

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

REGULATIONS ESTABLISHING SYSTEM)
OF RATEMAKING)

Docket No. RM2007-1

**REPLY COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
ON ORDER NO. 26**

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The National Postal Policy Council (“NPPC”) respectfully submits these reply comments pursuant to Order No. 26, “Order Proposing Regulations To Establish A System Of Ratemaking,” issued by the Commission on August 15, 2007, and published in the Federal Register at 72 Fed. Reg. 50744 (September 4, 2007). These reply comments discuss proposed changes in the filing requirements and standards for review of: (1) rate and classification proposals of general applicability; (2) Negotiated Service Agreements (“NSAs”); and (3) rate adjustments in exigent circumstances.

I. RATE ADJUSTMENTS OF GENERAL APPLICABILITY (RULES 3010.10 THROUGH 3010.14)

The rules proposed by the Commission in Order No. 26 authorize only limited review of proposed rate changes during the brief pre-implementation review period authorized by 39 U.S.C. § 3622(d)(1)(C). See Order No. 26 at ¶¶ 2026-2047 (discussing proposed rules 3010.13 and 3010.14). Several commenting parties, however, urge the Commission to expand the information that the Postal Service must submit in support of proposed rate changes, and the scope of Commission review of those rate changes:

- ***More burdensome filing requirements.*** Several parties argue that the Commission should impose more burdensome filing requirements on the Postal Service for any rate increases under § 3622(d). See NNA at 7-9 (contending that the Commission should require the Postal Service to provide cost justification for “subclass increases dramatically in excess of the price cap” even though “PAEA’s intent limits the Commission’s ability to correct disproportionate rate increases,” and “imposition of standards not explicitly found in PAEA might exceed the Commission’s authority”); Valpak at 10 (USPS should be required to provide a “complete explanation” of how its rates changes comply with “**each** of ‘the objectives listed in 39 U.S.C. § 3622(b) and properly take into account **each** of the **factors** listed in § 3622(c)’” (emphasis in original).
- ***Broader scope of challenges to proposed rate and classification changes.*** Several parties ask the Commission to allow pre-implementation challenges to rate changes proposed by the Postal Service not only on grounds of non-compliance with the § 3622(d) index cap, but also on any other ground relating to “any other policy of 39 U.S.C. § 3622.” McGraw-Hill comments at 6-8; *accord*, Valpak comments at 2-7. McGraw-Hill and Valpak also ask the Commission to authorize pre-implementation review of “major classification changes for market-dominant” mail. McGraw Hill at 2-5; Valpak at 12-16. McGraw-Hill also asks the Commission to extend the 45-day notice period upon a showing of “good cause” that more time is needed to adjudicate any challenges asserted in opposition to the classification changes. McGraw Hill at 2-5. NAA contends that pre-implementation review

should encompass discrimination claims under 39 U.S.C. § 403(c). And Medco Health Solutions contends that any limitation on the scope of issues that parties may raise in pre-implementation challenges to proposed rate or classification changes would violate the Administrative Procedure Act. Medco comments at 6-10; see *also* Valpak comments at 2-7.

- **Discovery.** APWU and OCA argue that the Commission should authorize interested parties to obtain discovery from the Postal Service and “make additional submissions to the Commission” during the pre-implementation review period. APWU comments at 1-4; OCA comments at 10-11.
- **Extended period for pre-implementation review.** McGraw-Hill and several other parties ask the Commission to extend the 45-day period to the extent necessary to adjudicate such other challenges “for good cause shown.” McGraw-Hill at 7 n. 4.
- **Special review of worksharing discounts.** APWU also asks the Commission to modify proposed rule 3010.14 to allow pre-implementation review of whether “proposed workshare discounts comply with the Act.” APWU Comments at 4-6. While acknowledging that the Commission could not complete the contemplated review before the rates take effect, *id.* at 5, APWU advocates adoption of an unspecified “process” that would result in the implementation of “any necessary changes to noncompliant rates as soon as possible,” and before the “annual compliance review.” *id.*

The Commission should reject these additional constraints. Their adoption would effectively write out of PAEA the streamlined system of ratemaking contemplated by Congress and return to the litigate-everything-but-the-kitchen-sink approach of the Postal Reorganization Act.

