

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

NOTICE OF MARKET-DOMINANT
PRICE ADJUSTMENT

Docket No. R2013-10R

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(August 31, 2015)

I. INTRODUCTION

Although the commenters do not agree on how to interpret the price cap in a manner that is consistent with the governing statute and comports with the decision of the Court of Appeals, there appears to be a broad consensus, as discussed in section II below, that the analytical framework that the Commission proposed in Order No. 2586 does not satisfy the court's order to establish a sufficiently clear and limited standard.

However, the alternative proposals submitted by the Alliance for Postal Commerce *et al.* (PostCom) and the Public Representative are as unclear and boundless as the standard that the court set aside and, like the 15-factor test that the Commission proposed, would significantly alter the ratemaking system that the Commission established in Docket No. RM2007-1. Rather than having a "modern," streamlined rate-setting process, in which both the amount of price cap authority and the "percentage change" in proposed rates are relatively simple matters to discern, both PostCom and the Public Representative envision a process that extends far beyond price changes (whether that term is understood as including only changes to posted rates or also actions that are designed to force mailers to pay the Postal Service higher prices in practice). As discussed in section III, their proposals would, in PostCom's

case, require pre-implementation review of virtually all mail-preparation requirements that impose compliance costs on mailers and, in the Public Representative's case, also require *post*-implementation adjustment of the cap whenever volumes change after a mail preparation requirement is implemented.

These approaches not only represent a complete about-face in how the Commission has historically envisioned the cap, but also run afoul of the purpose behind the "modern," price-cap-driven system of ratemaking. Improving the efficiency of postal operations is precisely what the price cap was designed to achieve, so interpreting it as constraining efforts to reduce costs or otherwise enhance efficiency thwarts congressional intent and runs counter to the thrust of the court's decision. Mail classification requirements that are plainly designed to incentivize mailers to change mailing practices to enhance the efficient processing and delivery of the mail (rather than simply to force mailers to pay higher rates) should not be treated as rate increases.

Even if the price cap could theoretically be interpreted as broadly as PostCom and the Public Representative maintain, their specific proposals impose a host of administrative burdens that would make it virtually impossible for the Postal Service to manage its day-to-day operations or for the Commission to fulfill its statutory obligation to administer the price cap. As discussed in section IV below, these burdens flow directly from the commenters' effort to interpret the price cap as covering actions that extend beyond actual or *de facto* changes in rates. The Commission can avoid these problems by interpreting the price cap in accordance with the statute and the court's order, limiting the price cap to actual rate increases, and using its authority under other

statutory provisions to police mail preparation requirements that are not designed to raise rates.

II. THERE IS BROAD AGREEMENT THAT THE COMMISSION'S PROPOSED MULTI-FACTOR TEST DOES NOT SATISFY THE COURT'S REQUIREMENT TO ARTICULATE A CLEAR, LIMITED STANDARD FOR WHEN A CHANGE TO MAIL-PREPARATION REQUIREMENTS CONSTITUTES A CHANGE IN RATES

As the Postal Service discussed in its initial comments,¹ the Court of Appeals remanded the case to allow the Commission to articulate a standard that both provides clear guidance for future cases and prevents the Commission from “indiscriminately treating mail-preparation requirement changes as rate changes.”² Were the Commission to have unbridled discretion to treat mail-preparation changes as price changes, the court cautioned, the Commission would be able to use the price cap to encroach unduly on the “day-to-day and month-to-month operations of the Postal Service, including its ability to reasonably manage its own policies.”³ Accordingly, there must be a clear standard. Moreover, if the Commission decides to extend the cap beyond changes in posted rates, then it must exclude some mail-preparation changes from the scope of the cap: specifically, those changes that are not designed to “evad[e] the price cap by shifting mail to more expensive rates” and that accordingly do not force mailers to pay higher prices to the Postal Service.⁴

Five sets of initial comments were submitted in response to the multifactor framework that the Commission proposed “as a guide for a case-by-case analysis to

¹ Initial Comments of the United States Postal Service, PRC Docket No. RM2013-10R (Aug. 17, 2015), at 2-5.

² *U.S. Postal Serv. v. Postal Regulatory Comm'n*, 785 F.3d 740, 755 (D.C. Cir. 2015).

³ *Id.*

⁴ *Id.* at 746; *accord id.* at 751.

determine whether a mail-preparation change is a rate change.”⁵ The three most substantial sets – those of the Postal Service, the Public Representative, and PostCom – agree that the Commission’s proposed framework fails to set forth a clear standard governing whether a future mail-preparation change will be deemed a change in rates subject to the price cap. Accordingly, the proposed framework “does not fulfill the requirements of the court’s remand,”⁶ since the application of the proposed factors and sub-factors “could be so varied that no objective standard could be discerned.”⁷

The other two sets of comments do not opine directly on whether the proposed framework comports with the court’s decision, but implicitly demonstrate that it does not. Valpak’s comments characterize the proposed framework as “a good initial step,”⁸ and further argue that, short of treating all mail-preparation changes as changes in rates, complying with the court’s decision by articulating a “a simple, bright-line test” would be impossible in light of the “full panoply of possible changes to mail-preparation requirements.”⁹ Valpak’s comments are otherwise devoted to critiquing some of the specific proposed factors and sub-factors without offering an opinion about how they all interrelate. Similarly, the Greeting Card Association (GCA) does not comment on the clarity of the proposed standard, focusing instead on which of the factors and sub-

⁵ Order No. 2586, Order Establishing Procedures on Remand and Requesting Public Comment, PRC Docket No. R2013-10R (July 15, 2015), at 4.

⁶ Initial Comments of the Association for Postal Commerce, *et al.*, in Response to Order No. 2586, PRC Docket No. RM2013-10R (Aug. 17, 2015), at 11 [hereinafter “PostCom Comments”].

⁷ Public Representative Comments, PRC Docket No. RM2013-10R (Aug. 17, 2015), at 2 [hereinafter “PR Comments”].

⁸ Valpak Direct Marketing Systems, Inc. and Valpak Dealers’ Association Initial Comments in Response to Order No. 2586 (Aug. 17, 2015), at 5 [hereinafter “Valpak Comments”].

⁹ *Id.* at 2.

factors would be uniquely relevant to its constituency of “citizen mailers.”¹⁰ Both comments demonstrate that the proposed framework, rather than setting forth an actual standard, is effectively a type of Rorschach test, permitting the Commission to interpret the term “change in rates” to mean virtually anything it chooses. As such, all of the comments essentially agree that the Commission’s proposed multifactor framework would fail to meet the court’s requirement to provide “meaningful guidance to the Postal Service [and] its customers on how to treat future changes to mail-preparation requirements.”¹¹

III. THE STANDARDS PROPOSED BY POSTCOM AND THE PUBLIC REPRESENTATIVE ARE INCONSISTENT WITH THE STATUTE AND WITH THE COURT’S ORDER

The court held that the plain language of the term “changes in rates” in 39 U.S.C. § 3622(d) does not necessarily completely foreclose the Commission from applying the price cap not only to changes in posted prices, but also to situations where the Postal Service seeks to “circumvent[]” the cap by “forc[ing]” mail “into a higher rate cell,” even where the prices of the rate cells do not change.¹² Accordingly, the court held that the Commission has “some authority” to determine that “some mail-preparation requirements” – that is, requirements that shift mailpieces to higher rate categories and thus increase the “rates that customers actually pay” – “constitute ‘changes in rates’.”¹³

¹⁰ Initial Comments of the Greeting Card Association, PRC Docket No. RM2013-10R (Aug. 17, 2015), at 1 [hereinafter “GCA Comments”].

¹¹ *U.S. Postal Serv.*, 785 F.3d at 754.

¹² *Id.* at 746. *Accord id.* at 751 (Commission may prevent Postal Service from “evading the price cap by shifting mailpieces to higher rates through manipulation of its mail-preparation requirements”).

¹³ *Id.* at 751, 753, 756.

