATION/
AMERICAN BUSINESS MEDIA ON PRICE CAP IMPLICATIONS OF
RULE MANDATING USE OF FULL SERVICE INTELLIGENT MAIL BARCODE**

(October 31, 2013)

Pursuant to Order No. 1853, the undersigned parties respectfully submit these comments on the price cap implications of the Full Service Intelligent Mail Barcode (“IMb”) “mandate” that is scheduled to take effect in January 2014. These comments respond in particular to the Postal Service’s October 24 responses to Chairman’s Information Request No. 3, questions 1 and 2.

As the Commission knows, starting on January 26, 2014, mailpieces must meet Full-Service IMb requirements to qualify for the automation price categories of First-Class Mail, Standard Mail, Periodicals Mail and Bound Printed Matter. Full verification is set to begin on July 1, 2014. Mailpieces not meeting these requirements will be

eligible only for higher nonautomation prices. See 78 Fed. Reg. 23137 (April 18, 2013) (imposing requirement effective January 26, 2014); USPS response to CHIR 3, Question 1 (October 24, 2013) at 5-6 (stating that “no assessments will be made as a result of any full-service electronic verification until July 1, 2014”). The issue in this docket is what assumptions to make about the percentage of pieces that will qualify for automation prices when determining whether the Postal Service’s proposed rates comply with the CPI cap imposed by 39 U.S.C. § 3622(d) and the Commission’s rules. The Postal Service has assumed in its filings that *all* mail volume that was entered at automation rates in the most recent year for which billing determinants are available (FY 2012, Q4 through FY 2013, Q3), whether or not the pieces met Full Service IMb requirements, will remain eligible for automation rates under the new requirement.

This assumption violates 39 C.F.R. § 3010.23(d). Rule 3010.23(d) requires that CPI cap compliance be evaluated based on actual historical billing determinants for the most recent available 12 month period. “Adjustments shall be based on known mail characteristics or historic volume data, *as opposed to forecasts of mailer behavior.*” *Id.* (emphasis added). The Postal Service’s noncompliance with this rule in the present docket, unless corrected, would produce revenues exceeding the CPI cap by close to \$1 billion per year.

As the Commission noted earlier this week, the question of how to treat the CPI cap implications of changes in mail preparation requirements or eligibility rules that are scheduled to take effect during the expected life of a CPI-based price adjustment was first raised less than six months after the enactment of the Postal Accountability and Enhancement Act of 2006 (“PAEA”). See Commission Information Request No. 1

(October 28, 2013) (“CIR 1”) at 1-2. On June 18, 2007, the Alliance of Nonprofit Mailers and Magazine Publishers of America filed comments on this issue in Docket No. RM2007-1. The ANM/MPA comments, while arguing that the revenue generally should be calculated for the CPI cap by using historic billing determinants (i.e., the same mail mix in years 1 and 2), argued that an adjustment was necessary when a tightening of mail preparation requirements was likely to force some volume into higher-priced rate categories:

On a related point, however, there must be an exception or adjustment to the general rule of using the same volume weights to calculate average revenue per piece under existing and new rates when changes in mail preparation requirements have significant rate implications. For example, an increase in the minimum number of pieces in a Carrier Route Basic bundle from six pieces to ten pieces would cause some Periodicals Outside County flats to shift from paying the lower Carrier Route Basic rate (16.9 cents) to paying the higher 5-Digit Automation rate (26.8 cents).

Such a change would be a de facto rate increase, and therefore must be accounted for when evaluating compliance with section 3622(d) of the PAEA. A possible way to account for such changes would be to adjust the volume weights applied to the new rates (but not to the existing rates) to reflect the impact of the rule change on rate eligibility. Following through with the above example, if a rule change caused a portion of Carrier Route Basic flats to fall back a presort level, the volume weights used to calculate average revenue per piece under the new rates should be adjusted accordingly.

ANM/MPA comments in R2007-1 (June 18, 2007) at 2-3.

