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

REVIEW OF COMMISSION'S PRICE CAP RULES	Docket No. RM2013-2

REPLY COMMENTS OF THE NATIONAL POSTAL POLICY COUNCIL
(May 31, 2013)

The National Postal Policy Council respectfully submits these reply comments on the Commission's proposed revisions to its rules governing the maximum amount of rate adjustments.[1] Although the Commission's proposed new language generally appears to clarify its rules, NPPC wishes to address certain issues raised in the initial comments.

In particular, NPPC:

- Opposes offsetting temporary promotional discounts with additional rate cap authority;
- Opposes requiring the Postal Service to provide the criteria required for new workshare discounts when the Postal Service proposes a new permanent discount that is not covered by Section 3622(e);
- Supports Valpak's comments asking the Commission to address the effect of service degradations on cap adjustments; and
- Urges the Commission to clarify the proposed 2 percent limitation language in proposed rule 3010.28.

[1] *Notice of Proposed Rulemaking Requesting Comments on Proposed Commission Rules for Determining and Applying the Maximum Amount of Rate Adjustments,* Order No. 1678 (March 22, 2013), 73 *Fed. Reg.* 22490 (April 16, 2013) ("*Notice*").

I. THE COMMISSION SHOULD PROHIBIT THE POSTAL SERVICE FROM USING INTERIM RATE ADJUSTMENTS TO CREATE ADDITIONAL CAP SPACE

Several commenters in this proceeding addressed issues arising from the Postal Service's proposal in Docket No. R2013-6 to offset the revenue that it would forego due to a one-time "Technology Credit" with a corresponding "reversible" increase in the cap authority for a future year.[2] In general, the commenters stated that proposed rule 3010.23(e) should be modified to continue the treatment of promotions that prevailed since the enactment of the Postal Accountability and Enforcement Act until late 2012. NPPC agrees.

Until October 2012, the settled treatment of temporary promotional discounts in the price cap regime was that the discounts had no effect. For purposes of calculating cap compliance, volumes mailed at promotional prices were treated as though they had paid full prices. This approach had the virtue of being simple and understandable.

To be sure, the pre-October 2012 approach also had the effect that the Postal Service would bear the full cost of its temporary promotions. There is nothing unreasonable or unbusiness-like about that. In the business world, companies that offer promotional discounts generally do not raise other prices to offset the promotions. Instead, they expect to recoup their investment either through increased volume spurred by the promotion or from cost savings accruing from the behavior induced by the promotion. Indeed, the Postal Service's previous promotions, such as the summer

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[2] *See Comments of Pitney Bowes Inc.* at 3 (May 16, 2013); *Comments of the National Association of Presort Mailers* at 3 (May 16, 2013); *Comments of the Association for Postal Commerce* at 2-3 (May 16, 2013); *Valpak Comments* at 2 (May 16, 2013).

discounts in Docket No. R2009-3 and Docket No. R2010-3, sought to generate a net profit through increased volume.[3] In fact, the Commission routinely treated all Postal Service promotions in precisely this manner until Docket No. R2013-1.[4]

In Docket No. R2013-1, the Postal Service for the first time proposed to include the revenue "leakage" from temporary promotions in its cap calculations, which necessarily resulted in cap space to raise other rates higher than would otherwise have been the case. Given that the Postal Service left little price cap authority on the table in those rate adjustments, it follows that some mail today must be paying higher rates than otherwise would have been the case.

A number of mailers challenged that Postal Service notice in comments last year.[5] Nevertheless, the Commission allowed the new market-dominant rates to take effect, and mailers are paying those rates today. The Commission's brief discussion of the matter focused only on the Postal Service's forecast of discounted volumes. The Commission did not discuss that it was treating promotional discounts in a new way.[6] It is important to remember, however, that Order No. 1541 is not a final decision on the

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[3] This is precisely why those programs were designed to require a mailer to send "new" volume as a precondition for the discounts.

[4] Volumes associated with negotiated services agreements receive the same treatment for similar reasons. The Postal Service has premised NSAs either on the notion that they will generate cost savings (Docket No. MC2007-1) or new volume (Docket No. MC2007-5). For price cap purposes, mail entered pursuant to an NSA is treated as if it paid full price.

[5] *E.g., Comments of the National Postal Policy Council* at 19-20 (Nov. 1, 2012); *Pitney Bowes Comments* at 8 (Nov. 1, 2012).

[6] *See* Order No. 1541 at 16-17.

legality of that approach, and a final legal determination will not even be ripe until the Annual Compliance review process for FY2013 that will occur in early 2014.