But it is not “unfettered authority.”¹⁴ The Commission has already stated, and the Court of Appeals has agreed, that not all mail-preparation changes are rate increases subject to the price cap. Accordingly, the applicable standard must exclude at least some changes to mail-preparation requirements from the price cap’s scope, and that standard must do so in a manner consistent with both the court’s order and the purpose of the price cap – which, the court noted, was designed to prevent the Postal Service from charging customers “unreasonably high prices.”¹⁵

PostCom and the Public Representative propose alternative tests for determining whether and when a given mail-preparation requirement can be interpreted as a change in rates. For PostCom, the “central inquiry” around which its proposal revolves is whether a change to a mail-preparation requirement either imposes “significant enough costs on mailers” or “require[s] mailers to pay higher postage.”¹⁶ For the Public Representative, the “critical question” is whether “the mail-preparation change force[s] a mailer who does not change behavior to pay a different price for the same mailing.”¹⁷

As discussed below, these alternatives are inconsistent with both the statutory scheme and the court’s remand order, which requires, at the very least, a clear line between changes that are designed to force mailers to pay more money to the Postal Service in the form of higher prices and changes that are designed to further the Postal Service’s operational efficiency. Because neither PostCom’s nor the Public Representative’s proposal even recognize the need for such a line, let alone offer

¹⁴ *U.S. Postal Serv.*, 785 F.3d at 753.

¹⁵ *Id.* at 751.

¹⁶ PostCom Comments at 4.

¹⁷ PR Comments at 9.

means for drawing it in a clear and predictable way, both proposals would result in virtually limitless application of the price cap to mail-preparation changes that are not designed to (nominally or in effect) increase the prices that customers pay the Postal Service.

A. Because Both PostCom’s and the Public Representative’s Proposals Are Even More Expansive Than the Formulation in Order No. 1890 That the Court Set Aside as “Boundless,” Both Proposals Are Inconsistent With the Court’s Remand Order

In Order No. 1890, the Commission concluded that the price cap covers not only actual changes in the posted rate charged for a given service (a point on which everyone agrees), but also some mail-preparation requirements that result in mailers paying higher prices when they fail to comply. Although PostCom notes that the “flaw in Order No. 1890 was the Commission’s failure to establish a reasonable limiting principle” concerning when a change to a mail-preparation requirement can be deemed a change in rates,¹⁸ neither PostCom’s nor the Public Representative’s comments actually set forth a reasonable limiting principle. In fact, both comments propose standards that are even broader than the Commission’s approach that the court set aside as “boundless and, thus, unreasonable.”¹⁹

1. PostCom’s Proposal, Which Applies the Price Cap Whenever a Mail-Preparation Requirement Imposes Compliance Costs, Is Far Too Broad

In PostCom’s view, the price cap should cover all changes to mail-preparation requirements that impose compliance costs on mailers. Because virtually all new

¹⁸ PostCom Comments at 3.

¹⁹ *U.S. Postal Serv.*, 785 F.3d at 744.

requirements impose some compliance costs on some mailers, PostCom's proposed standard is even broader than the test the court rejected.

The failure of PostCom's approach stems largely from its improper assumption that mailer "costs" are synonymous with "rates," which are the prices the Postal Service charges (and thus the payments the Postal Service receives from customers) in exchange for a given service. While the court concluded that the term "changes in rates" is ambiguous enough to refer not only to the posted rates the Postal Service charges but to the prices "customers actually pay,"²⁰ it nowhere suggested that the term can be stretched to encompass costs that mailers pay to third parties, rather than to the Postal Service in exchange for its services.

It may be true that, from the mailer's perspective, the overall "costs" to it of using a given service are more meaningful than simply the rate charged for using that service, but significance to a given mailer's finances does not qualify something as a "rate" regulated under Title 39. For this purpose, rates are fees paid to the Postal Service in exchange for services,²¹ whereas compliance costs reflect payments that mailers make to someone other than the Postal Service (i.e., to third-party vendors or the mailer's own employees) and therefore are not subject to rate regulation under Title 39. By way of analogy, consider the buyer of a house priced at \$300,000 who realizes that his current set of curtains are the wrong size for the windows, and that it would cost him \$300 to buy new curtains from a store. The cost of replacing the curtains (\$300) may be a factor in the buyer's decision whether to buy this house or another one, but no one

²⁰ *U.S. Postal Serv.*, 785 F.3d at 751.

²¹ 39 U.S.C. § 102(7).

would claim that the home price – that is, the rate that the buyer would pay to the seller – is actually \$300,300, much less that the seller owes the buyer a \$300 rebate. Thus, even putting aside the fact that (as discussed in section IV below) it would be impossible to administer a price cap measured by the aggregate compliance costs incurred by each individual mailer, a standard based on whether a requirement imposes implicit costs (rather than higher fees explicitly paid to the Postal Service) is necessarily an invalid conception of the price cap.

This is not to say that compliance costs are inherently irrelevant to the issue of prices paid. As noted above, the court observed that the Postal Service can effectively raise rates by forcing mailers to pay higher prices for their mailpieces.²² If a mailer believes that a new mail-preparation requirement requires it to incur compliance costs that are higher than the costs associated with simply paying a higher rate, then a rational customer will not pay those costs and instead will pay the higher rate (or perhaps leave the mail entirely). If, on the other hand, the customer believes that the compliance costs are lower than the cost of paying higher rates, then the mailer will comply with the requirement and its mail volume will accordingly not shift from one rate category to another.

It would still be very difficult to evaluate the decision-making process for even one mailer, let alone for mailers as a general matter, in the context of a rate proceeding. The price cap is thus an ineffective tool to police that inquiry, particularly when other regulatory avenues are available that expressly consider the effect on mailers (that is,

²² *U.S. Postal Serv.*, 785 F.3d at 746. This does not mean, of course, that the price cap is the appropriate tool to deal with such a scenario.

classification change and complaint cases). If a new term or condition of using a service were plainly designed to shift volume to a higher rate cell rather than to make mailers comply with the new term (and thus not pay the Postal Service more money in the form of higher rates), then perhaps there would be some basis to at least argue that the requirement is in effect a “price change” in another guise. But PostCom’s proposal, which effectively treats an increase in mailer “costs” as a *per se* increase in the “rates” a mailer pays to the Postal Service, does not even purport to measure the extent to which a mail-preparation change will force mailers into higher rate categories. The proposal thus is inconsistent with the court’s remand.

PostCom’s approach is not saved from boundlessness by its proposal to limit the term “change in rates” to mail-preparation changes that impose “significant enough” costs on mailers.²³ The term “significant enough” is no clearer than the term “substantial,” which PostCom maintains provides insufficient guidance.²⁴ Nor is greater clarity to be found in its proposal that “significant” should be deemed synonymous with the 0.001-percent threshold for *de minimis* rate changes found in 39 C.F.R. § 3010.30. Even assuming that it were possible in a rate case to precisely quantify any individual mailer’s compliance costs, let alone to arrive at any kind of meaningful comparison between the aggregate total of all individual mailers’ costs of using a particular service before and after a change in a mail-preparation requirement, the 0.001-percent threshold is so low that it would presumably ensnare most mail-preparation changes within the price cap. Based on FY2014 data, this approach would have translated into

²³ PostCom Comments at 4, 9.

²⁴ *Id.* at 5.

thresholds of \$280,481 for First-Class Mail, \$170,464 for Standard Mail, \$15,640 for Periodicals, \$7,685 for Package Services, and \$21,101 for Special Services.²⁵ Virtually every conceivable change in mailing rules would meet these thresholds for price cap treatment: indeed, they could theoretically be satisfied by a change that affects a single mailing by a single bulk mailer. As such, this approach would offer only the illusion of a meaningful distinction and would amount to merely a different flavor of the same “boundless” standard that the court proscribed.

