

**ORAL ARGUMENT NOT YET SCHEDULED**  
**No. 10-1324**

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**IN THE**  
**UNITED STATES COURT OF APPEALS**  
**FOR THE DISTRICT OF COLUMBIA CIRCUIT**

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UNITED STATES POSTAL SERVICE,

Petitioner,

v.

POSTAL REGULATORY COMMISSION,

Respondent.

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**ON PETITION FOR REVIEW OF AN ORDER OF THE**  
**POSTAL REGULATORY COMMISSION**

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**BRIEF FOR INTERVENOR**  
**NATIONAL POSTAL POLICY COUNCIL, INC.**

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Dated: February 28, 2011

## **CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES**

### **(A) Parties and Amici**

All parties and intervenors appearing before this Court are listed in the Brief for Petitioner. This is a petition for review of an informal rulemaking proceeding before the Postal Regulatory Commission. Numerous entities filed comments below that did not seek to intervene in this proceeding.

### **(B) Rulings Under Review**

Reference to the ruling at issue appears in the Brief for Petitioner.

### **(C) Related Cases**

The order on review has not been before this Court or any other court.

## **CORPORATE DISCLOSURE STATEMENT**

Pursuant to Federal Rule of Appellate Procedure 26.1 and Circuit Rule 26.1, Intervenor National Postal Policy Council, Inc. (“NPPC”) respectfully submits the following corporate disclosure statement:

National Postal Policy Council is an incorporated association of First-Class Mailers, who collectively pay billions of dollars annually in postage. No publicly held corporation or publicly held company has a 10% or greater ownership interest in NPPC.

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## **GLOSSARY**

ACD	Annual Compliance Determination
ACR	Annual Compliance Review
FCM	First-Class Mail
MCS	Mail Classification Schedule
Order	Postal Regulatory Commission Order Adopting Analytical Principles Regarding Workshare Discount Methodology, Order No. 536, Consideration of Workshare Discount Rate Design, Docket No. RM2009-3 (Sept. 14, 2010)
PAEA	Postal Accountability and Enhancement Act of 2006
PRA	Postal Reorganization Act of 1970
PRC	Postal Regulatory Commission Postal Rate Commission (prior to 2006)
USPS	United States Postal Service

## STATUTES AND REGULATIONS

The Brief for Petitioner United States Postal Service (filed Feb. 11, 2011) (“Petr Br.”) contains 39 U.S.C. §3622. Additional statutory provisions relied upon in this brief are set forth here.

Title 39, United States Code

### **§ 102. Definitions**

As used in this title—

\* \* \*

(6) “product” means a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied;

\* \* \*

### **§ 3642. New products and transfers of products between the market-dominant and competitive categories of mail**

(a) In General.— Upon request of the Postal Service or users of the mails, or upon its own initiative, the Postal Regulatory Commission may change the list of market-dominant products under section 3621 and the list of competitive products under section 3631 by adding new products to the lists, removing products from the lists, or transferring products between the lists.

(b) Criteria.— All determinations by the Postal Regulatory Commission under subsection (a) shall be made in accordance with the following criteria:

(1) The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products. The competitive category of products shall consist of all other products.

(2) Exclusion of products covered by postal monopoly.— A product covered by the postal monopoly shall not be subject to transfer under this section

from the market-dominant category of mail. For purposes of the preceding sentence, the term “product covered by the postal monopoly” means any product the conveyance or transmission of which is reserved to the United States under section 1696 of title 18, subject to the same exception as set forth in the last sentence of section 409 (e)(1).

(3) Additional considerations.— In making any decision under this section, due regard shall be given to—

- (A) the availability and nature of enterprises in the private sector engaged in the delivery of the product involved;
- (B) the views of those who use the product involved on the appropriateness of the proposed action; and
- (C) the likely impact of the proposed action on small business concerns (within the meaning of section 3641 (h)).

## **§ 3652. Annual reports to the Commission**

**(a) Costs, Revenues, Rates, and Service.**— Except as provided in subsection (c), the Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex to the report as the Commission may require under subsection (e))—

**(1)** which shall analyze costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe, and in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title; and

**(2)** which shall, for each market-dominant product provided in such year, provide—

- (A) product information, including mail volumes; and
- (B) measures of the quality of service afforded by the Postal Service in connection with such product, including—
  - (i) the level of service (described in terms of speed of delivery and reliability) provided; and
  - (ii) the degree of customer satisfaction with the service provided.

The Inspector General shall regularly audit the data collection systems and procedures utilized in collecting information and preparing such report

(including any annex thereto and the information required under subsection (b)). The results of any such audit shall be submitted to the Postal Service and the Postal Regulatory Commission.

**(b) Information Relating to Workshare Discounts.**— The Postal Service shall include, in each report under subsection (a), the following information with respect to each market-dominant product for which a workshare discount was in effect during the period covered by such report:

- (1) The per-item cost avoided by the Postal Service by virtue of such discount.
- (2) The percentage of such per-item cost avoided that the per-item workshare discount represents.
- (3) The per-item contribution made to institutional costs.

\* \* \*

## **STATEMENT**

The National Postal Policy Council (“NPPC”) submits this brief as an intervenor-petitioner in support of the United States Postal Service.

NPPC is a trade association representing companies that use First-Class bulk mail and other mail products to deliver statements and other information to their customers. NPPC’s members’ mail is both typical of Presorted First-Class Mail and, collectively, comprises a significant portion of the total volume of the product.

