BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

ANNUAL COMPLIANCE REPORT, 2009	))	Docket No. ACR2009

REPLY COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
AND NATIONAL ASSOCIATION OF PRESORT MAILERS
ON WORKSHARING DISCOUNTS FOR FIRST-CLASS MAIL
(February 23, 2010)

The National Postal Policy Council ("NPPC") and National Association of Presort Mailers ("NAPM") respectfully submit these reply comments concerning the Postal Service's Annual Compliance Report ("ACR") for Fiscal Year 2009. We respond here to the initial comments of American Postal Workers Union, AFL-CIO ("APWU"). In those comments, APWU renews its perennial claim that the existing "workshare discounts for First-Class Mail Presort Letters/Cards reported by the Postal Service violate the workshare discount restrictions of 39 U.S.C. § 3622(e)." APWU Comments (Feb. 1, 2010) at 1. APWU contends that the Postal Service has ignored the Commission's mandate to calculate workshare discount passthroughs for First-Class Mail Presort Letters and Cards using Bulk Metered Mail ("BMM") as a benchmark, and as a result has violated 39 U.S.C. § 3622(e) by setting workshare discounts in excess of avoided costs. APWU Comments at 4.[1]

[1] *Accord*, Docket No. ACR2007, *Annual Compliance Report, 2007*, APWU Comments (Jan. 31, 2008) at 2-3; Docket No. R2008-1, *Notice of Price Adjustment*, APWU Comments (March 3, 2008) at 2-3; Docket No. PI2008-3, *Report on Universal Postal Service and the Postal Monopoly*, APWU Initial Comments (June 30, 2008) at 5-6; Docket No. ACR2008, *Annual Compliance Report, 2008*, APWU Comments (Jan. 30, 2009) at 1; Docket No. RM2009-3, *Consideration of Workshare Discount*

The Commission, however, has consistently declined in annual compliance review cases under 39 U.S.C. § 3653 and general price adjustment cases under 39 U.S.C. § 3622(d) to override the judgment of the Postal Service as to the appropriate worksharing rate differentials for First-Class Mail. The same outcome is warranted here.

First, the basic question of what standards should govern worksharing rate differentials is currently pending before the Commission in Docket No. RM2009-3, *Consideration of Workshare Discount Methodologies*. Until the Commission decides what worksharing pricing standards to adopt, any finding that existing worksharing rate differentials violate those standards would be premature. Second, even if the issues raised by APWU were properly before the Commission in this docket, the rigid linkage that APWU seeks to restore between single-piece and presort prices is inconsistent with PAEA and contrary to the public interest. We discuss each point in turn.

I. THE RELIEF SOUGHT BY APWU IS NOT PROPERLY BEFORE THE COMMISSION IN THIS DOCKET.

APWU invokes the Commission's Annual Compliance Determination for FY 2008 (issued March 30, 2009) for the propositions that the Postal Service "is required to use a single piece benchmark in setting worksharing discounts," APWU Comments at 3-4, and that the Postal Service has "departed from the Commission's requirements" in its Fiscal Year 2009 ACR. APWU Comments at 4. APWU misreads the decision by ignoring the distinction between compliance reporting and pricing. The Postal Service

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Methodologies, APWU Initial Presentation (May 26, 2009); *id.*, APWU Comments (Sept. 11, 2009).

has in fact complied with the decision in ACR2008 by submitting a full set of compliance data based on the single piece benchmark. Nothing in the Commission's decision in ACR2008, however, prescribed the First-Class worksharing rate differentials that the Postal Service must actually charge. To the contrary, the Commission made clear in ACR2008 and RM2008-3 that prescription of worksharing rate relationships is premature until the Commission establishes the governing standards in RM2008-3.

In its decision in ACR2008, the Commission held only that the Postal Service should have used the Bulk Metered Mail ("BMM") benchmark in calculating worksharing cost differentials and passthrough percentages for purposes of annual compliance reporting:

> The Postal Service must discontinue the practice of changing established analytical methods in data filed with the Commission in support of . . . Annual Compliance Reports.

2008 Annual Compliance Determination (March 30, 2009) at 6 (quoted in APWU Comments at 3-4).

The Postal Service's compliance filings in the present docket indisputably use the "analytical methods" prescribed by the Commission in ACR2008. Acknowledging that the future role of the BMM benchmark is still unresolved, the Postal Service's Annual Compliance Report for FY 2009 "includes *two separate analyses* for FCM Bulk Letters and Cards"—one that "reports the passthroughs based on the method established by the Commission in the [FY 2008] Annual Compliance Determination . . . using the BMM benchmark for both Mixed AADC Automation Letters as well as Nonautomation Presort Letters," and one that "uses the methodology preferred by the Postal Service based on its interpretation of the law that inter-product passthroughs are not subject to the

limitations of U.S.C. § 3622(e)." USPS FY 2009 ACR at 62 (emphasis added). The Postal Service, therefore, has complied with the Commission's requirement to calculate workshare cost differentials and passthroughs using the BMM benchmark until this issue is resolved in RM2009-3.

The relief that APWU seeks in this case obviously goes beyond enforcing use of the "analytical methods" prescribed by the Commission for reporting the *cost passthroughs* implied by the Postal Service's worksharing prices; APWU wants to force the Postal Service to change the prices themselves. But rate prescriptions of this kind are premature in this docket. The Commission has repeatedly made clear that it will not rule on the lawfulness of the First-Class worksharing rate structure under 39 U.S.C. § 3622(e) until the Commission has established legal benchmarks for such an assessment. *See, e.g.*, Docket No. R2008-1, Order No. 66 (March 17, 2008) at 22 & 57 (holding that the "workshare discounts" proposed by the USPS for First-Class Mail "satisfy the requirements of 39 U.S.C. § 3622(e)" and allowing them to take effect without modification); Docket No. ACR2007, *Annual Compliance Determination* (Mar. 27, 2008) at 63-64 (noting but declining to resolve the issue).

Docket No. ACR2008, which APWU expressly relies on, is not to the contrary. The Commission *specifically declined* to find in ACR2008 that the workshare *prices* actually charged by the Postal Service for First-Class Mail in fact violated the law. Instead, the Commission initiated Docket No. RM2009-3 to resolve the threshold question of what legal standards should be adopted to resolve this issue. Docket No. ACR2008, *Annual Compliance Determination* (March 30, 2009) at 6 ("The Commission has initiated a proceeding [RM20090-3] to resolve this issue. Upon completion of that

proceeding, appropriate action will be taken."). The Commission elaborated on this point several months later in Docket No. RM2009-3 itself, explaining that the establishment of appropriate standards for worksharing rates raised

> a number of complex issues relating to the proper application of the . . . PAEA . . . to those rates [that] could best be resolved in a follow-on docket in which sufficient time and sufficiently flexible procedures would be available to ensure that these issues could be thoroughly examined.

Order No. 243 (July 10, 2009) at 1.

Any other position would be arbitrary and capricious. As the Commission noted in July 2009, the record in Docket No. RM2009-3 is voluminous and "wide ranging." Order No. 243 at 2. A Commission decision adopting the positions advanced by the users of presort First-Class Mail on a number of these legal and factual issues would eliminate any basis for restoring the pre-PAEA linkage between presort rates and the BMM cost benchmark. *Id.* at 2-5. Hence, until the Commission resolves the issues raised in RM2009-3, there is simply no basis for finding that the First-Class worksharing rate differentials maintained by the Postal Service in FY2009 were excessive under Section 3622(e)—or any other provision of Title 39.

II. THE RIGID LINKAGE THAT APWU SEEKS TO RESTORE BETWEEN SINGLE-PIECE AND PRESORT PRICES IS INCONSISTENT WITH PAEA AND CONTRARY TO THE PUBLIC INTEREST.

Even if (contrary to fact) the lawfulness of the existing First-Class Mail worksharing rate differentials in FY2009 were ripe for decision in this docket, APWU has failed to identify any legal or factual basis for reimposing the pre-PAEA rate relationships between presort and single-piece First-Class Mail. In Docket No. R2009-3, NPPC and other users of presort First-Class Mail offered a detailed point-by-point

refutation of APWU's case for restoring the pre-PAEA relationships. APWU has responded to most of these counterarguments by ignoring them.

A. PAEA Did Not Codify Previous Precedent Concerning Worksharing Discounts.

APWU continues to argue, as it has in other post-PAEA dockets, that PAEA "codified" the pre-PAEA precedent regarding the maximum permitted worksharing rate differentials within First-Class Mail. APWU Comments at 1 & 5; APWU Initial Presentation in RM2009-3 (May 26, 2009) at 2, 4-5. To the contrary, as NPPC explained in its September 11, 2009, comments in RM2009-3, the enactment of PAEA in fact marked a clear repudiation of the traditional pricing constraints that APWU seeks to impose. One of the central goals of PAEA was the establishment of a "modern system" of price regulation, 39 U.S.C. § 3622(a), a term of art that whose components included a move (1) from detailed pre-implementation review of rate changes by regulators to carrier-initiated pricing, (2) from cost-of-service ratemaking to index-based ratemaking, and (3) from detailed regulation of individual prices, often through accounting or cost formulas, to lighter-handed regulation that gives greater pricing flexibility to regulated companies. NPPC Comments in RM2009-3 (Sept. 11, 2009) at 5-8.[2] The notion that PAEA "codified" pre-PAEA standards disregards this fundamental paradigm shift.

[2] NPPC attaches its September 11 comments in RM2009-3 as Appendix A, and incorporates the comments by reference.

B. 39 U.S.C. § 3622(e) Does Not Even Apply To Many Of The Price Differentials Between Presort And Single-Piece First-Class Mail.

NPPC showed in its September 2009 comments in RM2009-3 that 39 U.S.C. § 3622(e), the primary statute relied on by APWU, by its terms constrains price differentials for only a limited range of worksharing activities: "presorting, prebarcoding, handling [and] transportation." But it is undisputed that the cost differences between Single-Piece and Presort First-Class Mail result from a far broader range of cost-saving activities by presort mailers. *See* NPPC Comments in RM2009-3 (Sept. 11, 2009) at 13-14; RM2009-3 Testimony of NAPM witnesses Bell *et al*. at 10-13. Price differentials that correspond with cost differences arising from mailer activities other than the four enumerated in Section 3622(e) are beyond its scope. APWU continues to ignore this point in its comments.

