
REGULATIONS ESTABLISHING
SYSTEM OF RATEMAKING

Docket No. RM2007-1

COMMENTS OF ADVO, INC. IN RESPONSE TO PROPOSED
REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING

ADVO, Inc., a wholly owned subsidiary of Valassis, Inc., hereby submits its comments in response to the Commission's Order No. 26, which sets forth proposed regulations to implement the new statutory postal regulatory scheme mandated in the Postal Accountability and Enhancement Act, Public Law 109-435 (the "PAEA").¹

OVERVIEW

Advo commends the Commission. Its proposed rules in broad measure comport with the intent of the PAEA to give the Postal Service substantially greater flexibility to set rates for both market-dominant and competitive mail categories, subject to oversight by the Commission to ensure that the Postal Service exercises its authority within the statutory boundaries. The proposed rules are an excellent starting point, although the true measure of their success will come when they are applied by the Commission to specific issues that arise in the future.

Our comments focus on a few aspects of the proposed rules that, although somewhat technical, have important implications on procedures and pricing under the new law. In particular, the definition and pricing implications of "products" warrant further refinement by the Commission, as discussed below.

¹ References herein to the proposed rules are to the revised numbering in the Federal Register notice, as described in the Commission's Notice of August 27, 2007.

A. Negotiated Service Agreements Should Not Be Classified As “Separate Products”

The Commission’s proposal to treat NSAs as separate “products” in both the market-dominant and competitive mail categories is not compelled by the PAEA and would have the unintended effect of greatly complicating the procedures for implementing NSAs. The statute specifies only that rates for market-dominant NSAs pursuant to section 3622(c)(10) should be established through the 45-day notice provision of section 3622(d)(1)(c), and for competitive NSAs through the 15-day notice provision of section 3632(b)(3). However, if characterized as a “new product,” an NSA proposal in either category would apparently also trigger section 3642, which applies whenever the Postal Service proposes to add “new products to the lists” of either market dominant-dominant or competitive products. Unlike section 3622(d)(1)(c), the procedure for adding new products in section 3642 (as implemented in proposed Rules 3020.30, et seq.) is open-ended with no time limits on Commission action.

This extra layer of “product list” procedures for implementing NSAs makes no sense. The Commission’s specific proposed rules in Part 3010 (Subpart D) and Part 3015 for considering NSAs are more than adequate to ensure that proposed NSAs satisfy the statutory criteria. Moreover, such an additional and largely redundant procedural layer for consideration of NSAs would be inconsistent with the clear intention of the statute to give the Postal Service flexibility to implement NSAs through the advance-notice provisions of sections 3622(d)(1)(c) and 3632(b)(3).

To the extent that the Commission’s concern is that NSAs must cover attributable costs, that requirement can be achieved without designating an NSA as a separate

product. Proposed Rule 3010.40, reflecting the requirements of PAEA section 3622(c)(10), requires that each market-dominant NSA must “improve the net financial position of the Postal Service” or “enhance the performance of operational functions.” Obviously, an NSA that did not cover attributable costs would fail these tests, whether or not the NSA were categorized as a “separate product.” Even in the competitive category, the Commission can require that NSAs cover attributable costs without having them designated as separate products.

B. The Filing Requirements For NSAs Should Conform To The Criteria Set Forth In The PAEA.

As set forth in Rule 3010.40, section 3622(c)(10) of the PAEA requires that market-dominant NSAs:

“(A) either—

“(i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or

“(ii) enhance the performance of mail preparation, processing, transportation, or other functions; and

“(B) do not cause unreasonable harm to the marketplace.

The Commission’s proposed Rule 3010.42 specifying the contents of an NSA notice largely conforms to the statutory requirements, except for the provision in subsection (d)(3) which would require an “analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement.”