NPPC intervened in this case because the Postal Regulatory Commission’s decision to require that rates for bulk Presorted First-Class Mail be derived from Single-Piece rates injures NPPC members that pay Presorted rates. NPPC members believe that, because of the PRC’s Order, the Postal Service will not be able to take market demand into account when pricing bulk Presorted letters as envisioned by the Postal Accountability and Enhancement Act of 2006, and the mechanics of the price cap system will force the Postal Service to charge higher rates for bulk Presorted mail than if the Order were reversed. NPPC members further believe that their mail, which is highly profitable to the Postal Service, is at risk of leaving the postal system for electronic alternatives, which would impair the financial viability of the Postal Service.

## **STATEMENT OF THE ISSUES**

The Statement of the Issues are presented in Brief for Petitioner United States Postal Service (filed Feb. 11, 2011). Petr Br. At 6-7.

## **STATEMENT OF FACTS**

### **I. The Origin of Discounts and Growth of Workshared Mail**

Until the mid-1970s, postal rates and products were generally limited to retail letters, advertising flyers, periodicals, and parcels. That changed on July 6, 1976 when the Postal Service and the Postal Rate Commission<sup>1</sup> created the first “workshare discounts” for First Class mail. Initial Comments of the United States Postal Service, Dkt. No. RM2009-3 (May 26, 2009) (JA 59).

Those initial discounts were created to induce bulk mailers to consider preparing their mailings into groups of either five-digit ZIP codes or the first three digits of the five-digit ZIP code (“3-digit”). By “presorting” letters to those levels before mailing them, mailers would perform “work” that would otherwise be performed by the Postal Service in processing and delivery. In return for saving the Postal Service costs, mailers were compensated by a discount.

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<sup>1</sup> Pre-PAEA, the PRC “recommended” rates to the Postal Service Governors after an on-the-record adjudicative hearing conducted under sections 556 and 557 of the Administrative Procedure Act. *See generally Mail Order Ass’n of Am. v. USPS*, 2 F.3d 408 (D.C. Cir. 1993). In practice, that gave the PRC essentially final authority over rates, although the Postal Service always initiated the case by proposing rates and the Governors had a limited ability to override the PRC’s recommendations.

A percentage of the costs that the mailer saved the Postal Service—*i.e.*, the costs that the Postal Service “avoided”— were “passed-through” to the mailer in the discount. Initially, pass-throughs typically were set at less than 100 percent of the full amount of costs avoided as a precaution against misestimates.

Although presorted mail volumes were not significant at first, they grew over the 1970s and 1980s as bulk mail took on a life of its own. By the 1990s, a variety of discounts were given to bulk mailers not only for sorting mail into 3-digit and 5-digit groups, but also for presorting to carrier routes, area distribution centers, etc., and for applying barcodes and other activities.

Driving this growth was the deployment of computers and sorting machines in the workplace. From the 1980s until the 2000s, the bulk mail sector expanded as large mailers invested millions of dollars in computers, software, industrial facilities and sorting machines to print, label, prebarcode, bundle, and palletize mail. *See generally* Initial Comments of Major Mailers Association, Dkt. No. RM2009-3 (May 26, 2009) (JA 40-41). Eventually, as smaller companies deployed computers more extensively, they too began to mail at these bulk rates, so long they could meet the minimums for the overall mailing and for the presort groups.

The growth of the bulk letter industry was spurred by the emergence of a second type of mailing company. These were “letter shops” -- companies that

were not mailers themselves, but provided bulk mail services for others. Letter shops print, label, prebarcode, stuff envelopes, and enter mail into the system.

Over the years, as additional bulk discounts were created (automation discounts for barcoding) and the Postal Service added additional addressing and containerization requirements, letter shops would also perform these functions for companies lacking the expertise or capacity to do it themselves.

Concurrently, a third entity evolved, the “presort bureau.” They collect and consolidate mail from various businesses whose numbers are not large enough to qualify for bulk rates. The bureaus combine, comingle, and presort the mail to get sufficient volumes that they can enter them into the mailstream at bulk quantities to obtain discounted Presorted mail rates.

As these three types of entities grew, over time a new mailing sector emerged – the bulk mail industry. That industry now operates separately and apart from Single-Piece mailers.

Today, as the Postal Service stated below, bulk mail preparation “is not a casual activity that an organization can undertake on a whim.” (JA 108). As it says, “businesses will undertake specialized mail preparation activities only when mailing activity reaches a certain threshold importance within the totality of activities in which the business engages.” *Id.*

To qualify for Presorted rates, bulk mailers today routinely perform a lengthy list of tasks that Postal Service employees must perform for Single-Piece mail, including traying letters, electronically transmitting data about a mailing to postal data centers, presorting trays of mail, placing the trays on larger pallets to facilitate transportation in bulk, and loading mail on to postal trucks. Initial Comments of Major Mailers Ass'n (JA 56). Presorted mail also must meet detailed Postal Service specifications on the acceptable envelope sizes for automation mail, address updating requirements, restrictions on typefaces and envelope color stock, and many more. Comments of NPPC on Order No. 243 (Sept. 11, 2009) (JA 214-215). These requirements do not apply to Single-Piece customers. *Id.* Thus, large-scale, sophisticated bulk mail differs fundamentally from Single-Piece Mail, which is created by business and citizens in small quantities and is not required to meet the highly-specified standards of the Postal Service's Presort mail requirements.