C. Section 3622(e) Does Not Apply To Price Differentials Between Separate Products.

39 U.S.C. § 3622(e) does not apply to the price relationships between Single-Piece And Presort First-Class Mail because they are clearly separate products, offered to distinct product markets. In Docket No. RM2007-1, the Postal Service proposed, and the Commission approved, a mail classification schedule ("MCS") that defined Presort and Single-Piece First-Class Mail as separate products. *See* Docket No. RM2007-1, *Regulations Establishing A System of Ratemaking*, Order No. 43 (Oct. 29, 2007) at ¶¶ 4013-4018. The Commission specifically found that treatment of Presort and Single-Piece First Class mail as separate products was reasonable. In rejecting APWU's position, the Commission stated:

> The Postal Service has the flexibility to initially describe its product lines in conformance with the statutory requirements of the PAEA. . . . It is possi-

> ble to apply this definition and categorize First-Class Mail postal services into products in several different ways. *The selections made by the Postal Service* comply with the definition, and *represent postal services with distinct cost or market characteristics*. The product lines are subject to adjustments in the future as conditions change. *The Commission finds that the Postal Service has appropriately described product lines applicable to First-Class Mail.*

Docket No. RM2007-1, Order No. 43 at ¶ 4017 (emphasis added).

The judgments of the Postal Service and the Commission on this issue were clearly correct. PAEA defines a product as "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied." 39 U.S.C. § 102(6). Single-Piece and Presort mail differ in *both* characteristics. First, Single-Piece and Presort clearly differ in their costs—and in respects that go beyond the four examples of worksharing enumerated in § 3622(e). Second, Single-Piece and Presort First-Class Mail clearly differ in their market characteristics, and, for most First-Class volume, are not close substitutes. NPPC Comments in RM2009-3, *supra*, at 14-15.[3] Because of these differences, applying the Section 3622(e)(2) pricing restriction to separately to Single-Piece and Presort First-Class Mail is entirely justified as a matter of economics. NPPC Comments (Sept. 11, 2009) at 14-17.

It is also consistent with the structure of PAEA. The primary mechanism established by Congress for enforcing compliance with Section 3622(e) is the Commission's review of the Postal Service's annual compliance report under 39 U.S.C. §§ 3652 and 3653. Section 3652(b), however, clearly limits the required information

[3] *See also* Docket No. RM32009-3, Comments of Robert W. Mitchell (Aug. 24, 2009) at 4 n. 6 (calculating from Postal Service cross-price elasticity data for the Presort and Single-Piece categories of First-Class Mail that a 10 percent increase in the "discount" would cause the volume of Single-Piece mail to decline by only 0.57 percent).

about "workshare discounts" to price differentials *within* "each market-dominant product." As the Postal Service has correctly noted, the language of 39 U.S.C. § 3652(b),

> which directs the Postal Service to provide the specified workshare data "*with respect to each market-dominant product* for which a workshare discount was in effect," suggests that the proper analysis is to measure worksharing differences on an intraproduct, rather than inter-product, basis. This is buttressed by the fact that section 3652 generally requires the reporting of data by product.

USPS FY 2008 Annual Compliance Report (December 29, 2008) at 50-51; *see also* USPS FY 2009 ACR at 58; NPPC Comments in RM2009-3, *supra*, at 16-17.

APWU has ignored these facts in its February 1 comments in this docket.

D. The Price Differentials Between Single-Piece And Presort First-Class Mail Fall Within Two Of The Exceptions Established By Section 3622(e).

NPPC also showed in its September 2009 comments in RM2009-3 that the price spread between Single-Piece and Presort First-Class Mail clearly falls within two exceptions to 39 U.S.C. § 3622(e) established by Section 3622(e) itself. NPPC Comments in RM20090-3, *supra*, at 19, 26-34. Reducing the price spread between Presort and Single-Piece mail would impede the efficient operation of the Postal Service within the meaning of § 3622(e)(2)(D), and the relinking of Presort and Single-Piece prices through the BMM benchmark would worsen both allocative and productive efficiency. Because the costs of Single-Piece mail vary widely, maximizing incentives for productive efficiency requires presort rate differentials equal to the unit cost differences between Presort Mail and the *marginal* piece of Single-Piece mail. John C. Panzar,

"Efficient Worksharing Discounts With Mail Heterogeneity," in M.A. Crew and P.R. Kleindorfer, eds., *Liberalization of the Postal and Delivery Sector* 121-134 (2006). Using the typical, median or average piece of Single-Piece mail as the benchmark produces incorrect results. *Id*. And using a *low-cost* subset of Single-Piece mail, such as BMM, produces results that depart even further from the Efficient Component Pricing Rule. *Id*.

Additionally, given the differences in demand elasticities and costs between Single-Piece and Presort First-Class Mail, further narrowing the price spread between the two products would reduce the aggregate contribution to Postal Service institutional costs from the "category or subclass subject to the discount"—i.e., First-Class letter mail. In its September 2009 comments in RM2009-3, NPPC demonstrated that narrowing the rate spread between Presort and Single-Piece First-Class Mail as APWU seeks would significantly worsen the Postal Service's shortfall in contribution to institutional costs. Because the CPI-based price cap is applied to the entire class of First-Class Mail as a whole, raising the rates for the presort category would require an offsetting reduction in rates for the single-piece category. Because the own-price elasticities of demand for single-piece and presort First-Class Mail are similar, the increase in single-piece volume would be roughly offset by the decrease in presort volume. But this shift in the makeup of First-Class Mail would not be neutral in terms of *contribution to institutional costs*: the percentage markups over attributable cost for presort mail are *several times* the percentage markups for single-piece mail. The net decrease in the contribution to the Postal Service's institutional costs would be about $373 million per year. NPPC Comments in RM2009-3 at 23-26.

The workshare discounts established by the Postal Service therefore fall within the exception established in 39 U.S.C. § 3622(e)(3)(A) ("Nothing in this subsection shall require that a work share discount be reduced or eliminated if the reduction or elimination of the discount would . . . lead to a loss of volume in the affected category or subclass of mail and reduce the aggregate contribution to the institutional costs of the Postal Service from the category or subclass subject to the discount.") NPPC Comments in RM20090-3, *supra*, at 19, 26-34.

APWU ignores this evidence. Instead, APWU asserts that none of the exceptions under Section 3622(e) can apply because the *Postal Service* has failed to meet its burden of establishing their applicability. APWU Comments at 7 n. 4; Public Forum Tr. at 40 (statement of Mr. Anderson). But nothing in 39 U.S.C. § 3622(e), or Title 39 generally, provides that the exceptions and limitations set forth in Sections 3622(e) may be satisfied only by information from the Postal Service itself. To the contrary, 39 U.S.C. § 3653(a) expressly requires the Commission to "provide an opportunity for comment by "users of the mails" and other "affected parties." If the Commission were foreclosed from considering the comments of participants other than the Postal Service, the opportunity to submit comments under § 3653(a) would be empty. Indeed, APWU itself concedes that "Intervenors certainly have a right to bring evidence and bring argument to the Commission and to seek an outcome based upon that . . ." Public Forum Tr. 41, lines 4-6 (statement of APWU counsel).

E. The Statutory Goal of "Binding The Nation Together" And The Uniform Rate Requirement Of 39 U.S.C. § 404(c) Are Irrelevant To This Issue.

In its comments, APWU also renews its perennial claim that rate relinking is mandated by 39 U.S.C. § 404(c), the "statutory requirement of a uniform rate for First Class mail," as well as the traditional statutory goal of "bind[ing] the Nation together," 39 U.S.C. § 101(a). APWU comments at 2-3; APWU RM2009-3 comments at 3-4.

APWU's reliance on the uniformity requirement of Section 404(c) is misplaced for reasons repeatedly explained by NPPC. First, the uniformity requirement is *geographic*: "rates for letters sealed against inspection" must "be available on the same terms *nationwide*." PRC MC76-1 Op. (July 15, 1977) at 6. Nothing in Title 39 forbids nonuniformity among First-Class rates with respect to *any other* physical or cost characteristic of the mail. *Id*. at 7-8. The Commission has approved discounts for worksharing and other cost drivers in the First-Class rate structure since the 1970s. Under APWU's idiosyncratic reading of Section 404(c), all of these forms of price nonuniformity would have to be scrapped. NPPC Comments (Sept. 11, 2009) at 22-23. NPPC has repeatedly noted these facts. APWU once again ignores them.

APWU's reliance on the bind-the-nation-together provision of 39 U.S.C. § 101(a) is misplaced for the reasons noted on pages 20-21 of NPPC's September 11, 2009 comments. APWU has ignored these inconvenient facts as well.

F. Relinking Single-Piece And Presort Prices Would Harm The Public Interest.

As noted above, NPPC explained in its September 2009 comments in RM2009-3 that narrowing the rate spread between Presort and Single-Piece First-Class Mail would

worsen the Postal Service's shortfall in contribution to institutional costs by approximately $373 million per year. NPPC Comments in RM2009-3 at 23-26. APWU completely ignores this issue in its current comments.

APWU, like the Commission, has professed concern in this docket about the Postal Service's poor financial health, and the regulatory "constraints" that "really are hamstringing the very organization which postal reform legislation was intended to preserve." Prehearing Conf. Tr. 11-14, 15-16. A good first step at reform in this docket would be rejection of the costly and legally unjustified pricing constraint proposed by APWU for First-Class Mali.

CONCLUSION

NPPC and NAPM respectfully request that the Commission find that the rate differentials between Presort and Single-Piece First-Class Mail in effect during FY2009 did not exceed the maximum levels allowed by law.

Respectfully submitted,

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Attachment A

COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
IN DOCKET NO. RM2009-3

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BEFORE THE
POSTAL REGULATORY COMMISSION
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CONSIDERATION OF WORKSHARE DISCOUNT METHODOLOGIES	))	Docket No. RM2009-3

COMMENTS OF NATIONAL POSTAL POLICY COUNCIL ON ORDER NO. 243 (September 11, 2009)

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COMMENTS OF NATIONAL POSTAL POLICY COUNCIL ON ORDER NO. 243

The National Postal Policy Counsel ("NPPC") respectfully submits these comments pursuant to Order No. 243, Order on Further Procedural Steps. These comments focus on rate differentials between Presort and Single-Piece First-Class Mail.