As many of the commenting parties have noted, the purpose of the Section 3622(d) rate index mechanism is to replace “the current lengthy and litigious rate-setting process” for market dominant products “with a rate cap-based structure” and thereby to achieve “10 years of predictable, affordable rates” and a “decade of rate stability.” Cong. Rec. S11675 (Dec. 8, 2006) (Sen. Collins); *accord, id.* at S11676 (Sen. Carper); *id.* at S11676-77 (Sen. Frist). As Senators Collins and Carpers have noted:

The *primary requirement* . . . is the requirement that, for at least ten years, the system “include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers.” We intended the objectives to supersede the factors in issues affecting the system’s design.

Comments of Senators Collins and Carper (filed April 10, 2007) at 1 (emphasis added).

Superimposing traditional cost-of-service rate regulation on the new index-based regulatory system would frustrate this intent. “The 45-day period that the Act gives the Commission to review rate filing[s] is largely intended to be used to determine whether or not a rate filing is within the rate cap.” *Id.* at 2. As the Commission has found, the reliance of PAEA on a CPI-based index mechanism “represent[s] a marked shift away from PRA-style in-depth examination” and “PAEA ushers in a fundamentally different approach to rate regulation for market dominant products.” Order No. 26 ¶¶ 2026, 2029.

Hence, the Commission was entirely correct in finding that PAEA “casts [the] ratemaking apparatus [of the Postal Reorganization Act] aside and replaces it with a simpler process”; that “formal discovery, Notices of Inquiry, Presiding Officer’s Information Requests, testimony, and hearings” will no longer be authorized; and that the “proposed scope of public comment is no longer open-ended.” Order No. 26 ¶¶ 2026, 2029.¹

Finally, Medco and Valpak gain nothing by asserting that “due process” under the Administrative Procedure Act entitles interested parties to assert the same procedural and substantive challenges to proposed rate changes that were available under the Postal Reorganization Act. Cf. Medco at 6-10; Valpak at 2-7. PAEA entitles “any interested person” who believes that an existing rate violates a ratemaking standard of Title 39 to seek relief by filing a complaint under 39 U.S.C. § 3662. If the Commission finds that the complaint is justified, the Commission

shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance (such as ordering unlawful rates to be adjusted to lawful levels, ordering the cancellation of market tests, ordering the Postal Service to discontinue providing loss-making products, or requiring the Postal Service to make up for revenue shortfalls in competitive products).

39 U.S.C. § 3662(c). The availability of the complaint remedy fully satisfies due process; hence, the Commission has no obligation to establish a duplicate set of procedural remedies before rate or classification changes take effect.

¹ *Accord*, PostCom (Sept. 24, 2007) at 2-5; Time-Warner (Sept. 24, 2007) at 2, 4-5. See also Advo (Apr. 6, 2007) at 2-3, 6-9; ANM-NAPM-NPPC (Apr. 6, 2007) at 6; MOAA (Apr. 6, 2007) at 2-3; PostCom (Apr. 6, 2007) at 2-3, 4-10; Time Warner (Apr. 6, 2007) at 7-9, 18-20; *accord*, ANM-MPA (May 7, 2007) at 6-7; ANM-NAPM-NPPC (May 7, 2007) at 2-6.

II. NEGOTIATED SERVICE AGREEMENTS (RULES 3010.40 THROUGH 3010.43)

Several participants similarly urge the Commission to impose more burdensome filing requirements or standards of review for proposed Negotiated Service Agreements (“NSAs”). APWU 6-8; NAA 2-12; NNA 11; OCA 3-9; Valpak 20-23. The Commission should decline to adopt these constraints, which are inconsistent with the policies of the PAEA, including 39 U.S.C. § 3622(c)(10). As a majority of the Commission held six days ago:

One goal of the PAEA is to provide the Postal Service with a level of flexibility to set rates and develop classifications, including the ability to enter into mailer-specific agreements that it finds beneficial. To provide this flexibility, it is necessary to shift initial responsibility to review and to determine whether or not to proceed with mailer-specific agreements to the Governors of the Postal Service.

PRC MC2007-1 Op. & Rec. Decis. ¶ 4060 (Oct. 3, 2007). For the reasons explained here and elsewhere, this finding is correct.