Indeed, because of the availability of the Internet as a means for delivering statements and invoices, Presort mailers today (unlike in the early days of worksharing) no longer "revert" to Single-Piece rates when bulk rates become uneconomical. When bulk mailers no longer use Presorted mail, they bypass the postal system entirely by converting to email and the Internet. Comments of Discover Financial Services, Dkt. No. RM2009-3 (Sept. 8, 2009) (JA 152-154)

(Single-Piece letters are no longer a viable alternative for bulk mailers); Testimony of Elizabeth A. Bell *et al.* (Sept. 11, 2009) (JA 166) (stating “Three decades after the introduction of presort discounts, both products are mature, and there is little migration between them.”).

The evolution of worksharing since 1976 is striking. What began in 1976 as a minor tail now wags the dog. Bulk Presorted letters have grown steadily as a share of FCM volume. Initial Comments of Major Mailers Association, Table 1 (JA 42). Presorted letters were 53.8 percent of total FCM volume in 2009, *see* PRC Annual Compliance Determination FY2009, Table VII-1 (Adden. 45), and 58.8 percent in FY 2010. USPS FY2010 Annual Compliance Report, Table 1 (Dec. 29, 2010) (Adden. 47).

Not surprisingly, the costs incurred by the Postal Service in processing and delivering Presorted FCM are lower than for Single-Piece mail. In fact, Presorted mail costs the Postal Service *far* less than Single-Piece mail. The actual costs of both Presorted and Single-Piece mail are known, because the Postal Service’s costing systems measure them separately. In 2009, the average postal costs for Presort and Single-Piece letters were 11.981 cents and 26.326 cents, respectively. PRC ACD FY2009 (Adden. 43-45); *see* Comments of Pitney-Bowes, Table 1 (showing ratio of unit costs for Single-Piece to Presorted FCM consistently near 2.5 since 2002) (JA 300).

Furthermore, the actual cost differences between Presorted and Single-Piece mail exceed the estimated costs avoided by worksharing. *See* Initial Comments of the USPS (JA 63-64). Put differently, “the intrinsic costs of Presorted and Single-Piece mail appear to be materially different, because the reported cost difference significantly exceeds the modeled avoided cost estimate.” *Id.*; *see* Petr Br. at 11, 40-41. For example, the *total* (not average) estimated worksharing costs avoided in FY2009 by the most deeply workshared type of Presort mail (5-digit Automation) was 9.5 cents, far less than the approximately 14.4 cent average cost difference between Presorted and Single-Piece mail. PRC ACD FY2009, Table VII-2 (Adden. 45).

The difference between a postal rate and the cost of that mail is called the “unit contribution” (“contribution” to overhead costs). As a result of (1) Presorted mail’s intrinsic costs being lower than simply the difference resulting from subtracting “avoided” costs due to worksharing from Single-Piece costs; and (2) Presorted Mail’s rates being set (due to the Order below) as a discount from the Single-Piece rate, the unit contribution of Presorted Mail materially exceeds the costs avoided by worksharing, and that of Single-Piece mail. Presorted letters are prepared in such a cost-efficient manner “that the price difference between Single-Piece and Presort First Class Mail letters is only a fraction of the actual cost

difference between these products.” Initial Comments of Bank of America Corporation *et al.*, Dkt. No. 2009-3, Table 1 (May 27, 2009) (JA 125).

In FY2010, Presorted FCM made an average unit contribution of 22.9 cents (on top of its 11.7 cents cost) compared to Single-Piece FCM’s average unit contribution of 17.4 cents (on top of its 27.2 cents cost). USPS ACR FY2010, Table 1 (Adden. 47).

Due to Presorted FCM’s larger volume and larger unit contribution per piece, Presorted Mail is the Postal Service’s most profitable mail, contributing a total of \$10.576 billion towards overhead in FY2010. *Id.* In contrast, Single-Piece, with lower volume and higher unit cost, contributed a total of less than \$5 billion. *Id.*

Presorted mail is both the most efficient and the most profitable mail in the postal system. As explained below, however, the Order – by applying the worksharing discount provision of subsection 3622(e) across separate products -- will prevent the Postal Service from setting the rates for Presorted mail in a manner responsive to the demand for that mail. As a result, Presorted mail will likely bear the greatest burden of future rate changes. The recently filed rate adjustments, to take effect in April 2011, did just that, as Presorted rates are rising by more than Single-Piece rates, and the 44 cent stamp is not changing. USPS Notice of Market-Dominant Rate Adjustment, Dkt. No. R2011-2 (Jan. 13, 2011) (Adden. 49-50).

## II. The Changing Theory Of Discount “Passthroughs”

When bulk worksharing discounts were first introduced, the PRC measured the costs avoided by estimating costs saved by the Postal Service from the mailers’ work. Over time, the Postal Service and the PRC used various models to estimate the costs avoided by the worksharing activity as compared to a “benchmark” of non-workshared mail.

Eventually, the PRC abandoned its initial practice of “passing through” less than 100 percent of the costs avoided in the discount. In Docket No. MC95-1, the PRC began to treat workshare discounts as a matter of allocative efficiency, recognizing that “passing through” 100 percent (instead of a lesser percentage) of the avoided costs establishes an incentive for work to be done by the lowest cost provider. Op. & Rec. Dec., Dkt. No. MC95-1 at IV-121-123 (Adden. 3-5).