2. The Public Representative’s Test Is Equally Expansive

Like PostCom, the Public Representative mistakenly interprets the price cap as regulating something other than prices. In the Public Representative’s view, the price cap is really a cap on “revenues,” so the “annual limitation on the percentage changes in rates” in 39 U.S.C. § 3622(d) is a cap on the extent to which postal revenues, not prices, can rise in a given year. However, the statute plainly imposes a cap on “rates,” not “revenues.” That the price cap is not, in fact, a “revenue” cap is immediately apparent when one considers the Postal Service’s years-long decline in market-dominant revenues, coinciding almost precisely with the period of the price cap. If the Postal Service actually operated under a “revenue cap,” it would be entitled to massive

²⁵ These figures are derived by multiplying 0.001 percent (that is, 0.00001) by the total FY2014 before-rates revenue (which excludes revenue from the exigent surcharge) shown in each of the Commission’s cap compliance workpapers in Docket No. R2015-4. See Excel file “CAPCALC-FCM-R2015-4 PRC-1.xls,” tab “Percent Change Summary,” cell C9, Library Reference PRC-LR-R2015-4/1 (Feb. 24, 2015); Excel file “PRC-LR-R2015-4-5-1.xlsx,” tab “3 SS Summary Table,” cell C28, Library Reference PRC-LR-R2015-4/5 (Mar. 11, 2015); Excel file “PRC CAPCALC-STD-R2015-4.xlsx,” tab “Detailed Price Change Summary,” cell J39, Library Reference PRC-LR-R2015-4/9 (May 7, 2015); Excel file “R2015-4PeriodicalsCC.xlsx,” tab “Summary,” cell D9, PRC-LR-R2015-4/10 (May 7, 2015); Excel file “R2015-4 Package Services Cap Calculations_.xlsx,” tab “All Package Services Summary,” cell D20, Library Reference PRC-LR-R2015-4/11 (May 7, 2015).

price increases to make up for the revenue losses that it has suffered since the Postal Accountability and Enhancement Act (PAEA).

In any event, the Public Representative's interpretation of the price cap's scope is no less sweeping than PostCom's. As noted above, the Public Representative proposes to apply the price cap to any mail-preparation change that "force[s] a mailer who does not change behavior to pay a different price for the same mailing."²⁶ But any term or condition of service, by virtue of it being a "requirement," forces a mailer to make a choice to either "change behavior" (i.e., to comply with the requirement) or stop using the service in question. If a rule change that forces a mailer to make such a choice is itself a rate increase, then the price cap applies to every change in mail-preparation requirements. As the Public Representative himself concedes, "virtually any change in either mailing requirements or terms of service . . . will, no matter how insignificant, . . . potentially alter some mailer's decision to use a particular rate cell," and accordingly "will technically have rate implications."²⁷ This conception of the price cap sweeps far too broadly. The court's decision suggested that the price cap can perhaps be used to prevent the Postal Service from manipulating its mail-preparation requirements as a means of forcing mailers to pay higher rates. Nothing in the opinion suggests, however, that the price cap can cover rule changes designed to force mailers to change behavior (and thereby avoid paying higher rates).

The Public Representative's proposal seeks to answer that question – whether a mail-preparation change causes a mailer to change behavior or to pay higher rates –

²⁶ PR Comments at 9.

²⁷ *Id.* at 8-9.

through the annual compliance review, which he says will enable the Commission to compute the “size of the revenue impact” of such a mail-preparation change.²⁸ As explained in more detail below, however, the Public Representative offers no way for the Commission to determine the extent to which any given mail-preparation change actually caused a shift in volumes (thereby altering the revenues that the Postal Service receives).

The Public Representative concedes that the Postal Service “constantly changes mail-preparation requirements” throughout the year,²⁹ and that the mail mix changes every year “even without changes in mail-preparation requirements.”³⁰ Given these facts, it is impossible – even after the fact – to determine with any confidence whether a change in a mail-preparation requirement motivated any particular mailer to shift its volumes among various services and rate categories, let alone to isolate the aggregate effect of any given mail-preparation change on the collective mailer population. The Public Representative’s approach would be impossible to administer, even if it were somehow theoretically sound.

While the Public Representative may be correct that the Postal Service should not be permitted to “game the system through . . . mail-preparation requirements that force mailers into paying more for service so that Postal Service revenue increases,”³¹ his approach does not begin to measure whether any “gaming” of the system has occurred. Nor does it provide a meaningful way to separate such “gaming” from the

²⁸ PR Comments at 2.

²⁹ *Id.* at 1.

³⁰ *Id.* at 7.

³¹ *Id.* at 7.

types of mail-preparation requirements that are aimed at improving the Postal Service's day-to-day operations or increasing efficiency through changes in mailer behavior, rather than through increases in postal revenues.

B. Both Approaches Undermine the Purpose of Price Cap Regulation: to Provide Incentives for the Postal Service to Cut Costs and Improve Efficiency

By proposing to extend the price cap to changes in mail-preparation requirements generally, Postcom and the Public Representative ignore the rationale for why, according to the court, the Commission has "some authority" to extend the cap beyond changes in posted rates. The court found that it was reasonable to interpret "changes in rates" to include not simply posted rates, but also the rates actually paid by mailers, because it "prevents the Postal Service from evading the price cap by shifting mailpieces to higher rates through manipulation of its mail-preparation requirements."³² The court's decision therefore suggested that the Commission can use the price cap to prevent the Postal Service from manipulating its mail-preparation requirements as a means to "evade" the price cap. Nothing in the opinion suggests that the price cap can cover rule changes designed to force mailers to change behavior (and thereby avoid paying higher rates) in order to increase efficiency. By extending the cap to such changes, the Commission would be applying the cap in a way that subverts, rather than advances, its purpose.

Through mail-preparation changes, the Postal Service is not seeking to "manipulate" mailers into paying higher rates, in order to generate additional revenue; it is seeking to reduce costs by incentivizing mailers to prepare their mail in a way that

³² *U.S. Postal Serv.*, 785 F.3d at 751.

can be more efficiently processed and delivered. For mailers who decide to make the operational change, the Postal Service does not generate any additional revenue; rather, the beneficial impact is reducing its costs, which is precisely what the price cap was designed to encourage. Additional revenue is only generated if mailers decide (1) not to make the operational changes, and (2) to mail at the postage rates to which their mail defaults as a result of not being prepared in accordance with the new requirements (rather than to leave the mail entirely). Thus, any additional revenue is purely incidental, and it is offset by the fact that the Postal Service would incur additional cost to the extent the mail-preparation change is not adopted (and would lose revenue from mailers who decide to leave the mail altogether rather than to adopt the change).

PostCom itself concedes that the Full-Service Intelligent Mail barcode (IMb) requirement was intended not to raise prices but to “improve efficiency and align mailing processes with Postal Service equipment.”³³ In light of that undisputed fact, it is ironic that PostCom simultaneously advocates that the price cap be the tool that regulates the requirement. The cap was not designed to constrain the Postal Service from making such efficiency improvements. PostCom argues that the purpose of a mail-preparation change is not relevant in determining whether the cap applies, but that cannot be correct, because it ignores the fact that Congress intended the cap specifically as a means of incentivizing the Postal Service to take certain actions in lieu of others.

Congress was concerned that, under the prior rate regulation regime (which, among other things, applied a breakeven standard and gave the Commission limited

³³ PostCom Comments at 6.

authority over the Postal Service's revenue requirement), the Postal Service too easily resorted to price increases as a means of raising revenue to cover its costs. In addition to promoting a limited measure of pricing flexibility, the price cap froze real (volume-weighted, class-average) prices at 2006 levels, thereby encouraging the Postal Service to improve its balance sheet strictly by reducing costs.³⁴ The Postal Service has few tools for doing so, however. The PAEA gave the Postal Service no additional authority to reduce labor costs; indeed, the PAEA expressly disclaims any ability to affect those very costs.³⁵ The Postal Service's ability to reduce costs through service adjustments is subject to political and practical constraints, as well as to its universal service obligation; besides, as the Commission has recognized, the Postal Service has already availed itself of most of the currently feasible opportunities for service-related cost reductions.³⁶ The only remaining option is for the Postal Service to try to increase the efficiency of its operations, which is precisely what the cap was intended to incentivize.³⁷

³⁴ See Order No. 1926, Order Granting Exigent Price Increase, PRC Docket No. R2013-11 (Dec. 24, 2013), at 29 ("Important goals of the PAEA are to foster the efficiency of Postal Service's operations and to promote rate predictability and stability."); Postal Regulatory Comm'n, Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006 (Sept. 22, 2011), at 39 ("The Commission finds that, in furtherance of the PAEA's goals, the use of the price cap promotes pricing flexibility for the Postal Service; predictability and stability in prices for mail users; and encourages cost reductions for the Postal Service."); Order No. 547, Order Denying Request for Exigent Rate Adjustments, PRC Docket No. R2010-4 (Sept. 30, 2010), at 80 ("Price cap rate regulation was expected to promote several goals, including, importantly, to incent the Postal Service to reduce costs and improve efficiency.").