In Docket No. R2013-6, the Postal Service took a step further by noticing a promotion (a "Technology Credit") and asking for the ability to recoup the promotional outlay not through a *simultaneous* price increase, but rather through an increase in cap authority applicable to the *next* market-dominant rate adjustment (*i.e.*, bypassing the "first-in first-out" principle applicable to unused [or "banked"] cap authority). *United States Postal Service Notice of Market-Dominant Price Adjustment (Technology Credit Promotion* at 6 (April 16, 2013); *Response of the United States Postal Service to Chairman's Information Request No. 1, Question 6* (May 7, 2013). In other words, the Postal Service sought to recover the cost of the temporary promotion from future mailers yet to be identified.

As the Commission knows, numerous commenters in Docket No. R2013-6 identified problems with the Postal Service's attempt to offset a temporary promotional credit with a future cap adjustment. NPPC stated that it would be more appropriate for the Commission to consider this issue in this proceeding, rather than in the limited context of a single rate incentive docket.[7] The issue is squarely raised by proposed rule 3010.23(e), which would give the Postal Service discretion to include or exclude the "leakage" from temporary promotional rates in its price cap calculations.

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[7] NPPC noted that there is no procedural basis upon which the request could be granted, but unlike the Postal Service urged that therefore the Commission could not approve a future offsetting adjustment to the price cap.

Offsetting temporary promotional discounts with higher other rates raises two issues. One is the risk that, by overestimating the volume using the discount, the Postal Service would be able to raise rates by more than the cap limitation. A second issue is whether the Postal Service or other mailers should bear the risks and costs of temporary promotions.

To date, the Commission has focused solely on the first issue, taking care to ensure that the Postal Service does not exceed the price cap by manipulating volume forecasts. NPPC commends the Commission for its attention to this risk. Until Docket No. R2013-1, this was addressed quite simply and effectively by treating, for cap purposes, volumes associated with promotional discounts as if they had paid full rates.

However, now that the Postal Service is attempting to shift the costs and risks (but not the benefits) of its promotions to other mailers, the second issue requires attention. NPPC believes that the Postal Service should not be allowed to "recoup" temporary promotional offerings (whether styled "discounts" or "credits") through offsetting price cap authority. As a general rule, the Postal Service should recover its promotional outlays either through cost savings or new volumes.

The Commission has not previously addressed this second issue. When it allowed the Postal Service to include the "leakage" from temporary promotions in its cap calculations in Docket No. R2013-1, the Commission focused only on the danger of overestimating the volume of mail that might use the discount. The Commission did not address whether requiring other (or future) mailers to pay higher rates to recover temporary promotional rates is just and reasonable under the PAEA, or whether

allowing the Postal Service to charge non-participants higher rates to pay for a temporary promotion is unreasonably discriminatory.

NPPC respectfully submits that the decision to allow the Postal Service to recover its temporary promotions via other rates in Docket No. R2013-1 was mistaken. A temporary promotion, by its nature, is a short-lived effort designed to benefit the Postal Service's business interests by, for example, spurring more volume in a slow period, demonstrating the potential of a new wrinkle (*e.g.*, the mobile barcode promotion). As a short-term exception to the general price schedule, It offers neither permanent prices nor discernible benefits to non-participants. The Postal Service has identified no reason mailers that do not participate in such temporary schemes should pay higher rates.

Accordingly, NPPC urges the Commission not to adopt proposed rule 3010.23(e) and in its current form, but instead change the word "may" to "shall" so that the revised rule 3010.23(e) would read:

> "The Postal Service shall exclude temporary promotional rates and incentive programs from its percentage change in rates calculations if the temporary promotional rates and incentives programs result in overall rate decreases."

II. THERE IS NO NEED TO REQUIRE THE POSTAL SERVICE TO FILE THE INFORMATION SPECIFIED BY SECTION 3622(e) WHEN IT PROPOSES A NON-WORKSHARE DISCOUNT

Proposed rule 3010.12(c) would provide that "whenever" the Postal Service establishes a new discount or surcharge, it must submit, among other things, a "certification based on comprehensive, competent analyses that the discount will not adversely affect either the rates or the service levels of users of postal services who do

not take advantage of the discount." As Valpak correctly notes, this new language would impose an unnecessary burden on the Postal Service and is likely in excess of the Commission's jurisdiction. *Valpak Comments* at 6-7.

This new certification plainly is copied from language in Section 3622(e)(4)(C) regarding workshare discounts. But the proposed new rule would not be limited to workshare discounts; it is intended to apply to *any* new discount, including new discounts that do not involve workshare activity as defined by Section 3622(e)(1). There is no statutory basis nor sound policy reason for importing the additional filing requirements applicable to workshare discounts – a specific provision enacted by Congress to address allegations that workshare discounts were excessive -- and applying them to other, non-workshare, discounts as well.