The Postal Service responded to the ANM/MPA proposal in reply comments filed in RM2007-1 on July 3, 2007. The Postal Service agreed that an adjustment should be made to reflect the revenue effects of changes in mail preparation requirements, although the Postal Service proposed to achieve the same result through a different adjustment mechanism:

The use of a “constant mail mix” facilitates the cap compliance calculation and mitigates potential difficulties in projecting changes in mail mix based on elasticities, forecasts, or other projections about the reaction of the marketplace to a change in price structures. ANM/MPA suggest an “exception...to the general rule” when changes to mail preparation requirements have “significant rate implications.” [citing ANM-MPA comments] In the Postal Service’s view, however, there is a compelling need to maintain a constant mail mix, and the ANM/MPA example of changes in mail preparation requirements causing mail to shift between presort categories should not precipitate a deviation from that principle. The ANM/MPA recommendation fails to place the Commission’s choice in context. Clearly, a constant mail mix rule might have potential advantages or disadvantages when viewed through the lens of an individual party. It is not difficult to conceive of circumstances in which assuming a constant mail mix would be in one party’s interest (perhaps a user of a mail product) if it kept prices lower, while being against the interests of another party (perhaps a competitor of that user). A constant mail mix assumption allows the Commission to adopt a pricing mechanism that simplifies the determination of cap compliance and reduces the reliance on forecasts. Basing cap compliance on anything other than a “constant mail mix” would invite contentious litigation and would be inconsistent with the need for a transparent, predictable price cap mechanism.

There is instead a simple way to deal with the situation discussed by ANM/MPA that does not violate the constant mix approach. Specifically, when some existing mail shifts from one category to a second category due to changes in mail preparation requirements, the solution is to create three volume groupings: (1) volume that starts in the first category and stays there, (2) volume that starts in the first category and shifts to the second category, and (3) volume that starts in the second category and stays there. When applying prices to these three groupings, volume in the first grouping is always charged the price applicable to the first category, volume in the third grouping is always charged the price applicable to the second category, and volume in the second grouping is charged the price applicable to the first category under existing rates, but the price applicable to the second category under the proposed rates. Such a process achieves the exact same objective sought by ANM/MPA – a fair process for the evaluation of compliance with the cap – but avoids the troubling prospect of allowing the volume weights to vary. The volume of each grouping remains the same at either set of prices. The identification of the contents of the three groupings in this example would constitute an illustration of an “adjustment” to historical billing determinants of the type discussed in the Postal Service’s Initial

Comments on Question 2 of the Second Advance Notice. [citation omitted] In practical terms, it requires the availability of no further inputs beyond those that would be required by the alternative approach advocated by ANM/MPA, and the computations are essentially equivalent.

USPS reply comments in RM2007-1 (July 3, 2007) at 2-4; see *also* CIR 1 at 2-3 (discussing USPS comments).

The Commission adopted the Postal Service's proposed approach in the Commission's September 2007 NPR in RM2007-1:

On this, there is near universal support for the Postal Service's proposed approach, or some slight variation thereof. Pitney Bowes, OCA, MOAA, ANM/MPA, APWU, PostCom, Advo, and JPMorgan/Chase all support the use of historical billing determinants as weights in their comments. The primary rationale for this position is that historical data are far less likely to be controversial than forecasts, and given the limited time and public participation for the review of notices of rate adjustment, simplicity and speed of analysis should take precedence.

* * *

The Commission's proposed rules calculate the percentage change in rates using the most recent available billing determinant as weights. As many parties point out, any attempt to develop a forecast of billing determinants would likely be controversial and complex, and a worthwhile analysis and resolution cannot realistically be achieved in the context of a pre-implementation review under section 3622(d)(1)(C).

The rules also instruct the Postal Service to make reasonable adjustments to the billing determinants to account for the effects of classification changes. The Postal Service has stated that such adjustments will typically be straightforward and based on known mail characteristics. Any adjustments are to be fully explained by the Postal Service at the time of the notice.

The Commission recognizes that the pre-implementation method of calculating the percentage change in rates in the proposed rules is not a perfect measure of what the actual change in rates will be. The billing determinants to be used will likely not correspond to a single set of rates, and adjustments for classification changes will be imperfect. Some

commenters suggest that the after-the-fact review will be the most effective means of ensuring compliance with the rate cap. *Id.* at 4–6; see also Transcript of Wilmington Field Hearing, July 9, 2007, at 47. (Emens). The statute requires the Commission to monitor the effectiveness of these rules and consider modifications to improve their effectiveness as events warrant.