³⁵ Pub. L. No. 109-435, § 505(b), 120 Stat. 3198, 3236 (2006).

³⁶ See Order No. 1926 at 131, 134-35 ("Unlike a private enterprise, the Postal Service must consider the impact of its cost-cutting activities on its ability to continue to provide postal services consistent with the policies of title 39, United States Code. . . . Although converting from door delivery might reduce costs, Valpak has not shown that converting from door delivery would also allow the Postal Service to maintain and continue to develop postal services of the kind and quality adapted to the needs of the United States.").

³⁷ See Order No. 2623, Order Resolving Issues on Remand, PRC Docket No. R2013-11R (July 29, 2015), at 1 (dissenting op. of Comm'r Hammond) ("[T]he instructions of the Congress in passing the PAEA . . . required the Postal Service to make its operations more efficient and cost effective, rather than seeking rate increases on mailers simply because more money was needed."); Advisory Opinion on Elimination of Saturday Delivery, PRC Docket No. N2010-1 (Mar. 24, 2011), at 1-2 (separate op. of

Considering that purpose, it is irrational to have the cap inhibit the Postal Service's ability to take actions that – as even PostCom itself admits – are not designed to manipulate mailers into paying higher rates, but instead to increase the Postal Service's efficiency. Doing so would stand the price cap's oft-touted rationale on its head and goes well beyond the rationale accepted by the court.

Improving efficiency will often require that the Postal Service change the requirements governing how mail is prepared by mailers, which is precisely what the Public Representative and PostCom's approach would disincentivize or even prevent the Postal Service from doing. Their approach ensures that the changes that will have the most significant effect on mailer behavior, and that accordingly would improve the Postal Service's finances most significantly by causing the greatest efficiency gains, are the very changes that are least likely to be implemented. That paradox is most pointed precisely when the cap and, with it, the Postal Service's ability to increase revenue through pricing, are at their lowest ebb. Even in times when more cap authority exists, the Postal Service would be forced to choose whether to devote that cap space to significant efficiency enhancements or price increases. The rational choice would almost always be to increase prices rather than improve efficiency: the financial effects of price increases are relatively predictable, whereas reliance on historical data rather than forecasts, combined with the inherent problems of attributing causation, would likely mean that the price cap could be "overcharged" for the impact of operational

Chairman Goldway) ("The PAEA clearly requires the Postal Service to fulfill its service obligations through gains in productivity and operating efficiencies rather than through price hikes or service reductions.").

changes.³⁸ In essence, the Public Representative and PostCom propose not merely to freeze real average postage prices at 2006 levels, but to extend that freeze to operating efficiency as well, or at least to the price-efficiency relationship. The price cap has proven burdensome enough in an era of declining revenue; it would be patently unreasonable to interpret the cap in a manner that imposes even more burden and closes off one of the last avenues for financial stability.

Rather than turning essentially every mail-preparation change into a mechanistic cap exercise, as PostCom and the Public Representative urge, the Commission should recognize that Congress established more suitable regulatory mechanisms to assess whether such changes conform to the statute. Specifically, the Commission should review such changes in complaint proceedings, to the extent that mailers are displeased with the outcome of the *Federal Register* rulemaking process that the Postal Service uses for changes to the Domestic Mail Manual (DMM). The Commission's complaint jurisdiction allows for full evaluation of whether the mail-preparation change is in accordance with the policies, factors, and objectives of the Act, without attempting to shoehorn those considerations into the rate change process, which Congress intended as a more modern, simpler process than ratemaking under the PRA.³⁹ Overall, the use of the complaint process to consider mail-preparation changes recognizes that such changes simply do not implicate the purposes underlying the price cap (unless perhaps the circumstances are such that it can be shown that the Postal Service is in fact

³⁸ For example, while the Commission used an IMb compliance rate averaging about 64 percent in Docket No. R2013-10, compliance has increased to almost 90 percent, even though compliance has never been required. Had the Postal Service gone forward with the IMb requirement, it would have been "overcharged" in price cap space under the current numbers.

³⁹ See Order No. 26, Order Proposing Regulations to Establish a System of Ratemaking, PRC Docket No. RM2007-1 (Aug. 15, 2007), at 11, 17, 21.

attempting to evade the cap), and that such a determination is most suitably made through a complaint case.⁴⁰

C. A Concrete Example Demonstrates the Fundamental Flaws with Both Approaches

To use a real-life example, consider how the Postal Service's final rule changing the DMM standards regarding address requirements for automation, presorted, and carrier route flat-size mail, effective March 2009, would have been evaluated under the various proposals before the Commission in this proceeding.⁴¹ On May 7, 2008, the Postal Service issued a final rule in the *Federal Register* that changed the address placement and formatting requirements for all pieces qualifying for automation, presorted, or carrier route prices flat sized pieces. The changes were in preparation for the nationwide deployment of the Flats Sequencing System (FSS), which it was hoped would provide greater efficiencies for carriers handling flats.⁴² The mail-preparation changes were crucial to capturing the efficiency gains in both processing and delivery that it was anticipated would be made possible by the FSS equipment.⁴³

⁴⁰ To assist consideration of these issues, the Postal Service can ensure that all of its rulemakings clearly address the purpose and impact of its rules with specific references to the policies, objectives and factors of the PAEA underlying the change.

⁴¹ New Address Requirements for Automation, Presorted, and Carrier Route Flat-Size Mail, 73 Fed. Reg. 25509 (2008).

⁴² *Id.* at 25509 ("As we move toward national deployment of FSS, we are working closely with the mailing industry to make the most of this investment and achieve the lowest combined costs for handling flat-size mail, including developing new standards for optimal addressing.").

⁴³ *Id.* ("The new standards will enable FSS to process flat-size pieces in delivery sequence at high speeds and output the pieces in vertical bundles that are optimized for carrier delivery. The new placement criteria will take advantage of the vertical bundle output and significantly reduce the time carriers spend reorienting pieces to read the address – whether the mail is held, pulled from a mailbag, or removed from a tray. The new standards for type size and line spacing will ensure carriers can read the addresses and delineate delivery stops. With over a quarter million carriers delivering mail six days a week, there are substantial opportunities to gain efficiency.").

During the rulemaking, the Postal Service received comments from 24 mailers, seven associations, four presort bureaus, three large printers, and two consultants. Twenty-eight commenters objected to the proposed standards for address placement, particularly insofar as the changes would affect mailpiece design, and the summary of comments contained a lengthy discussion of mailers' concerns and changes from the proposed rules to meet these concerns.⁴⁴ Twenty-one commenters objected to the change for financial reasons, "stating that the new requirements would adversely affect their costs or their ability to generate revenue."⁴⁵ These commenters explained that the new requirements would add "costs for spot-glue on inserts and onserts; new or reconfigured equipment and mailing software; and larger address labels or new window envelopes."⁴⁶ The notice provided a detailed explanation of the anticipated operational benefits of the change and how it would "help the Postal Service and the mailing industry achieve a lowest-combined-cost system."⁴⁷

The mailing standards, as implemented on March 29, 2009, require that all flats in First-Class Mail, Standard Mail, Periodicals, and Package Services comply in order to receive access to the presort, automation, and carrier route rates. Because the only rates in Standard Mail and Periodicals are for presort, automation, and carrier route, mailers of noncompliant Standard Mail and Periodicals flats would have to pay First-

⁴⁴ 73 Fed. Reg. at 25509-25511.

⁴⁵ *Id.* at 25510.

⁴⁶ *Id.*

⁴⁷ *Id.*

Class Mail Single-Piece prices.⁴⁸ Fortunately, however, there has been industry-wide compliance.