The central premise of these participants is that the Postal Service, unless closely supervised by the Commission, may enter into NSAs that are not contribution-positive. See, e.g., APWU 6-8; NAA 2 & 7; OCA 4. These participants have never explained, however, how this possibility could justify the intrusive regulatory oversight that these participants would impose.

First, 39 U.S.C. § 3622(c)(10) does not require that NSAs be contribution-positive. Sections 3622(c)(10)(A)(i) and (ii) are stated in the disjunctive, making clear that an NSA which “enhance[s] the performance of mail preparation, processing, transportation, or other functions” need not “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.” *Id.* The advocates of heavy-handed NSA regulation never confront this fact. Indeed, NAA and OCA simply *omit* clause (ii) when they quote or cite Section 3622(c)(10)(A)(ii) to the Commission. See NAA at 2 (omitting Section 3622(c)(10)(A)(ii) from block quotation of statute); *id.* at 7 (first full paragraph) (omitting Section 3622(c)(10)(A)(ii) from paraphrase of statute); OCA at 4 (asserting that “NSAs now ‘*must* . . . [i]mprove the net financial position of the Postal Service”).

Second, the proponents of stricter NSA regulation never explain how an NSA that reduced the Postal Service’s contribution to institutional costs could cause a single other mailer to pay a penny in higher rates. As NPPC and other parties have previously explained, the expiration in December 2007 of the Postal Service’s authority to file a traditional cost-of-service rate case under the Postal Reorganization Act will insulate other mailers from any revenue shortfalls potentially caused by the failure of any NSA to make a positive contribution to the Postal Service’s institutional costs. Regardless of the profitability of any individual NSA, or even all NSAs in the aggregate, 39 U.S.C. § 3622(d) caps overall increases to the levels justified by the CPI. 39 U.S.C. §§ 3622(d)(2)(A), 3622(d)(1)(D). If the Postal Service offers unwarranted or excessive discounts to an NSA partner, the Postal Service alone will bear the financial consequences.² This is a critical change from pre-PAEA law, for the perceived risk that

² Losses resulting from imprudent NSA terms could not provide a basis for an exigent rate increase. By definition such losses obviously would not be consistent with “honest, efficient, and economical” management” within the meaning of 39 U.S.C. § 3622(d)(1)(E).

Nor should NSA discounts, whether contribution-positive or negative, lead to higher rates for services of general applicability through the averaging of rates within a

the “burden of recovering” any loss in “contribution” resulting from unnecessary or needlessly large NSA discounts “would fall largely on captive monopoly mailers not party to the agreement” was the fundamental premise of the Commission’s previous oversight of NSA discount terms.³

Third, the proponents of heavy-handed NSA regulation fail to reconcile their demand that the Commission serve as the Postal Service’s nanny for NSAs with the light-handed (if not completely hands-off) approach the same participants take to the adequacy of the contribution produced by rates of general applicability for both market dominant and competitive products. No participant here—including the APWU, OCA, and Valpak—has proposed in Docket No. RM2007-1 that the Commission closely scrutinize future rate changes for market-dominant—or even competitive—products to verify that the rate changes will improve (or at least maintain) the Postal Service’s net contribution to institutional costs from those products.

To the contrary, APWU has acknowledged in its comments in Docket No. RM2007-1 that:

Section 3632 of the PAEA vests the Postal Service Governors with the primary responsibility for establishing rates and classes for competitive products. The Commission is tasked with enacting regulations to address

class in applying the CPI-based cap under 39 U.S.C. § 3622(d). Proposed rule 3010.24(a) eliminates this possibility by requiring the Postal Service to impute non-discounted rates to NSA mail volume, or if non-NSA rates do not exist, excluding the volume from the calculation of percentage rate changes. NPPC at 10. *accord*, NNA at 11 (first paragraph); Advo (June 18, 2007) at 4-5.