Underpinning this policy was the economic theory of Efficient Component Pricing (“ECP”). By ECP, worksharing discounts are set equal to the unit avoided costs of the Postal Service to promote productive efficiency and reduce the total costs of the postal sector, as this induces mailers to perform work if they can do it more cheaply than the Postal Service. *See* PRC Dkt. No. R2006-1 Op. & Rec. Dec., ¶¶4016-4024 (Feb. 26, 2007) (Adden. 12-15). As the PRC summarized, “in every subclass that has worksharing discount rates, both the Postal Service and the

Commission strive to obtain an ECP outcome, i.e., a one-hundred percent passthrough of the avoidable cost savings.” *Id.* ¶4005 (Adden. 9).

### **III. The Setting Of Workshare Discounts Under The Former Law**

Under the Postal Reorganization Act – the predecessor of the PAEA – workshare discounts were considered “rate categories” within “subclasses” of mail, which in turn were parts of still larger groupings called “classes.” Under the PRA, a “subclass” consisted of mail that had *both* distinct cost *and* demand differences. Rate categories, including worksharing discounts, were defined by the PRC as a type of mail that differed in *either* cost *or* demand from other mail within its subclass.

The bulk discount for presorting introduced in 1976 was a rate category within what became the “Letters” subclass of First-Class Mail. All of the numerous other discounts that arose in FCM over the next thirty years were classified as rate categories. Rates were discounted off of the rate of a Single Piece stamp.

In 1995, the Postal Service sought to have bulk letters reclassified as a separate subclass. The PRC rejected the request on the grounds that the Postal Service had failed to show the existence of both cost and demand differences. Op. & Rec. Dec., Dkt. No. MC95-1 at V-14-15 (Adden. 6-7).

In R2006-1, the PRC, applying pre-PAEA analysis, rejected a Postal Service proposal to price bulk FCM letters on their own, not as a discount from Single Piece letters. Thus, as of the end of the R2006-1 rate case decided under the old law, FCM workshare discounts were still set mechanistically off of the price of a consumer stamp.

#### **IV. The PAEA Changed How Postal Rates, Including Workshare Discounts, Are Set**

When Congress enacted the PAEA in 2006, it replaced the former cost-of-service, on-the-record adjudication ratesetting system with an entirely new regime based on a price cap approach, similar to that adopted since the 1980s by the FCC and other agencies. *See generally* 39 U.S.C. §3622. The PAEA reduced the role of the PRC in the ratemaking process<sup>2</sup>—even changing its name from the Postal Rate Commission to the Postal Regulatory Commission. It did so to give the Postal Service the authority to price flexibly and to change prices quickly in response to market needs. In the words of the House Report on an earlier bill equally applicable to the enacted PAEA, it: “also allows the Postal Service to better react to market conditions by streamlining the rate setting process, and permitting rates that are better tailored to consumers’ needs” and “the system must

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<sup>2</sup> Under the PAEA, one exception remains in which the PRC has a primary role in ratesetting. That is where the Postal Service seeks to increase rates above the price cap limit due to “exigent” circumstances. A case involving this provision is currently pending in this Court. *See USPS v. PRC*, No. 10-1343 (oral argument scheduled Mar. 15, 2011).

be responsive to market considerations.” H.R. REP. NO. 109–66 (I), at 43-44 (2005).

The process under the PAEA works in this way. From time to time the Postal Service files a notice of adjustment of market-dominant rates, in which it may include proposed changes in rates for workshared mail. Such proposed rates receive only light pre-implementation review from the PRC, which primarily checks that the rate changes comply with the applicable rate caps and that there are no egregious facial violations of any other ratesetting provision. As discussed below, the PRC’s primary substantive role in rates is to conduct a detailed after-the-fact review of the rates charged during each past year.

The PAEA made three specific changes in postal law relevant to this case. First, it enacted for the first time a definition of “product.” A “product” is “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).

Second, in response to concerns raised during the Congressional debate over postal reform about worksharing discounts being priced beyond “avoided costs,” Congress included a narrow subsection dealing with workshared pricing. 39 U.S.C. §3622(e). That subsection says that any worksharing discount should not exceed the avoided costs, with exceptions not at issue in this case. Congress did this in the same section of the law in which it expanded the Postal Service’s ability

to respond to the market in its pricing and shifted overall pricing authority away from the PRC.

Third, Congress enacted a new Section 3652, providing for the annual “after-the-fact” comprehensive review of postal rates. This process requires the Postal Service to file an “annual compliance report” and, after a 90-day review period, the PRC issues an Annual Compliance Determination whether postal rates had complied with the law during the period under review. 39 U.S.C. § 3652. Subsection 3652(b) implemented subsection 3622(e) by directing the Postal Service to provide data on worksharing rates and costs avoided for “each” “product” for which a workshare discount was in effect.

After enactment of the PAEA, the PRC issued regulations implementing the entirely new ratemaking system. As part of that process, the Postal Service proposed, and the PRC approved, a new mail classification schedule (MCS). That schedule classified Presorted First Class Mail and Single-Piece First Class Mail as separate products. Order No. 43 (Adden. 19-22).

At that time, the classification of Presorted mail as a separate product was opposed by some as violating worksharing principles and supported by others as eminently reasonable under the PAEA, given the differences in both cost and demand. The PRC addressed this point specifically in its order adopted the MCS.