I. INTRODUCTION AND SUMMARY

Order No. 243 poses a number of sensible questions. The Order properly recognizes that 39 U.S.C. § 3622(e) would not govern intra-First-Class rate differentials within First-Class Mail if Section 3622(e) were held not to cross product boundaries, or if the Commission were to find that Presort and Single-Piece products serve separate and distinct markets. Order No. 243 at 2-3. The Order also invites comments on whether the statutory protection given to Single-Piece mail should be limited to the "'just and reasonable' standard of section 3622(b)(8)." Order No. 243 at 4. Much of the Order, however, is an unfortunate step backwards.

The central purpose of the Postal Accountability and Enhancement Act of 2006 ("PAEA") was to establish a "modern system" of rate regulation. Consistent with the reform movement that swept much of common carrier and public utility regulation during the quarter century after the enactment of the Postal Reorganization Act of 1970, the PAEA (1) shifted the initiative in ratemaking from the Commission to the Postal Service, (2) replaced the Postal Service's costs of service with an exogenous cost index—the CPI—as the principal constraint on maximum reasonable rates, and (3) directed the Commission to move away from detailed prescription of individual rates, and a heavy reliance on elaborate costing and accounting formulas, in favor of a lighter-handed regulatory approach that would give the Postal Service more flexibility to raise rates within a broad zone of maximum rate reasonableness.

Most of the questions posed in Order No. 243, however, illustrate the unfortunately "high marginal propensity" of regulators to "micromanage the process of deregulation."[1] Instead of a modern system of maximum price regulation, the questions posed in the Order repeatedly hearken back to the pre-PAEA apparatus of "the traditional linkage of single-piece rates" to presort rates "through a suitable benchmark." *Id*. at 1-4. Most of the alternatives to relinking included in the Order are also arbitrary and heavy-handed: (1) requiring the Postal Service to apply the CPI index cap separately to both Single-Piece and Presort mail (an approach explicitly foreclosed by PAEA); (2) imposing a fixed

[1] Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation* (1998) at 70.

limit on the average price differential between Single-Piece and Presort mail, apparently without regard to the *cost* differential between the two products; and (3) imposing a fixed limit on the amount by which the "percent contribution to institutional costs" from Single-Piece mail may exceed the percent contribution from Presort mail or their "percent contribution to institutional costs" (an approach similar to formulaic approaches that were struck down repeatedly by Courts of Appeals in the early 1980s). Order No. 243 also invites comments on several elaborate new costing taxonomies, including distinctions between "pure" worksharing versus activities that are "facilitated by" or "naturally support" worksharing, and a proposal to "analytically decompose" cost differentials into "worksharing" and "nonworksharing." *Id*. at 5. These pricing and costing proposals are fundamentally at odds with the PAEA.

In Section II of these comments, we explain why relinking of Presort prices to the costs of Single-Piece Mail would be inconsistent with the modern system of maximum price regulation contemplated by Congress in 39 U.S.C. § 3622(a) through (d), and unsupported by the "workshare discounts" provisions of § 3622(e) or the other statutory provisions cited by APWU and GCA.

In Section III of these comments, we demonstrate that relinking of Single-Piece and Presort prices would harm the public interest by needlessly depriving the Postal Service, which is essentially insolvent, of several hundred million dollars each year. Relinking Presort prices to the costs of BMM would also violate the Efficient Component Pricing Rule: to the limited extent that mail still converts from Single-Piece to Presort mail (or *vice versa*), the volume at the

margin has the cost characteristics of high-cost collection mail, not the hypothetical low-cost model of BMM. Finally, rebalancing First-Class prices to reduce the preference enjoyed by Single-Piece mail would have only a minimal effect on the budget of the average American household.

In Section IV, we explain that most of the alternative forms of preference for Single-Piece mail would be unlikely to survive judicial review.

These facts do not leave the Commission without tools for protecting Single-Piece mailers or Presort mailers from excessive prices. Price differentials that are too wide or narrow may, in appropriate circumstances, be challenged under 39 U.S.C. § 3622(b)(8) as unjust and unreasonable. Price differentials that are too narrow in relation to cost differences may also be challenged as unduly discriminatory under § 403(c) or anticompetitive under § 404a(1). The upper end of the zone of reasonableness established by these provisions may be clarified in future complaint cases or annual compliance review proceedings based on the specific allegations raised in those cases, and the specific facts bearing on those allegations. Price differentials between Presort and Single-Piece mail may not be challenged, however, merely because the prices are not "linked" in a pre-PAEA sense, or violate other mechanical formulas of the kind that PAEA was meant to foreclose.

II. RELINKING PRICES FOR SINGLE-PIECE AND PRESORT FIRST-CLASS MAIL WOULD USURP THE PRICING FLEXIBILITY GIVEN TO THE POSTAL SERVICE BY THE POSTAL ACCOUNTABILITY AND ENHANCEMENT ACT OF 2006.

A. The Underlying Purpose Of Section 3622 Is To Establish A "Modern System" Of Price Regulation, Not To Perpetuate Detailed Regulation Of Maximum Prices.

One of the central goals of PAEA was the establishment of a "modern system" of price regulation. 39 U.S.C. § 3622(a). "Modern system of regulation" was not just a throwaway line. A wave of reforms swept the world of public utility and common carrier regulation in the United States during the quarter-century between the enactment of Postal Reorganization Act in 1970 and the enactment of PAEA in 2006. For the setting of maximum reasonable prices on market-dominant services, three primary elements of these reforms were:

(1) A shift from regulator-initiated price changes to carrier-initiated price changes, with only limited pre-implementation review by the regulator.[2]

[2] For example, Congress amended the Interstate Commerce Act in 1980 to allow railroad carriers to implement rate increases on 20 days notice, and to bar the Interstate Commerce Commission from suspending the effectiveness of a proposed rate change unless the ICC found that (1) the protestant was "substantially likely" to prevail on the merits, (2) without suspension, the proposed rate change would cause "substantial injury" to the protestant, and (3) a subsequent award of reparations would be unable to protect the protestant from injury. 49 U.S.C. §§ 10707(c), 10762(c)(3) (1995). In 1995, Congress repealed the Commission's suspension authority over railroad rates entirely. ICC Termination Act of 1995, Pub. L. No. 104-88, § 102(a), 109 Stat. 803, 804-52.

(2) A shift from cost-of-service to exogenous cost indexes such as the Consumer Price Index ("CPI") or Producer Price Index ("PPI") as the primary benchmark for maximum rate reasonableness.[3]

(3) A shift from detailed regulation of individual prices, often through detailed accounting or cost formulas, to lighter-handed regulation that gives regulated companies greater pricing flexibility within broad zones of rate reasonableness.[4]

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[3] Michael A. Einhorn, *Price Caps and Incentive Regulation in Telecommunications* 8 (1991); Michael A. Crew and Paul R. Kleindorfer, "A Critique of the Theory of Incentive Regulation: Implications for the Design of Performance Based Regulation for Postal Service," in Crew and Kleindorfer, eds., *Future Directions in Postal Reform* (2001); *accord*, *Policy and Rules Concerning Rates for Dominant Carriers*, 4 FCC Rcd 2873 (1989) at ¶¶ 8-15, 36-37, 88-90, 100-114; *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786 (1990) at ¶¶ 21-37, *aff'd*, *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993); *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. ¶ 30,985 (1993) ("*Order No. 561*") at 30,948-49 & n. 37, *aff'd*, *Ass'n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996); *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 486-87 (2002).

[4] For example, the Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793, § 11, codified at 49 U.S.C. § 10708 (1982 ed.), "created a zone of reasonableness within which [motor] carriers can raise rates without interference from the ICC." *Maislin Industries, U.S. v. Primary Steel, Inc.*, 497 U.S. 116, 133 (1990).

The ICC extended light-handed regulation to railroad rates a few years later. The ICC interpreted the "just and reasonable" ratemaking provisions of the Interstate Commerce Act to allow railroads to set rates for market-dominant services within a range bounded by short-run variable costs at the bottom and stand-alone costs at the top. Ex Parte No. 355, *Cost Standards for Railroad Rates*, 364 I.C.C. 898 (1981) (minimum rate floor), *aff'd*, *Water Transport Ass'n v. ICC*, 684 F.2d 81 (D.C. Cir. 1982); *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520, 542-546 (1985) (rate ceiling), *aff'd*, *Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3rd Cir. 1987); *accord*, *Wheeling-Pittsburgh Steel*

(footnote continued)

The PAEA incorporated all three elements. First, PAEA shifted primary responsibility for initiation of price changes from the Commission to the Postal Service, with only limited review of those price changes before they take effect. The key statutory provision here is 39 U.S.C. § 3622(d)(1)(C), which establishes a 45-day period for Commission review of proposed price changes:

> The Commission also concludes that Congress expected that a modern system for regulating rates and classes would afford the public and the Commission only a limited period of pre-implementation comment and review. This finding is supported primarily by the 45-day period of advance notice of proposed changes in rates that is referenced in section 3622(d)(1)(C).

Order No. 43, Docket No. RM2007-1, *Regulations Establishing A System Of Ratemaking* (October 29, 2007) at ¶ 2026. *Accord*, Docket No. RM2007-1, Comments of Senators Collins and Carper (filed April 10, 2007) at 2 ("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."). PAEA "casts [the] ratemaking apparatus [of the Postal Reorganization

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Corp. v. ICC, 723 F.2d 346, 355-356 n. 22 (3rd Cir. 1983); *Potomac Electric Power Co. v. ICC*, 744 F.2d 185, 193-194 (D.C. Cir. 1984).

To regulate "competitive access" pricing (the railroad analog of "worksharing discounts"), the ICC adopted standards that focused primarily on whether the margin between a dominant railroad carrier's bundled and unbundled rates (i.e., the "worksharing discount" offered by the carrier) would squeeze out efficient connecting carriers from participating in the through route. Significantly, the ICC did not treat the incumbent carrier's "avoided costs" as a ceiling on worksharing rate differentials. To the extent that avoided costs or incremental costs played a role, they served as a *floor* on worksharing rate differentials, not a *ceiling*. *See Baltimore Gas and Electric Co. v. United States*, 817 F.2d 108 (D.C. Cir. 1987).

Act] aside and replaces it with a simpler process . . . formal discovery, Notices of Inquiry, Presiding Officer's Information Requests, testimony, and hearings" will no longer be authorized; and . . . the "proposed scope of public comment is no longer open-ended." Order No. 26 ¶¶ 2026, 2029.