³ *Bank One NSA*, MC2004-3 PRC Op. and Further Rec. Decis. ¶ 1004 (April 21, 2006); *accord, id.*, PRC Op. & Rec. Decis. ¶ 1010 (Dec. 17, 2004); *Capital One NSA*, MC2002-2 PRC Op. & Rec. Decis. ¶¶ 1008 (if an NSA reduced the net contribution to the Postal Service from the mailer, “other mailers’ rates would have to increase to make up the difference”), 3062-63, 5061, 5084-85, 8036-37, 8043.

only three things: 1) prohibit subsidization of competitive products by market dominant products; 2) ensure these products cover their attributable costs; and 3) ensure these products cover their appropriate share of the institutional costs. *In so doing the Commission should use a light hand and give the Postal Service a maximum amount of flexibility.*⁴

OCA proposed a similarly light-handed approach to the pricing of competitive products:

OCA is not proposing that each competitive product, i.e., Priority Mail, etc. be required to make the same percentage of contribution to institutional costs as it did in Docket No. R2006-1. Rather, the percentage contribution each competitive product summed together made, in Docket No. R2006-1, is the *starting point* for the level of contribution that total competitive products must make to institutional costs. From that point, the Commission may apply adjustments, as it deems necessary, to reach the appropriate collective share of institutional costs.⁵

Valpak has taken a similar position. In describing the Commission's review of the rate setting decisions of the Postal Service, Valpak stated that under PAEA the

⁴ APWU (April 6, 2007) at 12 (emphasis added; footnote omitted). See also Initial APWU (June 18, 2007) at 5-6 ("As long as products within the competitive products category cover their attributable costs, there is no problem with cross-subsidization. . . . The annual compliance report should contain all the data necessary to enable the Commission to determine compliance. More frequent reporting is not and should not be required").

⁵ OCA (June 18, 2007) at 35 (emphasis in original). See also *id.* at 33 ("the appropriate standard for determining whether competitive products are being subsidized by market-dominant products should be based on the ability of *all competitive products, collectively*, to cover both their attributable and an appropriate share of institutional costs as determined by the Commission") (emphasis added). See also, e.g., OCA (April 6, 2007) at 15 (due to PAEA, "the Postal Service is no longer required to set rates by marking up attributable costs. Rather, the Postal Service, as a profit-seeking enterprise, can be expected to set rates for individual classes, categories or mailers (or individual pieces) based on *its* estimate of marginal cost and elasticity of demand. The Commission's task will be to verify that revenues of subclasses covered attributable and reasonably assignable costs, as defined by the Commission") (emphasis in original).

authority over rate setting for competitive products “is vested in the Board of Governors,” and that such authority is “broad.”⁶

The inconsistency between the deference that these participants would give to the Postal Service’s business judgment regarding the adequacy of rates of general applicability, and the intrusive oversight that the same parties advocate for NSA pricing, is heightened by the far greater importance of the former prices to the Postal Service’s overall financial health. The \$72 billion in revenues generated by postal rates of general applicability, including approximately \$6 billion from rates for competitive products, exceed by more than 200-to-1 the total rate incentives that the Postal Service is projected to pay mailers each year under all existing NSAs combined. It is utterly illogical to obsess over the profitability of the latter, while leaving the adequacy of the contribution generated by the former essentially to the Postal Service’s unsupervised discretion.

Finally, NAA is correct that NSAs still face potential scrutiny under PAEA for harm to the competitors of the NSA mailer or its customers. NAA 4, 7-8. NAA fails to explain, however, why these issues warrant advance review of NSAs. Competitors of the mailer party to an NSA and their customers are clearly better positioned to assess the competitive impacts of an NSA than are outsiders, however well-intentioned. Accordingly, it is telling that not a single NSA submitted to the Commission for review has ever been challenged by any person on grounds of competitive injury to that

⁶ Valpak (April 6, 2007) at 29. See also Valpak (May 7, 2007) at 10 (“If there is any observation about PAEA which is incontestable, it is that the Postal Service is given greater authority to set rates for competitive products than for market dominant products”).

person. Given the utter absence of any challenge to any existing NSA on grounds of competitive injury, requiring advance review of NSAs for competitive injury would be a solution in search of a problem.

For the foregoing reasons, the proposed restrictions on NSA pricing are demonstrably unnecessary. Their adoption therefore would violate the statutory goals of “allow[ing] the Postal Service pricing flexibility,” “reduc[ing] the administrative burden . . . of the ratemaking process,” and encouraging “agreements between the Postal Service and postal users” that either “improve the net financial position of the Postal Service” or “enhance the performance of mail preparation, processing, transportation, or other functions.” 39 U.S.C. §§ 3622(b)(4) and (6), and 3622(c)(10)(A).