Under either of the alternative proposals in the Postal Service's Initial Comments, this earlier change to mailing standards would not have had cap impact because it did not change a posted rate or a product-defining size, weight, or minimum-volume characteristic. Of course, that does not mean that it was immune from Commission oversight. The *Federal Register* notice of the final rule discussed in detail the reasons for the change and addressed the varying concerns of the commenters. If any mailers had a concern, they could have filed a complaint since the implementation period was approximately 10 months. None did so.

Under the proposals advanced by PostCom and the Public Representative, however, this rule would have been considered a *de facto* price change because failure to comply would result in some mail volume shifting to a much more expensive rate category (First-Class Mail Single-Piece). Using the Order No. 1890 methodology, treating the mailing rule as a price increase highlights how overlaying the cap on most mail-preparation changes would create disincentives to reduce costs and increase efficiencies, and would bear no relation to the costs incurred by mailers, as discussed above.

First, the Postal Service would have to identify historical billing determinants (i.e., identify the proportion of volume that complied with the change during the most recent 12-month period for which billing determinants are available). For purposes of this

⁴⁸ Package Services has single-piece prices for its flats products (Bound Printed Matter Flats, Media Mail, and Library Mail); those prices would be available for noncompliant customers.

example, we will assume that 25 percent of each product complies. Next, the Postal Service would be barred from forecasting that the remaining 75 percent would comply.⁴⁹ Instead it would have to adjust billing determinants so that 75 percent of the pieces would have remained in the mail and paid the single-piece prices during the historical 12-month period. For example, 75 percent of the volume of First-Class Mail flats paying the one-ounce automation 5-Digit price (\$0.364)⁵⁰ before the price change would be treated as paying the one-ounce single-piece price (\$0.83). And 80 percent of the volume of Standard Mail Carrier Route flats weighing 3.3 ounces or less and paying the Basic, Origin entry rate (\$0.255) would be distributed among the four First-Class Mail Single Piece rate cells (\$0.83 to \$1.34). Similar impacts would occur in the other products.

Under the Order No. 1890 methodology, the billing determinants for billions of flats would have been adjusted so that the single-piece prices apply for purposes of the cap calculation. The result of the Order No. 1890 methodology would be that the Postal Service would have had to choose between (1) lowering prices when it implemented the change in March 2009, (2) delaying the mailing standards change until its next price change (Docket No. R2009-2) and factoring in the loss of cap space with significantly lowered proposed prices, or (3) forgoing the mailing standards change and the increase in efficiency, in favor of retaining price cap authority.

In classes of mail where flats are a significant portion of the volume, such as Standard Mail and Periodicals, a relatively small percentage of non-compliant volume

⁴⁹ See Order No. 1890 at 35.

⁵⁰ This example uses the prices in effect in March 2009.

could easily cause an adjustment that exceeded the cap. For example, even if only 20 percent of the Standard Regular flats had been deemed noncompliant in Docket No. R2009-2 and the volume of those pieces had been moved to single-piece prices, the effect of this billing determinant adjustment alone would have resulted in a calculated price increase for Standard Mail of over 8 percent, far exceeding its then-prevailing cap space of 3.8 percent.⁵¹

The impact on Periodicals would be even greater because flats represent over 90 percent of the volume in the class⁵² and Periodicals pay reduced prices compared to Standard Mail.⁵³ In addition, the Postal Service estimates that only 5 percent of Periodicals volume complied at the time the final rule was issued⁵⁴ which would have required adjusting 95 percent of the volume to the single-piece price category. The end result is that if the Postal Service wanted to proceed, it would have had to give a massive price decrease to stay within the bounds of the price cap.

This example highlights how PostCom's approach, which focuses on mailers' compliance costs as well as volume shifts, is inconsistent with the PAEA. First, using the cap to offset or somehow recompense any mailer compliance costs simply does not work because there is no relation between the amount of the cap adjustment and the amount of the compliance costs to mailers. Under Order Nos. 1786 and 1890, the

⁵¹ See spreadsheet and description attached electronically. This dramatic result would occur despite the fact that Standard Mail Regular flats represent only 10 percent of total Standard Mail volume, and less than 30 percent of all Standard Mail flats. *Id.*

⁵² Mail Characteristics Study (Public Portion), Fiscal Year 2008, zip file, "RPW Shape.zip," "Tables," Excel file "Periodicals Shape Detail File.xls," USPS-FY08-14, PRC Docket No. ACR2008 (Dec. 29, 2008).

⁵³ See 39 U.S.C. §3626(a).

⁵⁴ The 5 percent figure of compliance with the address requirements is based upon the extensive mailer outreach conducted during the rulemaking.

Postal Service would have had no choice but to assume that when the rule goes into effect, a sizable portion of current mail volume at the presort, automation, and carrier route rates would pay the single-piece rate. On a per-piece basis, this would be a bigger adjustment than the Commission's treatment of Full-Service IMb in Order No. 1890, which resulted in moving volumes to non-automation presort rates, rather than the even higher single-piece rates.⁵⁵ The driver of the difference in impact on the cap is the default rate paid for non-compliance with the respective mail classification changes, and that has no rational relationship to mailers' costs of compliance.

PostCom's theory appears to boil down to the notion that mailers should be recompensed for their costs through a reduction in the prices they pay. However, there is no guarantee that lower rates would fall solely on flats – the product type that caused the compliance costs – when the Postal Service can adjust the prices across the class. For that reason, the price cap does not achieve the kind of specific remediation that PostCom suggests, and the corrective action that it proposes will bear little relation to the problem PostCom purportedly seeks to ameliorate. A mail-preparation change for flats could easily result in a price reduction for letters and packages. This is another reason why the class-wide price cap is an ineffective tool to address mailers' cost concerns about a product-specific change, and why it makes more sense to look to the remedial tools at the Commission's disposal (e.g., hearing a complaint case).

Moreover, the Postal Service, when faced with the dilemma of lowering prices to "pay" for mailers' compliance or forgoing efficiency to ensure adequate revenues, would likely choose the latter. If efficiency gains can only be realized by "paying mailers," this

⁵⁵ See Order No. 1890 at 29-30.

results in a significant disincentive to be efficient. One need look no further than the Postal Service's decision to forgo the Full-Service IMb requirement in order to preserve pricing authority after Order No. 1890, despite the fact that the Commission, past Public Representatives, and mailers alike had long clamored for increased Full-Service IMb adoption to promote transparency into service performance.⁵⁶

Speaking more broadly, using the cap to regulate mail-preparation changes that are designed to change behavior rather than force mailers to pay higher rates will create a disincentive for mailers to comply voluntarily with mailing standard changes that improve Postal Service efficiency. The less mail volume that is deemed to be in compliance when the billing determinants are measured, the more mail volume will be treated as not in compliance. This leads to a greater adjustment of volumes at higher rates, and the greater reduction in rates needed to stay within the cap. Thus, the lower the rate of mailer compliance, the lower the price increases that mailers would face thereafter. To use Order No. 1890 as an example, the Commission calculated that 73

⁵⁶ See Annual Compliance Determination Report, Fiscal Year 2014, PRC Docket No. ACR2014 (Mar. 27, 2015), at 90, 92-95 (agreeing with Public Representative's concerns about problems arising from "a lack of Full-Service IMb participation," and discussing the slow and, in some cases, negative progress toward greater adoption); Annual Compliance Determination Report, FY2011, PRC Docket No. ACR2011 (Mar. 28, 2012), at 64-65 ("[T]he Commission is concerned about the reliability of the reported service performance results for some products given the low participation rates. . . . It has been 3 years since the Commission approved the use of IMb as a service performance measurement. It is imperative for the Postal Service to find a reliable way to measure service performance."); Order No. 745, Order Concerning Temporary Waivers and Semi-Permanent Exceptions from Periodic Reporting of Service Performance Measurement, PRC Docket Nos. RM2011-1, RM2011-4, & RM2011-7 (June 16, 2011), at 14-15, 31 (reiterating the Commission's concerns from the FY2010 Annual Compliance Determination Report about whether "the Postal Service is on a path to successful implementation of a systemwide service performance measurement and reporting program"). It is odd that the Public Representative, Valpak, and PostCom would encourage the Commission to perpetuate the outcome of Order No. 1890 with regard to the Full-Service IMb requirement. Valpak itself once proposed "that the solution to gaining mailer participation in the IMb program is to use the pricing system and provide mailers with much stronger incentives," which is essentially what the Postal Service attempted to do in FY2013. Order No. 745 at 30 (citation omitted). PostCom and the Direct Marketing Association also expressed concerns about the slow pace of IMb adoption. See *id.* at 13. Yet those same parties now support the prospect of penalizing the Postal Service for its latest effort to encourage substantial Full-Service IMb adoption.

percent of Automation Presort Letters and Cards were assumed to be in compliance with Full-Service IMb and 27 percent were assumed to move to non-automation presort rates. PostCom's and the Public Representative's proposals would have created a financial incentive not to comply with Full-Service IMb, because noncompliance in the historical period before the rule goes into effect it could lead to even lower prices had the Postal Service moved forward with the proposal.