Second, 39 U.S.C. § 3622(d)(1) replaced the Postal Service's costs of service with an external cost index, the Consumer Price Index, as the main constraint on maximum reasonable prices. As the Commission found in Docket No. RM2007-1, the reliance of PAEA on a CPI-based index mechanism "represent[s] a marked shift away from PRA-style in-depth examination" and "ushers in a fundamentally different approach to rate regulation for market dominant products." Order No. 26 at ¶¶ 2026, 2029.

Third, while PAEA retained lists of "objectives" and "factors" for regulating maximum prices within each class, none of these items are stated as absolute requirements for maximum price regulation (*see* 39 U.S.C. §§ 3622(b) and (c)), and all are subordinated to the overall objective of a "modern system for regulating rates and classes for market-dominant products." 39 U.S.C. § 3622(a).

In the following subsections, we explain in turn why none of these provisions, or any of the other provisions cited by the supporters of continued rate preferences for Single-Piece First-Class Mail, justify relinking of Single-Piece and Presort prices.

B. Consistent With The Overarching Policy Of Modern Rate Regulation, None Of The Individual Provisions of 39 U.S.C. § 3622 Require Relinking.

1. Sections 3622(a) through (d): a modern system of maximum rate regulation

39 U.S.C. § 3622(d) contains the only mandatory constraint retained by PAEA on maximum reasonable prices: the CPI-based cap on class-wide price increases. 39 U.S.C. § 3622(d)(1)(A). This provision obviously provides no support for relinking.[5]

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[5] Two other mandatory constraints that survive PAEA do not constrain maximum rates as such. First, the traditional prohibition against undue discrimination has been recodified at 39 U.S.C. § 403(c). Relinking clearly cannot be justified as a remedy against undue discrimination against Single-Piece First-Class Mail, however, since that product already pays a much smaller per-piece contribution, coverage ratio, and percentage markup over attributable cost than does Presort First-Class Mail. *See* pp. 23-24, *infra*. It is relinking, not delinking, that potentially violates Section 403(c).

Second, 39 U.S.C. § 404a(a)(1) prohibits the Postal Service from engaging in unfair competition "except as specifically authorized by law." That provision likewise weighs against relinking of Single-Piece and Presort rates. Avoidance of unfair competition against private firms that supply presorting and other workshare services, however, requires that the Postal Service's worksharing "discounts"—i.e., price differentials—equal *or exceed* 100 percent of cost differentials. The notion of "conservatism" that limits worksharing price differentials to 100 percent of cost differences *or less* amounts to a regulator-imposed vertical price squeeze. As Professor Kahn has explained,

> what efficient competition requires is that the non-integrated rival not be subject to a vertical squeeze, such as was one basis for the condemnation of the Aluminum Company of America (Alcoa) under the antitrust laws. The source of the squeeze was not the absolute height of the price at which Alcoa sold ingot to competing manufacturers of sheet but the margin between its respective prices for ingot and sheet. It was the failure of that margin to cover Alcoa's own fabricating costs that made it impossible for equally efficient independent fabricators to compete.

(footnote continued)

None of the individual "objectives" and "factors" of section 3622(b) and (c) directs the Commission to restore the traditional linkage of prices between Single-Piece and Presort First-Class Mail. None of these items even mentions price linkage. And several of those items clearly weigh in favor of lighter-handed regulation of maximum prices:

- "To allow the Postal Service pricing flexibility." Section 3622(b)(4).
- "To assure adequate revenues, including retained earnings, to maintain financial stability." Section 3622(b)(5).
- "To reduce the administrative burden . . . of the ratemaking process." Section 3622(b)(6).
- "To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph *shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within . . . classes of mail.*" Section 3622(b)(8) (emphasis added).

Alfred E. Kahn and William E. Taylor, "The Pricing of Inputs Sold to Competitors: A Comment," 11 Yale J. on Reg. 225, 228-229 (1994); *see also* Docket No. R83-1, *E-COM Rate and Classification Changes, 1983*, PRC Op. & Rec. Decis. (Feb. 24, 1984) at 36-37; J. Ordover, A. Sykes, and R. Willig, "Nonprice Anticompetitive Behavior By Dominant Firms Toward The Producers of Complementary Products," in Franklin M. Fisher, ed., *Antitrust and Regulation* 123-27 (1985); Baumol and Sidak, *supra*, 11 Yale J. on Reg. at 180 & nn. 9-11 (citing decisions); William J. Baumol and J. Gregory Sidak, "The Pricing of Inputs Sold to Competitors: Rejoinder and Epilogue," 12 Yale J. on Reg. 177, 179-85 (1995) (describing decision of highest court in the British Commonwealth to approve ECPR as standard for telecom access pricing in New Zealand).

- To allow value-of-service pricing. Section 3622(c)(1).
- To consider the effect of rate increases on all mailers, not just the general public. Section 3622(c)(3).
- "[T]he importance of pricing flexibility to encourage increased mail volume and operational efficiency." Section 3622(c)(7).
- "[T]he need for the Postal Service to increase its efficiency and reduce its costs . . ." Section 3622(c)(12).

The reference to a "just and reasonable" schedule of rates in § 3622(b)(8) is particularly relevant. "Just and reasonable" is a term of art that has been held for decades to authorize a broad zone of rate reasonableness and a wide range of ratemaking methodologies. *See Verizon Communications Inc. v. FCC*, 535 U.S. 467, 501-502 (2002) (citing *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968)) ("responsibility for 'just and reasonable' rates leaves methodology largely subject to discretion"). Congress underscored this flexibility by adding the final proviso of § 3622(b)(8): "however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude *within*, between, or among classes of mail." (Emphasis added.) Hence, the notion that Section 3622(b)(8) codifies or freezes in place the price relationships that existed on the effective date of PAEA (*see*, *e.g.*, GCA Comments (Aug. 31, 2009) at 11-12) is flatly at odds with the explicit language of

the provision itself, as well as long-established understanding of the term "just and reasonable."[6]

Moreover, and in any event, all of the "objectives" and "factors" of Section 3622(b) and (c) are explicitly subordinated to the ultimate objective of establishing a "modern system" of rate regulation, 39 U.S.C. § 3622(a), through the "replace[ment of] the current lengthy and litigious rate-setting process" for market dominant products with a more streamlined and light-handed alternative. Cong. Rec. S11675 (Dec. 8, 2006) (Sen. Collins); *accord*, *id*. at S11676 (Sen. Carper); *id*. at S11676-77 (Sen. Frist).

2. Section 3622(e): limited constraints, broad exceptions

APWU and GCA, apparently recognizing that Section 3622(a) through (d) do not require mandatory relinking, rely instead on Section 3622(e). APWU has asserted that:

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[6] The term "fair and equitable," which appears in 39 U.S.C. § 101(d), has long been treated in regulatory contexts as synonymous in flexibility with "just and reasonable." *See Clinton v. City of New York*, 524 U.S. 417, 485 (1998) (citing *Yakus v. United States*, 321 U.S. 414, 426-427 (1944) ("fair and equitable"), and *FPC v. Hope Natural Gas Co*., 320 U.S. 591, 600-601 (1944) ("just and reasonable")); *Skinner v. Mid-America Pipeline Co*., 490 U.S. 212, 219 (1989) (same); *Mistretta v. U.S*., 488 U.S. 361, 373 (1989) (same); *see also New Haven Inclusion Cases*, 399 U.S. 392, 499 (1970) (holding that requisite findings under "fair and equitable" test of bankruptcy reorganization statute and "equitable" or "just and reasonable" tests for mergers or inclusions under Interstate Commerce Act are equivalent and provide the "same flexible standard"); *American Trucking Ass'ns v. U. S*., 355 U.S. 141 (1957) at nn. 2, 5 and 7 (treating terms as interchangeable); *Southeastern Michigan Gas Co. v. F.E.R.C*., 133 F.3d 34, 39-40 (D.C. Cir. 1998) (same).

> Congress adopted 3622(e) for the primary and almost exclusive purpose of ensuring that single-piece First-Class Mail would be protected against de-linking. . . . This requires that there be an appropriate benchmark which is bulk metered mail. . . . Congress in 3622(e) . . . was basically codifying the jurisprudence of this Commission.

RM2009-3 Public Forum (August 11, 2009), Tr. 18 and 24 (comments of Mr. Anderson); *see generally* GCA Comments (Aug. 31, 2009) (interpreting Section 3622(e)).

APWU and GCA read far more into § 3622(e) than the section warrants. The single-piece mailers and their political allies indeed sought to include a provision in PAEA that would have strictly limited the price differential between Single-Piece and Presort First-Class Mail to 100 percent of cost avoidances narrowly defined. But this language was vigorously opposed by business mailers. The compromise that emerged from this legislative tug-of-war imposes only loose constraints on the Postal Service's pricing flexibility—and subjects those constraints to broad exceptions.

a. Section 3622(e) applies to only a subset of the price differentials between Presort and Single-Piece First-Class Mail.

39 U.S.C. § 3622(e) by its terms constrains price differentials for only a limited range of worksharing activities: "presorting, prebarcoding, handling [and] transportation." But it is undisputed that the cost differences between Single-Piece and Presort First-Class Mail result from a far broader range of cost-saving activities by presort mailers. *See* Testimony of NAPM witnesses Bell *et al*. at 10-13. Price differentials that correspond with cost differences arising from mailer

activities other than the four enumerated in Section 3622(e) are beyond its scope.

b. Section 3622(e) does not apply to price differentials between separate products.

39 U.S.C. § 3622(e) does not apply to the price relationships between Single-Piece And Presort First-Class Mail because they are clearly separate products, offered to distinct product markets. In Docket No. RM2007-1, the Postal Service proposed, and the Commission approved, a mail classification schedule ("MCS") that defined Presort and Single-Piece First-Class Mail as separate products. *See* Docket No. RM2007-1, *Regulations Establishing A System of Ratemaking*, Order No. 43 (Oct. 29, 2007) at ¶¶ 4013-4018. The Commission specifically found that treatment of Presort and Single-Piece 1C mail as separate products was reasonable. In rejecting APWU's position, the Commission stated:

> The Postal Service has the flexibility to initially describe its product lines in conformance with the statutory requirements of the PAEA. . . . It is possible to apply this definition and categorize First-Class Mail postal services into products in several different ways. *The selections made by the Postal Service* comply with the definition, and *represent postal services with distinct cost or market characteristics*. The product lines are subject to adjustments in the future as conditions change. *The Commission finds that the Postal Service has appropriately described product lines applicable to First-Class Mail.*

Docket No. RM2007-1, Order No. 43 at ¶ 4017 (emphasis added).