Order No. 43, ¶¶4013-4018 (Adden. 20-22). In categorizing Presorted First-Class Mail as a separate product, the Commission specifically decided:

The Postal Service has the flexibility to initially describe its product lines in conformance with the statutory requirements of the PAEA. A product is defined 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). 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.

*Id.* ¶4016 (Adden. 21).

## **V. The Order Under Review**

In its 2009 rate filing, the Postal Service did not use pre-PAEA traditional worksharing principles to set Presorted rates. Instead, it stated that it took demand considerations – especially the risk of electronic diversion of Presorted letters, its most profitable product -- into account in pricing that mail:

Most commercial customers are actively seeking cost-reductions that may result in decisions to move towards electronic and other mail alternatives. A less-than-average increase in [First Class] automation prices may forestall some of these decisions and help to maintain automation letter volume.

USPS Notice Of Market-Dominant Price Adjustment (Feb. 10, 2009) at 13 (Adden. 30).

In its pre-implementation review of that rate filing, the PRC noted that some had urged rejection of the rates because the Postal Service had not followed the traditional workshare discount rate design methodology. Order No. 191 at 19-23 (Adden. 37-41). The PRC approved the rates but not the underlying methodology and pledged to “immediately institute a rulemaking docket to properly evaluate these new rate design practices.” *Id.* Significantly, the PRC did not overrule its prior determination that Presorted FCM is a separate product, leaving the MCS untouched.

The PRC opened Docket RM2009-1 on March 16, 2009 to evaluate these matters. It released Order No. 536 on September 14, 2010, which is the subject of this appeal. In that Order, the PRC reached a number of conclusions relevant to Presorted letters. For purposes of this brief, the PRC’s most critical findings were that:

- Subsection 3622(e) may apply both within and across products.
- A worksharing relationship exists if a factual inquiry shows that a workshared category serves the same market as a less workshared category at a reduced cost.
- First Class bulk (Presorted) Letter Mail has a workshared relationship with First Class Single-Piece Letter Mail.

Order at 2 (JA 319). In addition, the PRC also held that the PAEA provides no statutory basis for “protecting” Single-Piece mail from rate increases. *Id.*

Because the Order below requires Presorted letter discounts to be “linked” – that is, the rates for Presorted Mail must be set as a worksharing costs-avoided discount from the Single-Piece 44 cent stamp -- the Postal Service has little room to recognize in rates the clear and longstanding cost differences between the two products. The PRC’s interpretation that subsection 3622(e) empowers it to apply worksharing discounts across products deprives the Postal Service the ability to price Presorted mail in response to market demand and its intrinsic costs. Thus, the Order prevents the Postal Service from using demand-responsive pricing for the component of First-Class mail that constitutes a majority of its volume.

Also, by requiring Presort rates to be set mechanistically on the basis of costs avoided from a Single-Piece “benchmark” rather than on their own intrinsic costs, the Order produces rates that bear no rational relationship to Presorted mail’s actual costs. This process effectively precludes the Postal Service from setting Presorted mail rates at lower levels closer to their actual costs. The result is to impose the highest markups on the most efficient, low-cost mail – the highly prepared, cleaned, and presented mail sent at Presorted rates.

## **SUMMARY OF THE ARGUMENT**

The 35 years since the introduction of workshare discounts in First-Class Mail have witnessed enormous changes in the postal marketplace, including the emergence of a now-mature bulk mail industry. Postal technology, postal operations, mailers' business models, mailer preparation requirements, and the theoretical underpinnings of workshare discounts have all changed. Most importantly for this case, the 2006 enactment of the PAEA completely changed the postal ratesetting process, reducing the role of the PRC, and allowing the Postal Service much greater pricing flexibility.

Despite these changes, the PRC's approach to workshare discounts today is basically unchanged from the pre-PAEA law. In particular, the PRC has not come to grips with the PAEA's pricing flexibility and the substantive significance of Presorted and Single-Piece mail being separate "products" under the PAEA. The PRC's insistence on pre-PAEA ways of setting workshare discounts violates the PAEA, frustrates the policy of Efficient Component Pricing that underlies subsection 3622(e), ignores both the significance of a "product" under the PAEA and its own finding only three years ago that Single Piece and Presorted mail are separate products, harms the Postal Service by restricting its pricing flexibility and potentially reducing its revenues, and injures NPPC members.

This happens because the Order ties (“links”) rates for Presorted First-Class mail directly to the rate for a Single Piece stamp – currently 44 cents. The Order requires Presorted rates to be set on the basis of “costs avoided” from a Single-Piece “benchmark,” not on the basis of the actual intrinsic costs of and demand for Presorted mail. The “costs avoided” estimates, which systematically are less than the actual difference in average costs between Single-Piece and Presorted letters, are subtracted from Single Piece stamp rate to obtain Presorted rates.

If the PRC’s interpretation of the subsection 3622(e) worksharing provision were reversed, the Postal Service could price Presort FCM letters on the demand and cost characteristics of that product directly, rather than as a derivative rate mechanically subtracted from the Single-Piece rate. Workshare discounts within the Presort product would be set using a new benchmark selected from within Presort FCM.

The PRC’s application of subsection 3622(e) to require that rates for the Presort FCM product be derived from rates for the separate Single-Piece product via defining worksharing discounts across product lines is legal error under *Chevron* Step I, and is arbitrary and capricious. The Order below should be reversed and remanded.