These proposals are contrary to the policies of the PAEA.⁵⁷ Applying the cap to mail-preparation requirements designed to change mailing practices would foster inefficiency and drive the Postal Service to forgo efficiency to ensure adequate revenues. As the change to address requirements for flats demonstrates, such an approach would have likely stopped the implementation of the change and caused a significant decline in the efficiency gains that it was anticipated would be enabled by FSS.

IV. THE PUBLIC REPRESENTATIVE AND POSTCOM PROPOSALS WOULD BE IMPRACTICAL, UNPREDICTABLE, AND BURDENSOME IN PRACTICE

Even if the principle flaws discussed in the preceding section were not enough to doom PostCom and the Public Representative's proposals, it would be impossible to administer a price cap that is tied to the compliance costs that mailers incur (as

⁵⁷ It is worth noting that mitigating or recompensing mailer costs is not a factor, objective, or policy of the Act. To be sure, concerns about compliance cost might drive behavior that indirectly affects certain factors or objectives, which would need to be balanced against each other in any event. To the extent that costs would drive mail volume out of the system, the Commission would need to account for 39 U.S.C. § 3622(c)(4) (alternatives to mail) against the backdrop of the mandatory objective in Section 3622(b)(1) (interest in maximizing incentives to reduce costs and increase efficiencies) and factors (c)(5) (degree of mail-preparation performed by the mailer and its effect on reducing Postal Service costs) and (c)(10) (special classifications that enhance the performance of mail-preparation and processing). These matters are more appropriately dealt with through the classification, complaint, or annual compliance review process than through a price change.

PostCom advocates) or to mailers' response to such a requirement (as the Public Representative advocates).

As discussed above, both the Public Representative and PostCom comments assert that all mail-preparation changes that might raise mailer postage payments or internal/third-party costs above a very low revenue threshold must be accounted for in the price cap. A price cap impact would need to be analyzed and computed for all mail-preparation changes that would change the applicable price cell, depending on whether or not the mailer complies.⁵⁸ If the price cap impact is more than *de minimis*, then a full rate case would need to be filed before the Postal Service could go forward with the mail-preparation change. If the price cap impact is *de minimis*, the Commission's rules require a full Type I-A rate case, with an exemption from having to incorporate newly generated unused rate adjustment authority into the schedule of unused rate adjustment authority until the next rate case that is not *de minimis*.⁵⁹ While the comments are not clear, it appears that both PostCom and the Public Representative would grant some relief from this filing requirement for mail-preparation changes that are estimated to have *de minimis* impacts.

Nonetheless, as described below, these approaches would interfere with the Postal Service's ability to implement needed mail-preparation changes, would make it

⁵⁸ PostCom claims that "it is important to reiterate that any change in mail-preparation requirements that causes mail volume to shift from one rate category to another is a rate change. Further, as the court recognized, the magnitude of the change in preparation requirements does not determine whether there is a change in rates, only how much the rate will change." PostCom Comments at 9 (citing *U.S. Postal Serv.*, 785 F.3d at 755 (emphasis in original)). The Public Representative agrees with PostCom, asserting that "virtually any change in either mailing requirements or terms of service as described or required in the [Mail Classification Schedule] or DMM, no matter how insignificant, can potentially alter some mailer's decision to use a particular rate cell," and thus "will technically have rate implications in the next annual price cap calculation." *Id.* at 8-9.

⁵⁹ 39 C.F.R. § 3010.30.

impossible for the Postal Service to know with adequate certainty how much cap space it has available for price changes at any given time, and would impose undue administrative burdens on the Postal Service.⁶⁰ They would also tend to overstate the “cap effect” of a given change, ultimately leading to unfair reductions in cap space.

A. Trying to Include the Estimated Impact of Mail-Preparation Changes in Calculating Available Price Cap Space Would Severely Disrupt the Postal Service’s Ability to Prepare Price Changes

A key step in preparing a price change filing under the PAEA is to determine how much price cap space is available for price changes in each class of mail. In prior rate cases, that step was achieved by adding the CPI changes since the last case, available on the Commission’s website, to any banked space remaining from the previous price change, as presented in the Commission’s final order for that price change.⁶¹ Certainty in those numbers is critical to developing the proposed price changes so that they comply with the price cap.

If the Postal Service were further required to factor the estimated impact of mail-preparation changes into its price cap calculations, this would destroy the ability of the Postal Service to know where it stands when preparing price changes. A simple calculation using numbers that have been previously approved by the Commission would turn into a complex analysis of the price cap impacts of mail-preparation

⁶⁰ The Public Representative’s approach could hit the Postal Service with an unexpected price cap adjustment up to 18 months after the Postal Service implemented a rule change, if the change were implemented early in a fiscal year. Redefining the available cap space after rules have already been implemented would take away the Postal Service’s option to withdraw the rule in order to avoid the cap space hit. Cap space changes arising from a future ACR process would add further uncertainty to the Postal Service’s efforts to make reasoned business decisions about operational and price changes.

⁶¹ See, e.g., United States Postal Service Notice of Market-Dominant Price Change, PRC Docket No. R2015-4 (Jan. 15, 2015), at 3-4.

changes, without knowing at the time of development whether the Commission would accept the analysis.

Estimating price cap usage for all mail-preparation changes would overwhelm the Postal Service's resources. For each change, the Postal Service would need to determine the impact on the price cap for each class of mail. Depending on the timing of each change, the Postal Service would need to develop different historical billing determinant years on which to base the price cap analysis. Using these billing determinant volumes, the Postal Service would then need to determine how many pieces would not comply with the new requirement, and what alternative prices would be paid for these pieces.

PostCom's certification requirement for *de minimis* impacts, and the Public Representative's exemption for changes that fall below a specified lower bound for *de minimis* changes, provide virtually no relief.⁶² The Postal Service can certify that a change is *de minimis*, or exempt a *de minimis* change, only if it first estimates its price cap impact. Similarly, the Public Representative's exemption for changes with an impact under a new lower bound, such as 0.001 percent,⁶³ is effective only after the Postal Service has determined that the impact is that small. If the impact is slightly more than that lower bound, then the Postal Service would need to file a *de minimis* case with the Commission.

⁶² Petition of the Association for Postal Commerce and Alliance of Nonprofit Mailers to Initiate Rulemaking Proceeding, PRC Docket No. RM2015-20 (Aug. 17, 2015), at 3-4 [hereinafter "PostCom Petition"]; PR Comments at 14.

⁶³ PR Comments at 14.