Extending the requirements of Section 3622(e)(4)(C) to non-workshare discounts plainly is not required by the statute, which specifically requires such a certification only in the case of proposed new *workshare* discounts. There is no indication Congress intended for it to have broader effect. Given that Congress specified those additional criteria only for workshare discounts, the Commission may well lack legal authority to require them as to other discounts that do not involve worksharing.

The Postal Service could easily offer prices labeled "discounts" for many reasons other than worksharing without triggering Section 3622(e). An example would be a "discount" based on market-based pricing. For such prices, there is no statutory requirement that the Postal Service go to the additional effort of developing economic analyses or the "comprehensive" analyses underlying the required certification.

Nor is there a policy reason. Indeed, the proposed certification requirement would appear to impose a substantive restriction that is contrary to the statute. It apparently would prohibit the Postal Service from establishing *any new discount, for any reason*, if the discount would "adversely affect either the rates or the service levels" of postal users that do not use the discount. That is a substantive restriction that would impose an absolute regulatory strait-jacket on postal rate design.[8]

NPPC understands that this proposed rule revision likely arises from the Postal Service's introduction of the Standard Mail High Density Plus rate in the last rate adjustments. Although the Postal Service was initially imprecise in its characterization of that rate, the High Density Plus rate is an example of a discount that is not a "workshare discount." Instead, it was a market, non-cost-avoided based rate category.

Nonetheless, the proposed solution is much too broad. Instead, the Commission should simply defer, as an initial matter, to the Postal Service's characterization of a new permanent discount. If the Commission determines that there is reason to believe that proposed new permanent "discount" might fit the definition of a "workshare

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[8] NPPC notes that it is appropriate to distinguish, for cap purposes, between temporary and permanent rates. The former are short-term initiatives aimed at achieving a specific Postal Service business objective, and it is appropriate for the Service to bear the risk without offsetting cap adjustments. In contrast, the prices for permanent postal product offerings reflect broader financial and business objectives and to the extent some rates are lower, others will be higher.

Indeed, the Commission recognizes this distinction. If proposed rule 3010.12(c) were to apply to promotional rates and were in effect, the Postal Service could not make the certification with respect to the Technology Credit because the increased cap space necessarily implies that other mailers would be adversely affected by higher rates. But the *Notice* gives no indication that proposed rule 3010.12(c) is intended to address such promotional rates, evidencing the Commission's recognition that it is appropriate to treat promotional and permanent rates differently.

discount," it can request the Postal Service to file supplemental information, as it did in Docket No. R2013-1.

III. THE COMMISSION'S RULES SHOULD ADDRESS HOW THE CAP IS TO BE REDUCED WHEN THE POSTAL SERVICE DEGRADES SERVICE

NPPC supports the comments of Valpak to the effect that the Commission's rules should address how the price cap is to be adjusted to account for reductions in service quality by the Postal Service. A degradation in service quality equates to an increase in rates, because the customer is receiving inferior service for the same price.

The economic theory underlying price caps is that the regulated entity has an incentive, in the form of the cap, to minimize its costs and operate more efficiently. However, the economic literature also recognizes that a regulated entity may attempt to reduce costs in ways that are undesirable public policy. *See Mail Processing Network Rationalization Service Changes, 2012*, Docket No. N2012-1, at 151-153 (Sept. 28, 2012) (Advisory Opinion) (summarizing testimony of Public Representative witness Neels and NALC witness Crew). In particular, regulated entities facing a price cap may seek:

(1) to cut costs by reducing service quality;

(2) shift costs onto the customer, which can constitute another form of service degradation, because the customer incurs more costs to obtain the same (or lesser) service; or

(3) forcing customers to migrate to more costly products.

There is reason to believe that the Postal Service has engaged, or is beginning to engage, in each of these practices. The time is ripe for the Commission to consider how its price cap rules would apply in these scenarios.

First, the Commission has conducted several proceedings in which it has considered Postal Service initiatives to reduce service quality in the name of cost-cutting. These include Docket No. N2012-1 (Network Rationalization) and Docket No. N2012-2 (closings and reduced hours at post offices). Indeed, the issue of the effect of the changes on the price cap was raised specifically in the Network Rationalization proceeding. In its Advisory Opinion, the Commission noted approvingly testimony to the effect that service quality reductions could be tantamount to rate increases. *Advisory Opinion on Mail Processing Network Rationalization Service Changes*, Docket No. N2012-1 at 151-155 (Sept. 28, 2012).

To date, the Postal Service has yet to implement fully its plant and post office closings, and has said that it will preserve overnight delivery for approximately 80 percent of First-Class Mail until January 31, 2014. After that date, under current plans post office hours will shrink, and overnight delivery will be substantially reduced. Reduced speed of service constitutes a reduction in service quality, certainly for the NPPC members facing statutory requirements to provide legally-mandated notices within specific narrow time intervals. The statutes require speed, not "consistency."