## ARGUMENT

### **THE PRC’S EVALUATION OF DISCOUNTS ACROSS DIFFERENT PRODUCTS UNDER SECTION 3622(e) IS LEGAL ERROR**

#### **A. Standard of Review**

This Court’s review of the PRC’s Order is governed by the Administrative Procedure Act, 5 U.S.C. §706. *See* 39 U.S.C. §3663. The Order below must be held unlawful and set aside if, *inter alia*, it is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. §706(2)(A).

The PRC’s statutory interpretation of the workshare discount provisions in Section 3622(e) and the requirements of Section 3652(b) is governed by the two-step standard set forth in *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984). First, this Court applies the “traditional tools of . . . construction” to determine *de novo* whether the statute unambiguously addresses the matter at hand.” *Id.* at 843 n.9; *So. Cal. Edison Co. v. FERC*, 195 F.3d 17, 23 (D.C. Cir. 1999). Traditional tools require a court to examine “the language and design of the statute as a whole.” *So. Cal. Edison*, 195 F.3d at 23 (quotation marks omitted). Only if there is ambiguity in the statutory language will a court ordinarily defer to an agency’s reasonable construction of that ambiguity. *Chevron*, 467 U.S. at 843. “The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used and the broader context of the statute as a whole.” *Robinson v. Shell Oil Co.*, 519 US 337,

341 (1997) (citations omitted); *Kokoszka v. Belford*, 417 U.S. 642, 650 (1974) (“When interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute”).

**B. Section 3652 Unambiguously Requires That The Limitations On Workshare Discounts In Section 3622(e) Be Measured Within, Not Across, Products**

“The court, as well as the agency, must give effect to the unambiguously express intent of Congress.” *Chevron*, 467 U.S. at 842. Congressional intent may be discerned from the statutory language and from the “object and structure of the Act as a whole.” *Dole v. United Steel Workers of Am.*, 494 U.S. 26, 36 (1990).

The plain language and structure of the PAEA confirm that Congress intended for the Section 3622 limitation on the size of workshare discounts would apply only within a specific “product” as that term is defined in Section 102(6). Accordingly, the PRC’s ruling that Section 3622(e) could be applied across the Presorted and Single-Piece products in FCM is erroneous and should be reversed.

That Congress intended for worksharing discounts to be evaluated only on a “within product” basis is evident from the structure of the PAEA, particularly the interplay between subsections 3622(e) and 3652(c). The former establishes the general limitation; the latter establishes how the former is to be enforced. *See Motion Picture Ass’n of America, Inc. v. FCC*, 309 F.3d 796, 801 (D.C. Cir. 2002)

(“Statutory provision *in pari materia* normally are construed together to discern their meaning”).

In particular, under the PAEA the PRC reviews the workshare limitations under subsection 3622(e) as part of its annual compliance determination under Section 3652. This “after-the-fact” compliance review is enabled and informed by the specific, detailed reporting requirements set forth in 39 U.S.C. §3652. In that ACR process, the PRC reviews in detail whether workshare discounts complied with subsection 3622(e) during the year under evaluation.

Statutes are to be read as whole. *Coit Independence Joint Venture v. Fed. Savs. & Loan Ins. Corp.*, 489 U.S. 561, 573 (1989). Section 3652 defines the scope of the PRC’s annual review by specifying what information the Postal Service must report in order to enable the PRC to discharge its responsibilities in its after-the-fact annual compliance determination. Congress addressed workshare discounts directly in subsection 3652(b). There, Congress specified only that the Postal Service provide data regarding discounts on a product-by-product basis:

- (b) Information Relating to Workshare Discounts.—  
The Postal Service shall include, in each report under subsection (a), the following information with respect to *each* market-dominant product for which a workshare discount was in effect during the period covered by such report:
  - (1) The per-item cost avoided by the Postal Service by virtue of such discount.

(2) The percentage of such per-item cost avoided that the per-item workshare discount represents.

(3) The per-item contribution made to institutional costs.

(Emphasis supplied.) This is the only information Congress believed that the PRC needs to review compliance with subsection 3622(e). Notably, it did not direct the Postal Service to report the data, or to provide percentages of costs avoided, *across* products. As the Postal Service said below, “it is illogical to suggest that section 3622(e) would apply to a relationship for which section 3652(b) does not mandate the provision of cost information. (JA 71). Thus, Congress unambiguously confined the reporting obligation for information relating to workshare discounts to information at or within “each” product, not *across* products.

The PRC’s decision to measure (or “link”) workshare discounts for Presorted First-Class letters from the separate Single-Piece product effectively reads subsection 3652(b) out of the PAEA. This is an impermissible construction of the statute, as laws must be read “to give effect, if possible, to every clause and word.” *United States v. Menasche*, 348 U.S. 528, 538-39 (1955). A court may not adopt an interpretation that “emasculate[s] an entire section.” *Id.*; *Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) (Acts of Congress “should not be read as a series of unrelated and isolated provisions”).

**C. The Order Frustrates The Economic Efficiency Policy Objective Of Subsection 3622(e)**

The conclusion adopted by the PRC that subsection 3622(e)'s limitations on worksharing discounts applies across products must be rejected as contrary to the purpose of subsection 3622(e) itself.