The judgments of the Postal Service and the Commission on this issue were clearly correct. PAEA defines a product as "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be,

applied." 39 U.S.C. § 102(6). Single-Piece and Presort mail differ in *both* characteristics. First, Single-Piece and Presort clearly differ in their costs—and in respects that go beyond the four examples of worksharing enumerated in § 3622(e). *See* pp. 27-34, *infra*; Testimony of NAPM witnesses Bell *et al.* at 16-17. Second, Single-Piece and Presort First-Class Mail clearly differ in their market characteristics, and, for most First-Class volume, are not close substitutes. *See* p. 24, *supra*; Testimony of NAPM witnesses Bell *et al.* at 6-7.[7]

Even Single-Piece mailers have admitted this fact. As the Greeting Card Association acknowledged in Docket No. ACR2007:

> [O]n a broad level, the nature of the communication and its purposes differ between bulk and single piece letters/ postcards, with the former generally used for business applications involving groups such as customers and the latter generally used for individual correspondence or transactions. Thus, from both a cost and a market perspective, bulk letters and postcards are a much different product than are Single-Piece letters and postcards.

Docket No. ACR2007, *Annual Compliance Report*, Reply Comments of GCA (Feb. 13, 2008) at 4 (quoting with approval PRC Docket No. RM2007-1, USPS Submission of Initial Mail Classification Schedule In Response to Order No. 26 (Sept. 24, 2007) at 12).

[7] *See also* Comments of Robert W. Mitchell (Aug. 24, 2009) at 4 n. 6 (calculating from Postal Service cross-price elasticity data for the Presort and Single-Piece categories of First-Class Mail that a 10 percent increase in the "discount" would cause the volume of Single-Piece mail to decline by only 0.57 percent).

The bifurcation of Single-Piece and Presort First-Class into separate products properly bars a challenge to price differences between the two products under Section 3622(e). *First*, limiting the application of Section 3622(e) to intra-product price differences has an obvious economic logic. When two different kinds of mail differ in their costs, market characteristics, and demand—especially if cross-elasticities of demand between the two kinds of mail are limited—optimal pricing requires consideration of own-price elasticity effects, not just cross-elasticity effects. If the own-price elasticities and marginal costs of the two products differ significantly, the price differentials that maximize the Postal Service's efficiency—and minimize its losses—may very well exceed the differences in attributable costs.[8]

Second, limiting the application of Section 3622(e) to intra-product price differences is supported by the structure of PAEA. The primary mechanism established by Congress for enforcing compliance with Section 3622(e) is the Commission's review of the Postal Service's annual compliance report under 39 U.S.C. §§ 3652 and 3653. Section 3652(b), however, clearly limits the required information about "workshare discounts" to price differentials *within* "each market-dominant product." As the Postal Service has correctly noted, the language of 39 U.S.C. § 3652(b),

[8] *See* pp. 23-26, *infra*; MC95-1 Op. & Rec. Decis. ¶ 4256; J. Panzar, "Reconciling Competition, Downstream Access, and Universal Service in Postal Markets," in M. Crew and P. Kleindorfer, eds., *Postal and Delivery Services: Delivering on Competition* 100 (2002).

> which directs the Postal Service to provide the specified workshare data "*with respect to each market-dominant product* for which a workshare discount was in effect," suggests that the proper analysis is to measure worksharing differences on an intraproduct, rather than inter-product, basis. This is buttressed by the fact that section 3652 generally requires the reporting of data by product.

USPS FY 2008 Annual Compliance Report (December 29, 2008) at 50-51.

GCA offers a parade of counterarguments in its comments filed on August 31, 2009. First, GCA argues that the product boundary is irrelevant because § 3622(e) "nowhere refers to 'products'." GCA Comments at 4. But Sections 3622(e)(2)(D) and (3)(A) explicitly allow price differentials to exceed cost avoidances when reducing the differentials would impair efficiency or reduce the Postal Service's aggregate contribution to institutional costs. These circumstances are particularly likely to arise where (as here) the price differentials occur between distinct products, and the two products have different cost characteristics and own-price demand elasticities, and are not treated by most mailers as close substitutes. In this separate-product context, slavish limitation of price differentials to cost "avoidances" between the two products is particularly likely to lead to inefficiency, loss of institutional cost contribution, or both. A construction of § 3622(e) that limits its application to intra-product price differences thus springs directly from the express language and purposes of §§ 3622(e)(2)(D) and 3622(e)(3)(A).

Second, GCA contends that failure to apply § 3622(e) to cross-product price differences would allow the Postal Service to read § 3622(e) "out of the statute" by defining each worksharing category as a separate product. GCA Comments (Aug. 31, 2009) at 8-9. But this *reducto ad absurdum* is illusory. The

creation of a new product requires Commission approval under 39 U.S.C. § 3642. An attempt by the Postal Service to circumvent §§ 3622(e) and 3642 by embarking on a scheme of "unlimited product segmentation" (GCA Comments at 8) almost certainly would warrant Commission rejection, since it is doubtful that adjacent worksharing rate categories would have sufficiently "distinct cost or market characteristic[s] for which . . . rate or rates are, or may reasonably be, applied." 39 U.S.C. § 102(6).[9]

Finally, GCA argues that no inference may be drawn about § 3622(e) from the failure of 39 U.S.C. § 3652 to impose any reporting obligations for worksharing price relationships that cross product boundaries; drawing such an inference would be "illogical" and "backwards." GCA Comments (August 31, 2009) at 3, 6-8. GCA is mistaken. "It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Owasso Indep. Sch. Dist. No. I-011 v. Falvo*, 534 U.S. 426, 434 (2002) (quoting *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989)); *accord*, *United States Nat'l Bank v. Independent Ins. Agents of Am.*, 508 U.S. 439, 455 (1993) (citations omitted) ("in expounding a statute, we must not be guided by a single sentence or member of

[9] In this regard, the Commission has held repeatedly that worksharing cost avoidances, as traditionally defined, do not by themselves constitute "distinct costs" for purposes of creating a separate subclass. *See Newsweek, Inc. v. USPS*, 663 F.2d 1186, 1210 (2nd Cir. 1981); R84-1 Op. & Rec. Decis. ¶¶ 5090-5106; R87-1 Op. & Rec. Decis. ¶ 5144; MC95-1 Op. & Rec. Decis.¶¶ 3022-25, 5030-34. This logic applies with equal force to the analysis of cost differences between two putative products under 39 U.S.C. § 102(6).

a sentence, but look to the provisions of the whole law, and to its object and policy."). Hence, the absence of a reporting requirement in § 3652 for "worksharing" price differentials across product lines indeed supports the inference that Congress did not intend to establish a cross-product pricing constraint in § 3622(e).

c. The price differentials between Single-Piece and Presort Mail fall within two of the exceptions established by 39 U.S.C. §§ 3622(e).

In any event, the price spread between Single-Piece and Presort First-Class Mail clearly falls within two exceptions established by 39 U.S.C. § 3622(e) itself. *First*, reducing the price spread between Presort and Single-Piece mail would impede the efficient operation of the Postal Service within the meaning of § 3622(e)(2)(D)). As explained in more detail below (at pp. 26-34), the relinking of Presort and Single-Piece prices would worsen both allocative and productive efficiency.

Second, given the differences in demand elasticities and costs between Single-Piece and Presort First-Class Mail, further narrowing the price spread between the two products would reduce the aggregate contribution to Postal Service institutional costs from the "category or subclass subject to the discount"—i.e., First-Class letter mail. 39 U.S.C. § 3622(e)(3)(A); *see* pp. 23-26, below (contribution analysis).

C. None Of The Other Sections of Title 39 Support Relinking.

1. The goal of "binding the nation together" (39 U.S.C. § 101(a))

APWU has asserted on a number of occasions, most recently during the August 11 public forum at the Commission, that the traditional rate preference for Single-Piece First-Class Mail is warranted (or at least supported) by the "binding of the nation together requirement" of 39 U.S.C. § 101(a). RM2009-3 Public Forum (August 11, 2009), Tr. 23:4-9 (statement of Mr. Anderson). Here again, APWU overreaches.

The relevant sentence of Section 101(a) reads: "The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people." The obligation to "bind the Nation together" thus extends to all mailers, and all major classes and subclasses of mail—not just the users of Single-Piece First-Class Mail. Moreover, the focus of this provision is not limited to prices, but extends to *all* dimensions of universal service, including its geographic scope, product range, access, delivery and service quality as well as price. Docket No. PI2008-3, *Report on Universal Postal Service and the Postal Monopoly* (December 19, 2008), at 18. In this regard, § 101(a) must be read in tandem with § 101(d), which provides that postal rates "shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis."

Furthermore, as the Commission has recognized, Section 101(a) and the other statutory provisions that together establish a uniform service obligation do not impose "rigid, numerical standards" on the Postal Service:

> The USO is not specific. The Postal Service is to achieve the best possible balance of these service features consistent with efficient and economic practices. Congress has rarely established rigid, numerical standards of minimally acceptable service for each of these features. Rather, throughout its history, the Postal Service has been expected to use its flexibility to meet the needs and expectations of the Nation while balancing the delivery of service against budgetary constraints.

Docket No. PI2008-3, *Report on Universal Postal Service and the Postal Monopoly* (December 19, 2008), at 3.

Finally, as "history has demonstrated, what is necessary to bind the Nation together changes over time." *Id*. at 25. At a time when the telephone and the Internet have made deepening inroads into First-Class Mail as an instrument for binding the Nation together, the notion that Section 101(c) reflects an implicit legislative command to perpetuate the traditional rate preference for Single-Piece Mail is unsupportable.

2. The obligation to offer a "uniform" rate for at least one class of letter mail (39 U.S.C. § 404(c))

Equally without merit is APWU's perennial claim that delinking violates the Postal Service's obligation to "maintain one or more classes of mail for the transmission of letters sealed against inspection" with a "rate" that "shall be uniform throughout the United States" (39 U.S.C. § 404(c)). *Cf*. Initial Presentation of APWU (May 26, 2009) at 3-4; APWU R2006-1 Br. 8, 12-15.

APWU is correct that Section 404(c) recodifies former 39 U.S.C. § 3623(d) without substantial change. In every other respect, however, APWU's analysis of the statute is mistaken.