III. EXIGENT CIRCUMSTANCES (RULES 3010.60 THROUGH 3010.66)

A. The Commission Should Decline To Find That Reasonably Foreseeable Cost Increases Constitute Exigent Circumstances.

National Postal Mail Handlers Union (“NPMHU”) asserts in its comments that the Commission should find that exigent circumstances may arise from events that are entirely *foreseeable*. NPMHU at 1-7. The Commission should decline to make such a finding at this time.

The premise of NPMHU’s argument is that some cost increases may be “extraordinary or exceptional” within the meaning of 39 U.S.C. § 3622(d)(1)(E) despite being entirely foreseeable. The legislative history of this provision, however, demonstrates that the circumstances contemplated by Congress as sufficiently extraordinary to warrant above-cap rate increases were national emergencies

comparable in scale and severity to the “terrorist attacks of September 11, 2001, and the subsequent use of the mail to transmit anthrax . . . ” H. R. Rep. No. 108-31, 108th Cong., 2d Sess. 11, 43 (2004). Moreover, Congress, when finalizing the language that became Section 3622(d)(1)(E) by changing the phraseology from “unexpected and extraordinary” to “extraordinary or exceptional,” added the further requirement that the resulting revenue shortfall must be large enough to threaten the ability of the Postal Service “to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” *Id.*; Cong. Rec. H9160, H9162 (December 8, 2006). This language, which was added to the Senate bill during the final deliberations over its wording, makes clear their expectation that the exigency exception would be available only in rare circumstances. Moreover, the further requirement that an exigent rate increase must be “necessary” under “honest, efficient, and economical management,” 39 U.S.C. § 3622(d)(1)(E), clearly rules out application of the exigency clause when the cost increase at issue could have been avoided by reasonable exercise of foresight and prudence (e.g., through insurance or hedging).

Perhaps there exists circumstances in which cost increases might be “extraordinary or exceptional” and foreseeable yet incapable of prevention or mitigation through “honest, efficient, and economical management.” If so, however, NPMHU has failed to identify any plausible example. The two specific examples offered by NPMHU are a “terrorist attack” and “runaway fuel prices.” NPMHU at 6. A terrorist attack on a scale large enough to threaten the Postal Service’s ability to provide adequate mail service, however, is unlikely to be foreseeable. And changes in fuel prices should never be an exigent circumstance. Fuel is a major component of the CPI; and the weighting

of fuel costs in the CPI is roughly comparable to the percentage impact of fuel costs on the Postal Service's overall budget.

Under the circumstances, the Commission should decline to rule in the abstract that exigent rate increases may be justified by cost increases that are foreseeable. If and when the Postal Service contends that such a circumstance has arisen, the Commission can resolve the issue in the context of actual facts rather than theoretical scenarios.

B. The Commission Should Adopt A Sunset Rule Requiring The Rollback Of Exigent Rate Increases.

The logic of exigent rate increases requires the rescission of such increases when the cost increases that justified them (1) recede or (2) are reflected in the CPI itself. ANM-MPA at 6-8; *accord* DMA at 9. APWU and NPMHU contend, however, that circumstances may warrant maintaining the increases in effect even when the circumstances that justified them have dissipated. APWU at 9; NPMHU at 7-8. NPMHU asserts that the Postal Service could make shippers whole by foregoing further rate increases until the CPI caught up with the cumulative rate increases; APWU hypothesizes “a situation where the rate of inflation has caught up with [the] exigency increase.” *Id.* Neither party considers, however, the scenario in which “inflation” fails to “catch up” with the previously increased rates for an extended period. In that scenario, overrecovery of costs could likewise persist for an extended period.⁷

⁷ The above criticism assumes that the APWU position is identical to that of NPMHU: i.e., that rates will remain unchanged until the cumulative increases in the CPI catch up with the cumulative increases in overall rates, including the exigent increase. It is possible, however, that APWU seeks to allow the Postal Service to take *further* CPI-based increases until the cumulative changes in the CPI catch up with the cumulative

CONCLUSION

NPPC respectfully requests that the Commission adopt final rules in accordance with the above comments and the previous comments of NPPC.

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rate changes. This proposal would be even worse: it would allow the cost overrecovery cost persist indefinitely, or even permanently.