As the PRC acknowledges, “the purpose of section 3622(e) [is] the pursuit of economic efficiency goals by limiting discounts to the amount of costs avoided.” Order at 14 (JA 331). By generally limiting discounts to 100 percent of the Postal Service's cost savings, subsection 3622(e) ratified the use of the Efficient Component Pricing policy to ensure that workshare discounts send the correct economic pricing signals, so that work will be performed by the lowest cost provider. *Id.* at 20-21, 48 (JA 337-338, 365).

But the economic efficiency goals of ECP can only be realized if it is applied within a grouping having like cost and demand characteristics. A “slavish limitation of price differentials to cost ‘avoidances’ between [] two products is particularly likely to lead to inefficiency, loss of institutional cost contribution, or both.” Comments of NPPC, Dkt. No. RM2009-3 (May 26, 2009) (JA 17). This is because the rate for one product, instead of being set to address its distinct market demand and/or inherent cost differences, would be derived mechanically from the rate for the other product – which could be set on the basis of its own cost and

demand. The rate of the workshared product would not reflect the demand or distinct cost characteristics of that product at all.

Applied to this case, it means that, unless the Order is reversed, the rate for Presorted FCM letters will not be based on the market demand for such letters. Nor will the rates for Presorted FCM letters be based on the *costs* of those letters. Instead, they will be set on the basis of the price that addresses the demand for Single-Piece letters, from which would be subtracted an estimate of avoided costs between some “benchmark” group of Single-Piece mail and Presorted letters. The difference between the Single Piece rate and the estimated cost savings would be the Presorted rate, without any further consideration of relevant pricing factors. No consideration of the distinct demand or cost characteristics of Presorted mail would occur. But if Presorted mail rates are not priced to account for the demand for the product, the rates cannot send accurate economic signals regardless of any worksharing discount “signal.”

This process is, in fact, the *status quo*. This is the chain of reasoning by which NPPC member companies--whose mail costs the Postal Service less than 12 cents per piece-- pay more than 23 cents per piece in overhead “contribution.” This is the “reasoning” which forces the Postal Service against its wishes to make Presorted mailers pay a full nickel more than is contributed by Single Piece mailers whose mail has much higher intrinsic costs (more than 23 cents per piece). This

happens because the Order prevents the Postal Service from taking the distinct demand for Presorted mail -- including the risk of electronic diversion and the absence of any evidence suggesting that it ever reverts to Single-Piece – into account when setting the rates for Presorted letters.

**D. The PRC’s Failure To Give Effect To Its Earlier Decision That Single-Piece And Presorted First-Class Mail Are Separate Products Is Arbitrary And Capricious**

**1. The PRC determined when approving the MCS that Presort and Single-Piece are separate products under Section 106**

As explained above, in 2007 the PRC approved the Mail Classification Schedule, pursuant to Section 3642 of the PAEA, as the vehicle for presenting the product lists with necessary descriptive content. *See* 39 U.S.C. § 3642. In its Order directing the Postal Service to develop its initial product list under the PAEA, the PRC explained that “the explanatory information included with the product lists will inform participants in Commission proceedings of the nature and scope of Postal Service products and must be sufficiently detailed to allow the Commission to verify that the rates and categorization of products are in compliance with the PAEA.” Order No. 26, Dkt. No. RM2007-1, ¶4003(Aug. 15, 2007).

The Postal Service subsequently proposed, and the PRC approved, an initial MCS that identified and defined Single-Piece and Presort First-Class Mail Letters

as separate products. *See* Order No. 43, ¶¶4013-4018 (Adden. 20-22). In approving the initial MCS, the PRC specifically held that the classification of Single-Piece and Presort First-Class Mail as separate products was appropriate:

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.

*Id.*, ¶4017 (emphasis added) (Adden. 22).

In the Order below, however, the PRC ignored the consequence of this prior holding. It contends that “obtaining separate ‘product’ status on that list implies nothing about whether products on that list have, or do not have, a worksharing relationship.” Order at 22 (JA 339).

The PRC is wrong. As shown in the preceding section, the Efficient Component Pricing rule, which subsection 3622(e) endorses, can achieve its economic efficiency objective only when considered within a product.

The PRC makes no attempt to reconcile the Order below with its approval of the Mail Classification Schedule. Nor does it assert that conditions have so changed such that a reexamination of the product lists as defined in the MCS is

appropriate. *See Ass'n of Data Processing Serv. Orgs. v. Bd. of Governors of the Fed. Reserve Sys.*, 745 F.2d 677, 683 (D.C. Cir. 1984) (agency position “devoid of needed factual support” may be found arbitrary and capricious); *Atchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. of Trade*, 412 U.S. 800, 808 (1973) (agency has “duty to explain its departure” from prior decisions); *Skidmore v. Swift & Co.*, 323 U.S. 134, 139 (1944) (deference to agency not warranted where the agency’s decision is not consistent with earlier pronouncements).

**2. The record below reconfirmed that Presort and Single-Piece are separate products**

The judgments of the Postal Service and the PRC in creating the MCS that Single-Piece and Presort First-Class Mail Letters are separate products under the statutory definition in Section 102(6) were clearly correct. Although a “product” under the PAEA need have only distinct cost or demand characteristics, that Single-Piece and Presort First-Class Mail Letters have *both* distinct cost *and* demand differences was demonstrated when the MCS was adopted and confirmed in the proceeding below. The Order failed to give proper effect to the PRC’s previous determination that Presorted and Single Piece letters are different products, and ignored the conflict with its earlier ruling approving the MCS. For these reasons, the Order is arbitrary and capricious.