The uniformity required by that provision is *geographic*: "rates for letters sealed against inspection" must "be available on the same terms *nationwide*." PRC MC76-1 Op. (July 15, 1977) at 6 (emphasis added). Nothing in the Act forbids nonuniformity among First-Class rates with respect to *any other* physical or cost characteristic of the mail. As the Commission noted in MC76-1:

> No one can seriously contend that Congress intended the uniformity clause of section 3623(d) to end all rate distinctions applicable for first-class mail or to prohibit new distinctions from being used when appropriate under section 3622. Our construction gives effect to the plain meaning of the language of section 3623(d) by maintaining the requirement that rates be uniform throughout the nation.

Id. at 7-8.[10]

The Commission has included discounts for worksharing and other cost drivers in the First-Class rate structure for more than two decades. In MC73-1, for example, these forms of rate deaveraging included "both a new first-class rate differential based on mailer preparation, and prospective surcharges for first-class mail with difficult to process shapes." PRC Op. MC76-1, *supra*, at 7.

[10] Even with respect to geographic uniformity, the Commission has long held that the uniformity requirement allows geographic rate deaveraging of First-Class Mail as long as the deaveraged rates (e.g., "local" rates) are "available on the same terms nationwide." PRC MC76-1 Op., *supra*, at 7.

These forms of rate deaveraging have proliferated since then, and have become an integral part of the First-Class price structure. If APWU's cramped reading of Section 404(c) were correct, all of these forms of price nonuniformity would have to be eliminated.

III. RELINKING SINGLE-PIECE AND PRESORT PRICES WOULD HARM THE PUBLIC INTEREST.

A. The Traditional Rate Preference For Single-Piece Mail Is A Luxury That The Postal Service Can No Longer Afford.

The existing rate preference for Single-Piece First-Class Mail already deprives the Postal Service of several hundred million dollars of contribution each year. Relinking would make matters worse. At a time when the Postal Service is essentially insolvent, this costly form of political ratemaking has become an unaffordable luxury.

The own-price elasticities of Single-Piece and Presort mail are similar, yet Single-Piece pays a much smaller markup over attributable costs. The demand elasticities for the two products are similar: -0.218 for Single Piece letters and -0.250 for Presort letters. *See* USPS, Econometric Demand Equation Tables for Market Dominant Products as of November 2008 (submitted to PRC on Jan. 16, 2009). Presort First-Class Mail, however, pays a much higher average contribution per piece. In FY 2007, the average Presort letter paid approximately 3.4 cents more in contribution per piece under the rates set in R2006-1 than did the average Single-Piece letter. FY 2007 CRA (PRC version) at 2. For FY 2008, the PRC found that the average contribution of presorted First-Class Mail to

Postal Service institutional costs was almost *five cents per piece* greater than the average contribution from Single-Piece mail. *Fiscal Year 2008 Annual Compliance Determination*, *supra*, at 48.

Presort First-Class Mail also has a much higher coverage ratio. In FY 2007, the cost coverages of the two kinds of First-Class Mail were 279 percent and 157 percent, respectively. FY 2007 CRA (PRC version) at 2. Similarly, in FY 2008, the Commission found that the average coverage ratio of Single-Piece First-Class letter mail was 167.1 percent, compared with a coverage ratio of 298.1 percent for Presort First-Class letter mail. USPS FY 2008 Annual Compliance Report (Dec. 29, 2008) at 18, Table 1, "cost coverage" column.

The preferential treatment given to Single-Piece First-Class Mail can also be stated in terms of percentage markup over attributable costs. In FY 2007, the percentage markups over attributable costs were 179 percent and 57 percent, respectively, for the Presort and Single-Piece products. FY 2007 CRA (PRC version) at 2. Similarly, in FY 2008, the Commission found that the average percentage *markup* of Single-Piece First-Class letter mail over attributable costs was 67.1 percent, only about *one-third* the corresponding percentage markup over attributable costs generated by Presort First-Class letter mail (198.1 percent). USPS FY 2008 Annual Compliance Report (Dec. 29, 2008) at 18, Table 1, "cost coverage" column (the percentage markup is the cost coverage minus 100 percent).[11]

[11] These figures actually understate the full value of the rate preference. The availability of the Forever, which enables consumers to postpone the effect of

(footnote continued)

Given these facts, the Postal Service almost certainly could improve its financial position by reducing Presort First-Class prices (or increasing them more slowly than the CPI) and using the resulting headroom under the overall CPI cap for First-Class Mail to raise Single-Piece prices. Conversely, increasing prices on the more price-elastic product, Presort First-Class Mail, while offsetting reductions in prices on the more price-inelastic product, Single-Piece mail, would reduce the net contribution from First-Class Mail as a whole. These conclusions are corollaries of the standard economic formula for maximizing the overall profit of a multi-product firm, with or without an overall regulatory constraint on profits.[12]

The comments filed *pro se* by Robert W. Mitchell on August 24, and the comments filed today by the Direct Marketing Association, demonstrate that the current rate preference for Single-Piece First-Class Mail costs the Postal Service several hundred million dollars in potential contribution to institutional costs each year. Mr. Mitchell estimates that moving Single-Piece and Presort First-Class prices to their profit-maximizing levels in light of available data on own-price and cross-price elasticities would increase the Postal Service's net contribution by only $1.6 million. DMA's comments, however, demonstrate that correcting two errors in Mr. Mitchell's analysis—most notably, his unwarranted assumption that

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forthcoming increase in the Single-Piece price by stocking up on stamps before the increase takes effect, further reduces the present value of the Single-Piece postage that most consumers must pay.

[12] *See* William J. Baumol and David Bradford, "Optimal Departures From Marginal Cost Pricing," 60 *Amer. Econ. Rev.* 265-283 (June 1970); Jean-Jacques Laffont and Jean Tirole, *A Theory of Incentives in Procurement and Regulation* 30-31 (1993).

the shifts in the volumes of Single-Piece and Presort mail induced by changes in the workshare discount are exactly equal and offsetting—reveals that the maximum gain in contribution from profit-maximizing prices for First-Class Mail is approximately $373 million.

We emphasize that we are not asking the Commission to undertake in this docket a further widening of the price spread between Single-Piece and Presort products. Forcing the Postal Service to *narrow* the current price differential, however, would clearly be a step in the wrong direction. Now, when the Postal Service is on the brink of financial default, is not the time to cut the Postal Service's earnings further by reimposing a regulatory pricing constraint that PAEA does not require.

B. Restoring The Pre-PAEA Rate Linkage Between Presort Mail And Bulk Metered Mail Would Violate The Efficient Component Pricing Rule.

Prior to the enactment of PAEA, the Commission, and the interest groups that supported continued rate preferences for Single-Piece First-Class Mail, often argued that the traditional version of linking (i.e., limiting the average price spread between Single-Piece and Presort Mail to the cost differences between Bulk Metered Mail ("BMM"), a hypothetical low-cost form of Single-Piece Mail, and Presort Mail) was required by the Efficient Component Pricing Rule ("ECPR"). MC95-1 Op. & Rec. Decis. ¶ 4259 *et seq*.; R2006-1 Op. & Rec. Decis. ¶¶ 5091-5109. This claim, however, rests on a simplistic form of the ECPR whose assumptions do not fit First-Class Mail. Generalizing the ECPR to reflect

the actual cost characteristics of First-Class Mail demonstrates that the price spread between Single-Piece and Presort mail should be wider, not narrower.

The ECPR is a rule for achieving lowest combined costs through the pricing of individual components of vertically integrated goods or services offered by a regulated monopolist. The rule requires that a vertically integrated firm offer potentially competitive components at the marginal cost of supplying those components. Applied to the Postal Service, ECPR requires that the discounts offered to mailers for private sector activity that reduces Postal Service costs should be set equal to the per unit avoided costs of the Postal Service. Prices that satisfy this standard induce mailers to engage in such private sector activity if (and only if) the savings to the Postal Service exceed the added costs to society of the additional private sector activity. *See* PRC Op. & Rec. Decis. MC95-1 ¶ 4256; R2006-1 Op. & Rec. Decis. (Feb. 26, 2007) ¶¶ 4001-4038.

If Single-Piece First-Class Mail were homogeneous, the choice of a cost benchmark would be unimportant, for any benchmark could produce ECPR-compliant rate differentials. Regardless of the starting point on the presort ladder, subtracting the cost savings produced by the specified level of presorting should arrive at the same price for the latter presort category. The choice of a price benchmark would also be immaterial if the First-Class price structure fully recognized all of the various non-presort cost drivers that cause the costs of Single-Piece First-Class Mail to vary. As long as estimates of presorted-related cost avoidances were controlled fully for all of the non-presort characteristics, the

results should be the same regardless of the presort category used as the benchmark.

Unfortunately, however, neither of these conditions holds. First-Class Mail service is "heterogeneous"—i.e., its costs vary with multiple dimensions of quality other than the amount of mail sorting performed by the Postal Service. Many of these non-presort quality attributes are recognized only partially, if at all, in individual rate elements. For example:

- First-Class prices include neither destination-entry discounts nor distance based rate zones, and thus do not recognize the cost effects of the distance between the entry point and the addressee.
- Rates for Single-Piece mail are unaffected by whether the mail is trayed and faced before entry, or just stuffed into cardboard boxes or other unsuitable containers, with stuck-together envelopes.
- Rates for Single-Piece mail are unaffected by the legibility of the address (which may range from fully machinable to handwritten and virtually eligible).
- Until recently, the First-Class price structure offered little recognition of the cost effects of the shape of the mailpiece (letter, flat, or parcel). Although the USPS has given increased rate recognition to shape as a cost driver in recent years, the recognition is far from complete; the passthroughs of shape-related costs are still below 100 percent.
- The unit cost of First-Class Mail is also affected by the number of pieces in a mailing, and the total volume of all mail pieces entered by a

given mailer in a year. Greater mail volumes reduce the *unit* transaction costs of mail acceptance and enforcement of mail design and address quality requirements.

- The First-Class price structure recognizes none of the unit cost differences caused by the sales channel (e.g., retail window or CAPS account) or postage evidencing methods (postage stamps vs. meters vs. permit indicia) used by the mailer.
- Mail addressing requirements allow wide variations in the correctness, completeness, and legibility of addresses for Single-Piece Mail.

Testimony of NAPM witnesses Bell *et al*. at 16-17.