B. PostCom’s Proposal Adds to the Burden by Requiring the Postal Service to Incorporate Mailer Costs into Price Cap Analyses

For each mail-preparation change, PostCom would require the *Federal Register* notice to include information about whether the price cap impact would be *de minimis*, taking into consideration mailers’ internal costs – that is, amounts that they pay to their employees or third parties – as well as “costs” from higher postage payments. First of all, the Commission has previously declined similar suggestions to factor changes in mailers’ compliance costs into the price cap, because of the difficulty of obtaining information on mailer costs.⁶⁴

Indeed, in order to prepare the *Federal Register* notice, the Postal Service would need not only to perform a normal price cap analysis, but also to gather reliable information from the entire mailing industry on compliance costs. Any given requirement will affect each mailer differently, and, as the Public Representative correctly noted, the Postal Service does “not have detailed information on whether and the extent [to which] costs of mailers, if any, might be affected” by a change to a mail-preparation requirement.⁶⁵ Yet PostCom would require the Postal Service to certify at

⁶⁴ Annual Compliance Determination Report, Fiscal Year 2010, PRC Docket No. ACR2010 (Mar. 29, 2011), at 83 [hereinafter “FY2010 ACD”] (“NPPC suggests that the Commission should initiate a rulemaking to require the Postal Service to: (1) conduct a cost-benefit analysis when contemplating changes in mailing regulations or entry requirements to identify and calculate the uncompensated “shadow” costs incurred by mailers; and (2) estimate the uncompensated costs it imposed on mailers during the year due to shadow rate increases. While the issue NPPC raises has important rate cap implications, the Commission is not persuaded at this time that a rulemaking focusing on requiring the Postal Service to undertake cost-benefit analysis whenever it imposes an operational change that may affect mailing regulations or entry requirements would be productive. Any cost-benefit analysis designed to calculate ‘uncompensated shadow costs’ incurred by mailers would require accurate, detailed information on mailers’ costs. Neither the Postal Service nor the Commission has access to such information or a ready means to obtain it. Moreover, mailers, rightfully, may be reluctant to divulge such information.” (citation and footnote omitted)).

⁶⁵ PR Comments at 18. Moreover, rough estimates are worthless when dealing with very low *de minimis* limits.

the time it files each *Federal Register* notice that the mail-preparation changes it proposes are *de minimis* (or, if unable to so certify, file a price change case with the Commission).⁶⁶ Alternatively, for mail-preparation changes filed in conjunction with a price change filing, the certification would be done as part of the price change filing.⁶⁷

Under that approach, the Postal Service would need detailed cost information from mailers not only at the time it prepares its *Federal Register* notice, but also at the time it files its notice under 39 C.F.R. Part 3010 with the Commission (because such costs may have changed in the interim).⁶⁸ Unless the mailing industry provides comprehensive information about its finances to the Postal Service or to the Commission on a regular basis, neither the Postal Service nor the Commission could undertake the calculations necessary to fulfill its obligations under the cap. The PAEA does not envision such a broad expansion of the regulatory scheme to cover private market actors beyond the Postal Service.

At best, the Postal Service would have to make determinations on the basis of incomplete and anecdotal representations from mailers; at worst, the Postal Service would have to make its own judgments based on speculation or else forgo changes entirely. PostCom's proposal would not provide "meaningful guidance" to the Postal Service and mailers, and would interfere with the Postal Service's ability to manage its day-to-day operations.

⁶⁶ PostCom Petition, at 3-4.

⁶⁷ *Id.* at 2.

⁶⁸ For changes filed outside of regular rate filings, the Postal Service needs to certify at the time of the *Federal Register* notice that the change is *de minimis*, and then needs to certify again at the time of the next price change filing that all mail preparation changes since the last rate adjustment have been *de minimis*. *Id.* at 2-4.

C. The Public Representative’s Proposed Requirement to Include Mail-Preparation Changes in the Annual Compliance Review Would Only Add to the Administrative Burden and Uncertainty, And Would Lead to Unfair Reductions in Available Pricing Authority

The Public Representative proposes that the Postal Service identify in its Annual Compliance Report (ACR) all mail-preparation changes that introduce, delete, or redefine a rate cell and that are undertaken outside the context of a rate change filing.⁶⁹ Following the Commission’s rules for *de minimis* changes, the Postal Service would likely need to show its calculations of the price cap impact for each change, even if *de minimis*, and provide the supporting calculations.⁷⁰ The Commission would review the Postal Service’s determinations of the cumulative impact of *de minimis* changes.⁷¹ The Commission also would use “after-the-fact information reported in the ACR” to conduct a look-back comparison of the volume adjustments for all rate effect calculations against how volumes actually shifted due to the mail-preparation requirement change.⁷² Then, the Commission would correct for any differences when the Postal Service over- or underestimated the cap effect, by adjusting the cap space available for future price changes.⁷³

⁶⁹ PR Comments at 2, 10.

⁷⁰ *Id.* at 10; see 39 C.F.R. § 3010.30.

⁷¹ PR Comments at 10, 13.

⁷² *Id.* at 15.

⁷³ *Id.* at 2. Both the Public Representative and PostCom fail to acknowledge the possibility of mail-preparation changes that would lower mailer prices and thus create more cap space for the Postal Service. This may be because the PR and PostCom rely on the Commission’s *de minimis* rules, which currently apply only to price increases. Either the *de minimis* rules could be modified to address *de minimis* price decreases, or the Type I-C rules (39 C.F.R. § 3010.6) could be used for *de minimis* or larger price decreases.

1. The Commission Has Already Rejected Look-Back Proposals Similar to the Public Representative's Proposed Requirement

In developing the regulations that now govern the Postal Service's price cap authority, the Commission recognized "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" and that "adjustments for classification changes will be imperfect."⁷⁴ Nonetheless, the Commission has continuously stressed that "the percentage change in rates is calculated by using a fixed set of historical billing determinants to weight current rates and proposed changes."⁷⁵ Indeed, the Commission explicitly rejected the "after-the-fact review" suggested now by the Public Representative.⁷⁶

Most notably, the Commission rejected a "true-up" requirement for promotions, which PostCom proposed in Docket No. RM2014-3, under which the Postal Service would have been required "to reconcile the volume sent at promotional rates with the

⁷⁴ Order No. 26 at 35.

⁷⁵ Order No. 2086, Order Adopting Final Rules on the Treatment of Rate Incentives and De Minimis Rate Increases for Price Cap Purposes, PRC Docket No. RM2014-3 (June 3, 2014), at 36 (noting that the proposition was "explained at length in Order No. 1786"); Order No. 1786, Order Adopting Final Rules for Determining and Applying the Maximum Amount of Rate Adjustments, PRC Docket No. RM2013-2 (July 23, 2013), at 14, 19 (finding that 39 C.F.R. § 3010.23(d) should be "modified to clarify that adjustments to billing determinant may not be based on forecasts of mailer behavior," in the interest of consistency with the rule's "original design" and with 39 U.S.C. § 3622's "objective of predictable and stable rates").

⁷⁶ Order No. 26 at 35. This rejection is buttressed by the Commission's findings in the "empirical review of price cap application" contained in the Annual Compliance Determinations (ACDs). These reviews generally found that some classes had a greater price increase, and other classes had a lower price increase, than anticipated. The Commission never suggested that these findings required a corrective adjustment to the price cap available for future price changes. Furthermore, the Commission's inability to conduct the "empirical review of price cap application" in past ACDs demonstrates the practical difficulties of conducting a look-back analysis, especially when classification changes are involved. Significantly, in prior ACDs, the Commission has "noted the difficulty of using a forward-weighted index to take into account major classification changes, rates that are in effect for only part of a year, and rate increases that are more than 12 months apart." Order No. 2086 at 38; see, e.g., Annual Compliance Determination Report, Fiscal Year 2013, PRC Docket No. ACR2013 (Mar. 27, 2014), at 134 (acknowledging its inability to conduct the analysis due to the major classification changes that had been implemented in conjunction with the prior rate case).

adjustment authority it claims in its next scheduled price adjustment.”⁷⁷ The Commission determined that the “true-up” requirement failed to comport with “the current backward-weighted index used to calculate price changes” and 39 U.S.C. § 3622(b)(2)’s requirement that the system for regulating rates for market dominant classes “create predictability and stability in rates.”⁷⁸ In addition, the Commission rejected the proposed look-back analysis’s disparate treatment of volumes in the rate cap calculation, finding “no rational basis” to reconcile volumes sent at promotional rates, but not volumes sent at non-promotional rates.⁷⁹

2. The Public Representative’s Look-Back Proposal Is Analytically Flawed and Would Lead to Unfair Reductions in Cap Space

Even if the Commission were willing to revisit a look-back proposal, the Public Representative’s proposed approach is riddled with flaws. First, the idea that it is possible to isolate the effect of any given mail-preparation requirement on overall mail volume is a fiction. As noted above, the Public Representative admits that the Postal Service “constantly changes mail-preparation requirements” throughout the year,⁸⁰ and that millions of pieces of mail move in and out of the system and change price tiers, regardless of whether a given mail-preparation requirement has changed. It is therefore

⁷⁷ See Comments of the Association for Postal Commerce, PRC Docket No. RM2014-3 (Mar. 18, 2014), at 7-9.