Proposed rule 3010.23, captioned “Calculation of percentage change in rates,” explains in paragraph (b) that for each class of mail, the percentage change in rates is calculated in three steps. The first step involves multiplying the volume of each rate cell in the class by the current rate for that cell and summing the resulting products. (In the case of seasonal or temporary rates, the most recently applied rate shall be considered the current rate.) The second step involves multiplying the same set of rate cell volumes by the corresponding planned rate for each cell and summing the resulting products. The third step involves calculating the percentage change in rates by dividing the results of the first step by the results of the second step and subtracting 1 from the quotient. The result is expressed as a percentage. Paragraph (c) sets out the formula.

72 Fed. Reg. 50744, 50754 (Sept. 4, 2007); see also CIR 1 at 3.

In November 2007, the Commission codified the proposed rule without substantial change as 39 C.F.R. § 3010.23(d):

The volumes for each rate cell shall be obtained from the most recent available 12 months of Postal Service billing determinants. The Postal Service shall 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. Whenever possible, adjustments shall be based on known mail characteristics. The Postal Service shall identify and explain all adjustments. All information and calculations relied upon to develop the adjustments shall be provided together with an explanation of why the adjustments are appropriate.

72 Fed. Reg. 63662, 63695 (November 9, 2007) (emphasis added).

The Commission eliminated any possible doubt about the command of this rule in Docket No. RM2013-2. In its April 2013 notice of proposed rule changes, the Commission stated that it wanted to clarify Rule 3010.23 to require more unambiguously that “adjustments to billing determinants should not be based on anticipated changes in mailer behavior”:

The Commission has repeatedly emphasized that, *for purposes of calculating a percentage change in rates, adjustments to billing determinants should not be based on anticipated changes in mailer behavior.* Order No. 1541 at 17, 37; Order No. 606 at 19. This position is consistent with the existing rule 3010.23(d), which requires that “[w]henever possible, adjustments shall be based on known mail characteristics.” Proposed rule 3010.23(d) expresses more strongly 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, Docket No. RM2013-2, *Review of Price Cap Rules*, 78 Fed. Reg. 22490, 22493 (April 16, 2013) (emphasis added).

The Postal Service, in its May 16, 2013, comments, asked the Commission to temper the proposed rule by allowing exceptions when the Postal Service “anticipate[d] changes in mailer behavior”:

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. While this makes sense as a default approach, the Postal Service notes that, in particular circumstances, it would be more sensible to project anticipated changes in mailer behavior, and the Commission’s rules should be flexible enough to accommodate such circumstances.

USPS comments in RM2013-2 (May 16, 2013) at 4 (discussed in Order No. 1786, 78 Fed. Reg. 52694, 52699 (August 16, 2013)).

The Commission considered and rejected the proposed exception. *Id.*, 78 Fed. Reg. at 52698-52700. As recodified by the Commission in Docket No. RM2013-2, 39 C.F.R. § 3010.23(d) now reads:

The volumes for each rate cell shall be obtained from the most recent available 12 months of Postal Service billing determinants. The Postal Service shall 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. Adjustments shall be based on known mail characteristics or historic volume data, as opposed to forecasts of mailer behavior. The Postal Service shall identify and explain all adjustments. All information and calculations relied upon to develop the adjustments shall be provided together with an explanation of why the adjustments are appropriate.

78 Fed. Reg. at 52707 col. 1 (codified at 39 C.F.R. § 3010.23(d)) (emphasis added); *accord*, CIR 1 at 3. In adopting this language, the Commission emphasized that its “experience with projections based on forecasts of anticipated mailer behavior has not been positive,” and that “projections of mailer behavior carry the risk of relying on assumptions that are ‘unfounded,’ ‘unsupported,’ or ‘erroneous.’” 78 Fed. Reg. at 52699.