The lack of price elements for many individual cost drivers might be of little concern if the overall cost effects of these quality characteristics were distributed evenly between the Single-Piece and Presort categories of First-Class Mail. In fact, the non-presort characteristics are *not* evenly distributed. Compared with Single-Piece Mail, the average piece of First-Class Presort Mail is less costly in multiple respects, and has significantly lower unit costs than Single-Piece Mail *even after* cost differences recognized by the Commission as presort cost avoidances are netted out. Testimony of NAPM witnesses Bell *et al*. at 16-17

Because the costs of Single-Piece mail vary widely, maximizing incentives for productive efficiency requires the Commission to set presort rate differentials equal to the unit cost differences between Presort Mail and the *marginal* piece of Single-Piece mail. John C. Panzar, “Efficient Worksharing Discounts With Mail

Heterogeneity," in M.A. Crew and P.R. Kleindorfer, eds., *Liberalization of the Postal and Delivery Sector* 121-134 (2006). Using the typical, median or average piece of Single-Piece mail as the benchmark produces incorrect results. *Id*. And using a *low-cost* subset of Single-Piece mail produces results that depart even further from ECPR. *Id*.

The foregoing analysis should make clear that bulk metered mail ("BMM") can no longer be considered an appropriate rate benchmark. BMM is a fictional category of low cost Single-Piece First-Class Mail loosely defined as bulk mailings of letters that are "machinable, homogeneous, non-barcode pieces with machine printed addresses that are properly faced and entered in trays." Kobe Direct (APWU-T-1) at 15 (quoting R2005-1 Tr. 4/952 (Abdirahman)). BMM is best described as a result—lower costs—in search of supporting facts. It has no precise definition,[13] and even its proponents are unsure of how much mail with the characteristics of BMM actually exists.[14]

The record provides no evidence that the marginal Single-Piece mailpiece is remotely akin to BMM; that mail converted from BMM represents more than a

[13] *See* R2006-1 Tr. 20/7078 (APWU witness Kobe) (defining BMM as mail tending to be "at the cleaner end of the continuum," and defining "clean mail" as "mail which, for a variety of reasons, is cheaper than average to process . . . there is no precise definition of this term").

[14] "To my knowledge the Postal Service does not provide volumes of BMM letters nor am I aware of any source of data that provides the conversion information that you seek." R2006-1 Tr. 20/7093 (Kobe); *id*. at 7093 (there are no data showing how much BMM is expected to convert to presort First-Class Mail in TY 2008); *id.* at 7199 ("I haven't personally seen it [BMM], but I know it exists.").

tiny share of the *existing* presort mailstream; or that any significant amount of Presort mail would revert to BMM if presort discounts were reduced. To the contrary, the testimony of several experienced presort bureau operators submitted today by NAPM makes clear that the marginal piece of Single-Piece mail currently sought and obtained by presort bureaus has costs characteristics akin to collection mail, which is much costlier that BMM. Testimony of NAPM witnesses Bell *et al*. at 9-15. There are several reasons why this is so:

- Most customers do not know what sizes of envelopes are acceptable for automation mail. *Id*. at 10.
- Most customers do not know what type faces and color of envelope stock can be read by optical character readers. *Id*. at 10.
- Many pieces tendered to presort bureaus have handwritten addresses, not pristine typed or computer-generated addresses like those on BMM. *Id*. at 10; *accord*, R2006-1 Tr. 38/12947 (Bell); *id*. at 12990-91 (noting that hospitals tend to generate significant volumes of hand-addressed mail from doctors).
- Most mailers do not know what a barcode clear zone is, and would have no reason to provide one. Testimony of NAPM witnesses Bell *et al*. at 10.
- Most do not know what Move Update is. Without the involvement of a presort bureau, these mailers would have no reason to comply with Move Update requirements, especially for Single-Piece First-Class Mail, which the USPS forwards free of additional charge. *Id*. at 10.

- Most mailers do not understand “loop mail” (mail that is designed in a way that causes the optical character reader—whether owned by the Postal Service or a presort bureau—to read the return address and send the mailpiece back to the sender) or how to avoid it. *Id*. at 10.
- A significant number of mailpieces deposited by employees in workplace collection boxes arrive at presort bureaus in envelopes that are unsealed or stuck together. Mailpieces stuck together must be separated by hand before they can be fed into mail sorting equipment. *Id*. at 11.
- Most new mailers do not know how to properly use tabs and wafer seals. *Id*. at 11.
- Without presort discounts, most Single-Piece mailers would lack access to a timely and adequate supply of trays, would have no incentive to seek such trays, and would have no incentive to orient and sequence their mail properly in the trays. *Id*. at 11-13.
- Furthermore, Single-Piece mailers that somehow managed to prepare large quantities of BMM would have difficulty entering it in the Postal Service network. Because BMM is Single-Piece mail, bulk mail entry units would not accept it, and it would need to be entered at a *retail* mail entry facility, which typically would not be organized to accept bulk mailings efficiently. *Id*. at 13.
- Finally, bulk mailings of clean First-Class Mail that still remain in the single piece mailstream are likely to be resistant to conversion.

> Government-originated mail is a good example, as Mr. Abdirahman acknowledged during cross-examination in R2006-1 by MMA counsel. R2006-1 Tr. 35/12013 (Abdirahman).

Postal observers with limited experience in actual presort mail operations have sometimes claimed, based on a few visits to Postal Service mail processing facilities, to have seen large volumes of BMM waiting to be processed. These reports are mistaken. What the inexperienced observer sees as BMM almost certainly is single-piece mail that the Postal Service requires presort mailers to entered faced and in trays as a condition to entering mail at presort rates. Testimony of NAPM witnesses Bell *et al*. at 13; *accord*, R2006-1 Tr. 16/4938-39 (USPS witness Taufique).

In Docket No. R2006-1, the Commission found that BMM is the best proxy for the marginal piece of mail because BMM "represents not only that mail most likely to convert to worksharing, but also, to what category current worksharing mail would be most likely to revert if the discounts no longer outweigh the cost of performing the worksharing activities." R2006-1 Op. & Rec. Decis. ¶ 5109 (quoting R200-1 Op. & Rec. Decis. § 5089). This finding was contrary to the credible evidence the record, and should be given no precedential weight in this proceeding. In finding that BMM was the mail at the margin of conversion or reversion, the Commission brushed off, with virtually no discussion or analysis, the substantial evidence from both a presort bureau operator and a Postal Service witness that the typical Single-Piece mail at the margin of conversion is collection mail, not BMM; that most mailers lack the know-how, trays, or access

to USPS facilities needed to enter large volumes of BMM; and that most or all of the mail in the postal network that looks like BMM is in fact mail that has been processed by a presort bureau or an upstream USPS facility. *Compare* R2006-1 Op. & Rec. Decis. ¶ 5109; R2006-1 Brief of NAPM and NPPC (Dec. 29, 2006) at 12-21 (citing record); R2006-1 Reply Brief of NAPM and NPPC (Jan. 4, 2007) at 4-6 (citing record).

The Commission's failure to give thorough attention of the record on the BMM issue in R2006-1 was perhaps understandable, given the large number of other issues that the Commission had to resolve within a statutory deadline in the same docket. In this docket, however, the Commission has the time to consider the issue more closely, and we respectfully ask the Commission to do so.

C. Rate Rebalancing Between Single-Piece And Presort Mail Would Have A Minimal Effect On The Budget Of The Average Household.

The traditional rate preference for Single-Piece First-Class Mail clearly owes its durability to a longstanding desire to shield the average consumer from disproportionate postage increases. The long-term decline in mail usage by households, however, has reduced this concern to insignificance. The average household sent only 3.4 pieces of First-Class Mail (other than parcels) per week in 2008. 2008 Household Diary Study at 9, table 1.6. Reducing the price of Single-Piece First-Class Mail clearly would not have a significant effect on the budget of the average household. And consumers who are atypically sensitive to future increases in the price of Single-Piece mail can hedge against the increases by stocking up on Forever stamps.

Moreover, any savings enjoyed by households would be largely if not entirely offset by increases in the cost of Presort First-Class Mail. The average household receives 9.4 pieces of First-Class Mail per week, approximately three times the volume sent. *Id*. The difference appears to consist largely of business-to-household mail, which consists disproportionately of bills, statements and other presorted First-Class Mail. *See id*. at 24, 27. Firms operating in competitive markets shift a large portion of the incidence of postage costs to consumers through higher prices or lower returning investment accounts.[15] And the shifting of the incidence of postage costs further offsets any savings to households from reduced Single-Piece prices.

Finally, consumers are unlikely to benefit from regulatory action that hastens the Postal Service's descent into insolvency. As noted above, restoring the linkage between Single-Piece and Presort prices is likely to worsen the Postal Service's financial straits. This is no longer just a theoretical possibility: the dramatic fall in First-Class Mail volume during the current recession has demolished the notion that First-Class Mail volume is insensitive to economic conditions. Even with the current price structure, the overall volume of Presort First-Class letters and cards fell by 8.7 percent in the second quarter of Fiscal Year 2009 vs. the second quarter of the previous year. USPS Preliminary

[15] Changes to the costs of inputs used by firms in competitive industries tend to be passed on to consumers, often quickly. *See* George J. Stigler, *The Theory of Price* 183-184 (3rd ed. 1966) ("The Quicksilver Character of Competitive Industries"); Paul A. Samuelson and William D. Nordhaus, *Economics* 74-75 (14th ed. 1992).

Revenue, Pieces and Weight Report (April 2009) at 1. While the volume of Single-Piece First-Class letters and cards fell as well, the effect of a rate rebalancing that favored Single-Piece mail—and thus increased Single-Piece volume while suppressing presorted volume—would not be contribution-neutral. The average contribution of Presort First-Class Mail to Postal Service institutional costs is almost *five cents per piece* greater than the average contribution from Single-Piece mail. *Fiscal Year 2008 Annual Compliance Determination*, *supra*, at 48. If the Postal Service runs out of cash, the consequences are likely to include disruption of mail service for the average consumer, layoffs for postal labor, higher taxes for the average taxpayer if relief for the Postal Service is funded with tax dollars, increased inflation and interest rates if the relief is funded by increased Treasury borrowing, or all of the above. None of these are consumer-friendly outcomes.

IV. DISCUSSION OF THE ALTERNATIVE FORMS OF "PROTECTION" ON WHICH THE COMMISSION SEEKS COMMENT

Order No. 243 also solicits comments on a variety of alternatives to relinking. *Id*. at 4. While the Commission's desire for a "third way" between pre-PAEA ratemaking norms and deregulation of maximum rate design within mail classes is understandable, the only alternative that is likely to survive judicial review is a balanced application of the general "just and reasonable" standard of 39 U.S.C. § 3622(b)(8), along with the other components of § 3622, on a case-by-case basis. We discuss each alternative standard in turn.