First Class Mail service standards already are partially reduced from those that were in effect when the current rate cap regulations were adopted. More substantial service reductions may not occur until 2014. But the Postal Service has given mailers ample notice that it is coming, and the Commission should be prepared to consider the circumstances that would justify reducing the rate cap applicable to First-Class and Periodicals Mail – the classes whose service stands in the greatest jeopardy.

Second, the Postal Service has recently begun a process of shifting costs onto mailers, which mailers must incur in order to remain eligible for certain postage rates. NPPC members, in particular, are incurring or have incurred substantial costs in converting to Full Service Intelligent Mail barcode capabilities. Mailers that do not pay the cost of converting will have no option but to pay higher, non-Automation rates after the Full Service IMb requirement takes effect. To date, the Postal Service has enabled mailers to recover a small portion of their investments through the Intelligent Mail barcode incentive, but it will take years before large mailers will see a positive ROI on their investments in Full Service IMb.

Third, a regulated entity can circumvent a price cap is to eliminate a lower price service while forcing customers to a new, higher priced alternative. As several commenters pointed out, the Postal Service has announced its intention to do just that by requiring mailers, by January 2014, to use Full Service Intelligent Mail barcodes in order to earn Automation rates.[9] No longer will mailers be eligible for Automation rates if they use only the Basic IMb or PostNet.

As Valpak observes, until the Commission's rules provide

> "that some reductions in service, depending upon their severity or egregiousness, will be given consideration when determining the maximum price cap adjustment in any given year, the Postal Service each year will have unrestrained license to increase operating profitability by reducing the quality of service being provided to mailers and the public."

Valpak Comments at 8.

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[9] *Public Representative Comments,* Docket No. R2013-6 at 3; *Valpak Comments* at 7-11 (noting that the Postal Service plans to impose a *de facto* rate increase on former PostNet barcode and Basic IMb mailers that do not undertake the cost of converting to Full Service IMb.

NPPC recognizes that the Postal Service sets the service standards, and that the Commission's role with respect to service standards is advisory. But the Postal Service's primary responsibility in setting service standards does not minimize or constrain the Commission's primary role in administering the price cap. Where the Postal Service makes changes that reduce service quality, raise mailer costs, or force mailers into higher priced products, its changes fall squarely within the Commission's authority over the price cap. Nothing in the PAEA immunizes such degradations in service from having implications on the price cap. NPPC supports Valpak's suggestion that the Commission address how service quality degradation will be reflected in its price cap rules.

IV. PROPOSED RULE 3010.28 SHOULD BE CLARIFIED TO LIMIT THE MAXIMIUM SIZE OF UNUSED RATE ADJUSTMENTS TO THE LESSER OF UNUSED AUTHORITY OR TWO PERCENTAGE POINTS

Section 3622(d)(2)(C)(iii)(IV) of the PAEA limits the allowable rate increases using unused rate adjustment authority to two percentage points. 39 U.S.C. §3622(d)(2)(C)(iii)(IV). That limitation applies to the exercise of unused rate adjustment authority from prior years, as provided by Section 3622(d)(2)(C)(ii). Read together, these provisions mean that in a given year the Postal Service may utilize its unused rate adjustment to increase rates by no more than two percent above the inflation-based annual limitation.

The Commission currently implements these statutory provisions in section 3010.28 of its rules, which limits the exercise of unused rate adjustment authority to the:

"lesser of:

(a) 2 percent; or

> (b) The sum of any unused rate adjustment authority for that class."

That limits the class-wide increase above inflation to two percent, but only if such unused rate authority exists.

In contrast, the proposed revisions to the rule 3010.28 removes the "lesser than" limitation:

> "Unused rate adjustment authority used to make a Type 1-B rate adjustment for any class in any 12-month period may not exceed 2 percentage points."

That creates an ambiguity that arguably might allow the Postal Service to raise rates by two percent even when it lacks the unused rate authority necessary to do so. The *Notice* explains that this change arises from Order No. 1573. In that Order, the Commission addressed the situation when the sum of all unused rate adjustment authority for previous years was negative:

> "when the sum of unused rate adjustment authority is negative, it appears that rule 3010.28 is in conflict with rule 3010.27 and 39 U.S.C. 3622 (d)(2)(C)(iii)(III), which allow the Postal Service to use unused rate adjustment authority in a first-in, first-out method."

Order No. 1573 at 5-6.

NPPC understands the intent of the proposed revision, but respectfully suggests that the new rule would be more precise if it were reworded as follows:

> "Unused rate adjustment authority, if available, used to make a Type 1-B rate adjustment for any class in any 12-month period may not exceed 2 percentage points."

V. CONCLUSION

For the foregoing reasons, the National Postal Policy Council respectfully urges the Commission to modify its proposed rule revisions as described herein.

Respectfully submitted,

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