This proposal appears to be an inadvertent carryover from the old cost-of-service breakeven ratemaking regime under the Postal Reorganization Act. Under the old law, by virtue of the breakeven requirement, any loss of contribution on an NSA would have to be made up by other mailers in the form of higher rates. That is no longer the case under the PAEA where other mailers are protected by the rate-cap mechanism. As the statute specifies, the relevant “impact” consideration is not the effect on the institutional cost contribution of other mailers but that the NSA “not cause unreasonable harm to the marketplace,” a requirement that is covered by subsection (f) of Rule 3010.42.

C. The Pricing Of “Products” Should Align Closely With The Treatment Of Subclasses Under The Postal Reorganization Act.

The Commission in its discussion distinguishes “products” under the PAEA from “subclasses” under the PRA on the ground that products differ from one another on the basis of either cost or market differences, whereas subclasses must exhibit both kinds of differences. However, if classification groupings under the PAEA are to be confined to products, there is the danger that this could lead to less flexible pricing of products that are currently classified as separate subclasses, such as the Regular and ECR subclasses of Standard Mail.

If the Commission were to take a narrow view of product pricing by treating separate products within a class as little more than rate categories – applying both Efficient Component Pricing principles and the worksharing discount restrictions of PAEA section 3622(e) to pricing differences between products – the result would be that ECR mail would be subject to greater pricing constraints than as a subclass under the PRA. Such an outcome would be totally at odds with the Postal Rate Commission’s

determination in Docket MC95-1 that ECR mail has intrinsic cost and demand differences that warrant separate application of the pricing factors of the PRA. Clearly, there is nothing in the PAEA that would warrant backtracking on pricing flexibility for ECR mail. To the contrary, the essence of the PAEA is that the Postal Service should have greater flexibility in the pricing of its products than under the PRA. The best way to achieve this necessary flexibility under the PAEA is to treat pricing between products akin to the treatment of subclasses under the PRA.

D. Proposed Implementation Of Rate Cap Price Limitations

Rules 3010.20 through 3010.28 specify the Commission's proposed rules regarding application of the CPI-U price cap, including annual rate adjustments, partial year price changes, and use of "unused rate adjustment authority." We agree with the Commission that the Postal Service should be provided the opportunity both to (a) adjust rates during a rate year in the event of a substantial unexpected change in inflation, and (b) recapture the statutory level of "unused rate adjustment authority." We also agree with the Commission's attempt to ensure the following two restrictions on rates:

- Over the longer run, the cumulative percent change in average rates will not increase more than the cumulative percent change in the CPI-U over the same period. This applies even to the use of unused rate adjustment authority.
- With the exception of application of any unused rate adjustment authority, the percent change in average rates should not exceed the CPI-U percent change over the previous 12-month (moving) average.

As a result, we believe an overall Commission policy statement on the above two restrictions and tracking of the cumulative percent changes in annual averages for both CPI-U and postal prices would be helpful.

The Commission's proposed rules for calculating CPI-U adjustments, however, warrant further consideration and refinement. Because these are technical matters, they are addressed in the separate statement of Antoinette Crowder and William C. Miller that explains the problems and recommends improvements in the rate cap adjustment process in two respects:

- The proposed "partial-year" price adjustment limitation permits a partial-year average price increase that is excessive. The Crowder statement provides the correct method for making such an adjustment.²
- The proposed measure of the annual percentage change in the average monthly CPI-U used to determine average rate limitations is developed as a weighted average increase. The Crowder statement demonstrates that a simple, unweighted average increase provides a statistically superior estimate of the annual inflationary increase.

Regardless of the technical methodology adopted by the Commission, we would urge the Commission to include in its rules a general statement of the clear statutory intent that, over time, cumulative average rate increases can not exceed the cumulative corresponding change in the CPI-U index. In the event of a conflict between the calculational methodology and this policy, the policy should prevail.

² We also note that the procedural rules for a partial year rate adjustment are unclear. A Type 1 procedure does not appear appropriate since a partial year request would indicate the need for expedition. It would be helpful if the Commission would explain its intent in this regard.

Respectfully submitted,

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