A. Linking Presort First-Class Prices to Single-Piece Mail Through A Cost Benchmark Other Than BMM.

Order No. 243 appears to solicit comments on whether the Single-Piece and Presort prices should be linked through a "suitable benchmark" *other than* BMM. *Id*. at 4. For the reasons explained above, the Commission should not restore a cost-based linkage between the two products using *any* cost benchmark. Even a cost benchmark such as collection mail would deprive the Postal Service of appropriate flexibility to adjust price relationships as warranted by relative demand elasticities of the two products, and by transaction cost-related constraints such as the integer rule.

If the Commission were to relink the two products, however, relinking with collection mail as the cost benchmark obviously would be a less destructive alternative than relinking to BMM. As explained above, the limited amount of substitution that occurs at the margin between the Presort and Single-Piece products appears to be collection mail. Such a benchmark would at least minimize the artificial price compression that results from the BMM benchmark. *See* pp. 26-34, *supra*.

B. Establishment Of Separate CPI-Based Price Caps On Single-Piece And Presort First-Class Mail.

Order No. 243 also solicits comment on whether the Commission should "protect" Single-Piece First-Class Mail by "[e]stablishing a separate class of Single-Piece First-Class Mail subject to its own rate cap." Order No. 243 at 4. PAEA does not authorize the Commission to impose this additional pricing restriction. 39 U.S.C. § 3622(d)(2)(A) states that, with certain exceptions not

applicable here, the CPI-based rate cap "shall apply to a class of mail, *as defined in* the Domestic Mail Classification Schedule as *in effect on the date of enactment of the Postal Accountability and Enhancement Act*." (Emphasis added). On the date of enactment of PAEA, Single-Piece and Presort letter mail were part of the same rate class. (Indeed, they still are today.) Hence, the plain language of Section 3622(d) forbids the Commission from increasing the rigor of the CPI-based price gap by applying it independently to subsets of the mail classes that existed when PAEA was enacted.

This restriction on the Commission's authority was clearly not inadvertent. The legislative history of the bills that culminated in PAEA reflects years of debate and deliberation over the breadth of the baskets of products to which the index cap should apply. In S. 2468, the postal reform bill passed by the Senate Homeland Security and Governmental Affairs Committee in the 108th Congress, the choice of groupings for application of the index was to be left to the Commission. The committee noted:

> The Committee expects that the Postal Regulatory Commission, in public proceedings and with the input of all interest parties, will fully and carefully evaluate the merits of a wide range of rate cap structures. This consideration should include, but should not be limited to . . . the definition of the product groupings to which the caps will be applied.

S. Rep. No. 318, 108th Cong., 2d. Sess. 10 (Aug. 25, 2004).

The predecessor of PAEA passed by the same Committee in the 109th Congress, however, abandoned this open-ended approach by specifying directly that the price index must be applied at the class level:

> The annual limitation under paragraph (1)(A) shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.

S. 662, 109th Cong., 1st Sess. (reported June 22, 2005), § 201(a) (proposed 39 U.S.C. § 3622(d)(2)(A)).

The predecessor of PAEA passed by the House of Representatives would have disaggregated the relevant product baskets in a manner similar to that now proposed by the Commission—i.e., by applying the index separately to each *subclass*:

> In the administration of this section, the Commission shall not permit the average rate in any *subclass* of mail to increase at an annual rate greater than the comparable increase in the Consumer Price index, unless it has, after notice and opportunity for a public hearing and comment, determined that such increase is reasonable and equitable and necessary to obtain the Postal Service, under best practices of honest, efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

H.R. 22 (reported by the House Committee on Government Reform on April 28, 2005) at § 201(a) (proposing language to be codified at 39 U.S.C. § 3622(e)) (emphasis added). "To ensure fairness," the Committee explained, "the new system provides that rates from any one subclass should not increase faster than CPI." H. R. Rep. No. 66, 109th Cong., 1st Sess. 48 (April 28, 2005).

This version did not prevail, however. The version of the legislation ultimately enacted as 39 U.S.C. § 3622(d)(2)(A) resolved the conflict between the

Senate and House bills by defining the relevant baskets as classes, not subclasses.

C. Limiting The Difference Between Single-Piece And Presort First-Class Mail In Terms Of Average Revenue Per Piece.

Order No. 243 also request comments on the alternative of "limit[ing] the difference allowed between single-piece and presorted First-Class Mail in terms of . . . average revenue per piece . . ." *Id.* at 4. A limitation of this kind is unlikely to withstand judicial review. The two kinds of First-Class Mail are different products, with different costs, different uses and different demand. There is simply no way that an arbitrary cap on the difference in the average revenue per piece of the two products could reflect in a principled and reasoned way the complex (and, in all likelihood, continually changing) cost and demand factors that the Postal Service must consider in setting prices for the two products.

A series of decisions of the Interstate Commerce Commission from 1979-80 are closely on point. Recognizing that variations in competition and demand required that railroads be permitted to set some rates on market-dominant services above fully distributed costs ("fully allocated costs" in railroad parlance) in order to recover total fixed and common costs (roughly equivalent to postal institutional costs) for the system as a whole, the ICC prescribed a "just and reasonable" maximum rate ceiling on individual rates equal to 107 percent of fully allocated costs.[16] The "seven percent solution," assailed by railroads and

[16] *Increased Rates on Coal, L&N R.R., October 31, 1978*, 362 I.C.C. 370 (1980); *Increased Rates on Coal, Colstrip and Kuehn, MT to Minnesota*, 362 I.C.C. 30

(footnote continued)

shippers alike as arbitrary, was overturned by every court that reviewed the standard.[17] *San Antonio, Texas v. United States*, 631 F.2d 831, 852 (D.C. Cir. 1980), explained the issue clearly. While recognizing that "differential pricing" (i.e., setting rates with varying coverage ratios)

> may be a legitimate criterion for the ICC to consider . . . the Commission still must provide adequate justification for its choice of a particular increment above fully allocated costs. In [its decision], however, the ICC did no more than make the general assertion that it could not find that the railroads had achieved revenue adequacy. There is nothing in the record in the way of findings, evidence, or rationale to support the seven percent solution or any percentage solution. The Commission's general allusion to the need to consider the revenue requirements of the carriers and the economics of differential pricing is so broad as to be meaningless as a standard this rationale could be put forth just as readily in an attempt to justify a 1%, 21%, 45%, or even a 99% additive.

An arbitrary regulatory ceiling in the difference between the two First-Class products in average revenue per piece would be vulnerable to the same fate.

(1979); *Unit Train Rates on Coal—Burlington Northern, Inc.*, 361 I.C.C. 655 (1979); *Arkansas Power & Light Co. v. Burlington Northern Inc.*, 361 I.C.C. 504 (1979); *Annual Volume Rates on Coal—Wyoming to Flint Creek, Arkansas*, 361 I.C.C. 533 (1979).

[17] *System Fuels, Inc. v. United States*, 642 F.2d 112 (5th Cir. 1981); *Union Pacific R.R. Co. v. United States*, 637 F.2d 764, 768-69 (10th Cir. 1981); *Iowa Public Service Co. v. ICC*, 643 F.2d 542 (8th Cir. 1981); *San Antonio, Texas v. United States*, 631 F.2d 831 (D.C. Cir. 1980).

D. Limiting The Difference Between Single-Piece And Presort First-Class Mail In Terms Of Percent Contribution To Institutional Costs.

The Commission has also invited comment on an alternative proposal to "limit the difference allowed between single-piece and presorted First-Class Mail in terms of . . . percent contribution to institutional costs" (Order No. 243 at 4). One is tempted to respond with Mohandas Gandhi's supposed answer when asked for his opinion of Western civilization: "It would be a good idea."

It would indeed be a good idea if the percentage contributions exacted from the two First-Class products were close enough that the possibility of a higher percentage contribution from Single-Piece Mail than from Presort Mail became plausible enough to worry about. But the traditional preference for Single-Piece mail has produced a rate structure in which a massively higher "percentage contribution to institutional costs" consistently has been borne by *Presort* mail. The politics of postal rates make remote the prospect that this relationship will invert in the foreseeable future. Hence, a constraint that limited the amount by which the percentage contribution of Single-Piece mail could exceed the percentage contribution of Single-Piece mail is unlikely to have any practical effect.

Moreover, a fixed percentage limit in the difference in the average percent contribution of the two products is likely to be overturned on the same grounds as a regulatory cap on the average difference in revenue per piece. Such a limit almost certainly would not—and could not—reflect in a principled and reasoned way the complex (and, in all likelihood, continually changing) cost and demand

factors that the Postal Service must consider in setting prices for the two products. Hence, the constraint would likely be found arbitrary and capricious.

E. The "Just And Reasonable" Standard Of 39 U.S.C. § 3622(b)(8).

Order No. 243 also invites comment on whether the Commission may protect single-piece mailers from excessive prices by "[r]elying on a qualitative or subjective standard of protection, such as the 'just and reasonable' standard of section 3622(b)(8)." The answer is yes. PAEA certainly authorizes the Commission to entertain complaints under 39 U.S.C. § 3662 alleging that prices for Single-Piece First-Class Mail—or any other kind of mail, including Presort First-Class Mail—exceed just and reasonable levels in light of the various objectives and factors of 39 U.S.C. § 3622(b) and (c). But claims of this kind must be resolved through the "judicious application" of the relevant factors and objectives as a whole. *Accord*, RM2009-3 Conference (August 11, 2009), Tr. 19 (statement of Mr. German). As discussed above, modern regulatory precedent holds that the "just and reasonable" standard, properly applied, supports a broad zone of maximum reasonableness. *See* pp. 11, *supra*.

For these reasons, Section 3622(b)(8) cannot be read as resurrecting the arbitrary and heavy-handed linkage schemes imposed under the Postal Reorganization Act, or authorizing the Commission to substitute other, equally arbitrary, alternatives that were repudiated decades ago by courts and regulators in other jurisdictions. Nothing in PAEA suggests that Congress intended Section 3622(b)(8) as a Jurassic Park for regulatory life forms of the pre-PAEA era.

CONCLUSION

For the foregoing reasons, the Commission should decline to relink Presort and Single-Piece First-Class prices. Instead, future claims that prices for individual categories of First-Class Mail exceed just and reasonable levels should be adjudicated on a case-by-case basis under the criteria discussed here.

Respectfully submitted,

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