The Commission’s actions in Docket Nos. RM2007-1 and RM2013-2 are dispositive. Rule 3010.23(d) requires that the Postal Service, in projecting its after-rates revenue for purposes of compliance with the CPI cap, must use the “volumes for each rate cell . . . from the most recent available 12 months of Postal Service billing determinants.” Whether a piece satisfies Full Service IMb requirements is a billing determinant. The existing rate structure includes Full Service IMb discounts of 0.3 cent

per piece for First-Class Mail and 0.1 cent per piece for other classes of mail. Hence, the Postal Service's CPI compliance in this docket must be computed by assuming the same percentage of mail meeting Full Service IMB requirements that appears in the historical billing determinants.

The Postal Service's assertion that the CPI "cap does not apply to additional sources of revenue that might arise from changes in mailing rules that the Postal Service is statutorily authorized to issue" (USPS Response to CHIR 3, Question 1) has it backwards. When the tightening of a mail preparation requirement will cause mail volume to migrate into more expensive price categories unless mailer behavior changes from the historical billing determinants, Rule 3010.23(d) requires that historical mailer behavior, not the assumed revenue, be held constant.

Equally wide of the mark is the Postal Service's assertion that Rule 3010.23(d) applies only to changes in the Mail Classification Schedule ("MCS"), not the Domestic Mail Manual ("DMM") (USPS Response to CHIR 3, Question 1, at 3). Nothing in Rule 3010.23(d) draws such a distinction. Moreover, the discussion in Docket No. RM2007-1 of the revenue effects of changes in minimum bundle size for discounted rate categories (cited above) makes clear that the Commission had both MCS and DMM changes in mind when it adopted Rule 3010.23(d). In any event, a contrary rule would have nonsensical consequences. The Postal Service could, for example, drastically increase the minimum bundle size for discounted rate categories through a rule change published in the DMM, force mail to migrate to costlier price categories, and ignore the extra revenue in CPI cap calculations on the ground that the rule change was codified in the DMM rather than the MCS.

Faithful adherence to Rule 3010.23(d) undoubtedly may allow the Postal Service less revenue in this docket than would the substitution of projected billing determinants based on speculation about the extent of changes in mailer behavior that will result from the Full Service IMb rule change. But that is the consequence of the policy choice that the Postal Service advocated and the Commission adopted. As the Postal Service itself noted in Docket No. RM2007-1:

Clearly, a constant mail mix rule might have potential advantages or disadvantages when viewed through the lens of an individual party. It is not difficult to conceive of circumstances in which assuming a constant mail mix would be in one party's interest (perhaps a user of a mail product) if it kept prices lower, while being against the interests of another party (perhaps a competitor of that user). A constant mail mix assumption allows the Commission to adopt a pricing mechanism that simplifies the determination of cap compliance and reduces the reliance on forecasts. Basing cap compliance on anything other than a "constant mail mix" would invite contentious litigation and would be inconsistent with the need for a transparent, predictable price cap mechanism.

USPS Reply Comments in RM2007-1 (July 3, 2007) at 2-3.

The only remaining question is how much of the Postal Service's proposed revenue increase must be disallowed as exceeding the amount authorized by Rule 3010.23(d). The Excel spreadsheets produced by the Postal Service to accompany its response to CHIR 3, Question 2, indicate that the understatement of revenue (and therefore the downward adjustment required by Rule 3010.23(d) to the requested rate increase by the Postal Service in this case) is approximately \$1.6 billion per year. That amount appears to be an overstatement. First, the Postal Service's workpapers erroneously apply the Full-Service IMb requirement to certain discounted price categories of mail—e.g., Periodicals Nonautomation Carrier Route prices—to which the requirement will not apply. Second, as noted above, the Postal Service has stated that

it does not intend to fully enforce the Full Service IMb requirement until July 1, 2014, slightly more than five months after the date when the price changes proposed in this docket are scheduled to take effect. Accordingly, it would be appropriate to reduce the \$1.6 billion adjustment to net out the revenue from the price categories that the Postal Service mistakenly assumed would be subject to the Full Service IMb requirement, and reduce the adjustment further to reflect that full implementation will not occur until July.

Respectfully submitted,

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October 31, 2013