⁷⁸ Order No. 2086 at 37.

⁷⁹ The Commission noted that, even if such an analysis were not so problematic as to warrant dismissal, it would have to cut both ways: not only would it place the Postal Service “at risk of a reduction in unused rate adjustment authority if volumes sent at promotional rates in a particular year are lower than those sent at promotional rates during the previous year,” but the Postal Service would “also be eligible for an increase in unused rate adjustment authority if volumes sent at non-promotional rates during a particular year exceed the volumes sent at non-promotional rates during the previous year.” *Id.*

⁸⁰ PR Comments at 1.

impossible to confidently isolate the degree to which shifting volumes were caused by a given mail-preparation change.

Moreover, by focusing on the volumes only for rate cells affected by mail-preparation changes, the Public Representative's approach would distort the billing determinants snapshot by superimposing volumes from one time period onto the mail-mix picture from another, with the result often being an artificial reduction in cap space. The price cap system of analyzing current and proposed prices against volumes "from the most recent available 12 months of Postal Service billing determinants"⁸¹ works only if all volumes used are representative of that period.

In the price cap calculation, volumes are used to establish the relative weights of the various rate cells in a class and, consequently, the weighted average price change for that class. It is the relationship between volumes that is relevant to the price cap analysis, not any single rate cell's volume standing alone. For example, if volumes in every category of First-Class Mail increase by 50 percent, then the volume-weighting of First-Class Mail prices remains constant. Changing the price cap results based on the 50 percent increase for just one rate cell or even product (such as Single-Piece First-Class Mail Letters/Postcards), would be wrong. By the same token, adjusting the price cap solely on the basis of rate cells affected by a mail-preparation change fails to fairly factor in other (and potentially countervailing) changes to a mail class's volume-weighting. If one volume is updated using data from a later period, all volumes should be updated for that period.

⁸¹ 39 C.F.R. § 3010.23(d)(1).

The Public Representative's example based on the addition of a discount for Full-Service IMb demonstrates the practical problems with this approach.⁸² In Docket No. R2009-2, the Postal Service calculated the price cap impact for Standard Mail using a volume estimate of roughly 23 billion pieces for the Full-Service IMb discount of \$0.001, a total estimated revenue loss of \$23 million.⁸³ However, FY2010 data shows that only 13 billion Standard Mail pieces were actually mailed at the Full-Service IMb price, totaling only \$13 million in revenue actually foregone.⁸⁴ Based on this data, the Public Representative concludes that "the Postal Service's price cap authority was increased by \$10 million due to the inaccurate estimates, and the Commission could have recaptured that amount during the FY 2010 ACD."⁸⁵

However, by only considering volumes for Full-Service IMb, this conclusion suffers the analytical flaws identified above, and would have produced an unfair result. In FY2009, volumes fell throughout the Standard Mail class, not just in rate cells associated with Full-Service IMb. Indeed, between FY2008 and FY2009, total pieces in the Standard Mail class overall dropped by 16.5 percent,⁸⁶ and did not recover in

⁸² PR Comments at 16-17.

⁸³ USPS-R2009-2/2, Standard Mail Cap Compliance, Excel file "CAPCALC-STD-FY2009," tabs "LPF IM Adjustment" and "HD-Sat-CR-IM Adjustment," PRC Docket No. R2009-2, (Feb. 10, 2009).

⁸⁴ Market Dominant Billing Determinants, Fiscal Year 2010, zip file "FY10-4.zip," Excel file "Standard BDs 2010.xls," tabs "REG AUTO LETTERS P. G1-1," "REG AUTO FLATS P. G1-3," "ECR LETTERS P. G2-1," "ECR FLATS P. G2-2," "NP REG AUTO LETTERS p. G3-1," "NP REG AUTO FLATS P. G3-3," "NO ECR LETTERS P. G4-1," "NP ECR FLATS P. G4-2," USPS-FY10-4, PRC Docket No. ACR2010 (Dec. 29, 2010).

⁸⁵ PR Comments at 17.

⁸⁶ Revenue, Pieces and Weight Report, Quarters1-4, FY 2009, Excel file "Fy2009_RPWsummaryreport_public.xls" (Nov. 20, 2009) [hereinafter "RPW Summary Report FY2009"].

FY2010.⁸⁷ Notably, volumes dropped in every product in the Standard Mail class.⁸⁸

This across-the-board volume decline means that the relative weight of the Full-Service IMb discount rate cells likely changed much less than assumed by the Public Representative, in relation to other rate cells in the class. Accordingly, in addition to improperly converting the price cap into a revenue cap, the Public Representative's proposal would have penalized the Postal Service by reducing cap space to compensate for a \$10 million discrepancy in revenue that likely was at least in part (and perhaps in large part) attributable to other causes.⁸⁹

In fact, in the FY2010 ACD, the Commission conducted a look-back analysis by applying volumes for FY2010 to determine the actual percentage change in prices for Standard Mail under Docket No. R2009-2, and determined that the average price increase was slightly smaller than predicted.⁹⁰ The Commission noted that even though “[t]he [Full-Service IMb] adoption rate[] for . . . Standard Mail [was] significantly less than forecast[,] . . . the amount of the Full-Service IMb discount for Standard Mail [was] small enough that the effect of the low adoption rates on the average rate increases

⁸⁷ Revenue, Pieces and Weight by Classes of Mail and Services, Quarters 1, 2, 3, 4, Annual Summary, Fiscal Year 2010, Excel file “Fy2010_RPWsummaryreport_public.xls” (Nov. 29, 2010).

⁸⁸ RPW Summary Report FY2009.

⁸⁹ Moreover, it should be noted that the Postal Service's cap authority would have increased, rather than decreased, had the Postal Service used historical billing determinants under current rules. The Public Representative argues that its look-back approach would have reduced price cap space by \$10 million for the initial Full-Service IMb discount implementation. PR Comments at 17. However, billing determinant adjustments in Docket No. R2009-2 were based on forecasts of customer behavior, Responses of the United States Postal Service to Chairman's Information Request No. 2, PRC Docket No. R2009-2 (Feb. 24, 2009), at 4-5, which were accepted based on the original Commission rules in effect at the time but are no longer acceptable under Order No. 1786, Order No, 1786, at 19. Instead, under the current rules, the Postal Service would have used historical billing determinants showing no or very little volume for Full-Service IMb during the billing determinant year. If the Public Representative's look-back approach were adopted, the price cap space would have increased to reflect the actual, higher adoption rates.

⁹⁰ FY2010 ACD at 154.

was relatively small.”⁹¹ Upon consideration of volumes for other Standard Mail products, the Commission’s look-back analysis revealed that the Postal Service had overestimated the price increase for the Standard Mail class by 0.207 percent.⁹² Thus, the Postal Service received lower revenue than anticipated for Standard Mail in an amount much greater than the \$10 million that the Public Representative suggests should be taken away from the Postal Service.

V. CONCLUSION

There is widespread agreement that the proposal set forth in Order No. 2586 does not comport with the court’s decision. For the reasons stated above, the alternative proposals of PostCom and the Public Representative also do not satisfy the requirements of the court’s order and, moreover, are inconsistent with both the language and the purpose of the PAEA. The Postal Service requests that the Commission (1) reject the approaches advanced by PostCom and the Public Representative, and (2) publish a revised proposal and allow the parties an opportunity to file comments in response, as it did in Order No. 2586.

Respectfully submitted,

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⁹¹ *Id.* at 154-55.

⁹² *Id.* at 155.

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