***Presorted First-Class Mail has lower intrinsic costs than Single-Piece Mail***

In the proceedings below, the Postal Service conclusively established that there large and consistent cost differences exist between Single-Piece and Presort First Class Mail. Initial Comments of U.S. Postal Service, Technical Appendix, historical Cost and Revenue Analysis data (JA 105-106). The data presented confirmed that the intrinsic cost differences consistently exceed the average workshare-related cost avoidances, confirming that Single-Piece and Presort First-Class Mail Letters are inherently different products. For example, the worksharing-related costs avoided account for less than 8 cents of the total 13.95 cent cost difference between Single-Piece and Presorted Letters in FY 2008, so that about five cents of the 13.95 cent CRA-measured cost difference must be caused by factors other than worksharing. *Id.*

***Presorted First-Class Mail has different market demand than Single-Piece Mail***

The record also confirms that Single-Piece and Presort First-Class letters have distinct *market* characteristics. The Postal Service's extensive comments below, based in large part on data from the FY 2008 Household Diary Study (HDS), demonstrated that for economic and technical reasons, household personal correspondence (*e.g.*, birthday cards, postcards, etc.) and some business reply mail (*e.g.*, bill payments) will always be Single-Piece. Initial Comments of USPS at A-

3 (JA 107). Furthermore, bulk entered transaction mail (*e.g.*, (billing and statements)) will almost always be mailed at Presorted rates. *See id.* (JA 111). From the perspective of the mailer, there is little opportunity for substitution in production or consumption between the two products.

The Postal Service summarized the different market characteristics between these two products in the record below:

[O]n a broad level, the nature of the communication and its purpose 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.

*See Id.* at 13 (JA 69). This language was subsequently quoted approvingly by the largest representative of Single-Piece mailers. Reply Comments of the Greeting Card Association, Dkt. No. ACR2007 at 4 (Adden. 23-28).

The record below showed that any overlap between the markets for Single-Piece FCM and Presorted FCM Mail is small and shrinking because Presort is a mature product and the Single-Piece mail that could convert has largely already converted. Initial Comments of USPS at 18-19 (JA 74-75). The likelihood of Presorted letters reverting to Single-Piece is even smaller: the analytical construct of a “two-way street” in which Presorted letters revert to Single-Piece is no longer

viable. *Id.* Presorted First-Class Mail is much more likely to revert to Standard Mail or an electronic channel. *Id.* (JA 75).

### **3. The PRC’s “Economic Purpose” assessment is unsupportable and internally inconsistent**

The PRC discounted both the empirical data and the anecdotal evidence submitted by the Postal Service and mailers regarding the distinct market characteristics of Single-Piece and Presorted First-Class Mail. *See* Order at 50-54 (JA 367-371). It concluded that Single-Piece and Presorted First-Class Mail do not have distinct market characteristics based on its review of historical demand data and its own assessment of the “economic purpose” and “functionality” of the two products.

With respect to the historical demand data, the PRC focused on own-price elasticity data for Single-Piece and Presort First-Class Mail Letters. *Id.* at 55-57 (JA 372-374). The flaw with this approach, however, is that unrelated products can have similar, or identical, own-price elasticities (*e.g.*, pencils and tennis balls). A more reliable gauge is whether the two products are substitutes for each other. As discussed above, Single-Piece and Presort are not substitute products in any meaningful way.

The PRC’s assessment of the “economic purpose” and “functionality” of Single-Piece and Presorted letters as a means of identifying the relevant market is unsupported in the record. It concludes that Single-Piece and Presorted letters

serve the same market because the “economic purposes” of both products is the “secure transmission of individualized, confidential, time-sensitive messages and documents.” Order at 50-51 (JA 367-368). But this functional assessment conflates the market definition of these two products with the regulatory definition of First-Class Mail. By definition, *all* First-Class Mail products – letters, flats, parcels, Priority Mail – meet this same “economic purpose” test. The PRC’s view that Single-Piece and Presorted First-Class Mail Letters are used to “transmit correspondence and conduct transactions” invites a boundless and meaningless market definition that also would include such indisputably separate products as Express Mail or even encrypted email.

The Order’s “economic purpose” test also fails because the PRC used it in an internally inconsistent manner, applying it to First-Class Mail but not to Standard Mail. *See Burlington N. & Santa Fe Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 778 (D.C. Cir. 2005) (application of different standards to similarly situated entities is arbitrary and capricious); *FEC v. Rose*, 806 F.2d 1081, 1089 (D.C. Cir. 1986) (disparate treatment is arbitrary and capricious); *Airmark Corp. v. FAA*, 758 F.2d 685, 691 (D.C. Cir. 1985) (deference to agency “is not a license to . . . treat like cases differently”). The PRC’s discussion of Standard Mail products abandons any notion of a functional assessment. There, the PRC concludes that High Density and Saturation Standard Mail serve separate markets even though

many mailers use the two products interchangeably and both products serve the same essential advertising function. It concluded that the different usage has less to do with a price differential than the preparation requirements (minimum households on a specific route). Order at 60-61 (JA 377-378). In contrast, the PRC cites no evidence that First-Class mailers use the two products interchangeably, the essential function of the products is comparable only at a level of abstraction approaching meaninglessness, and the PRC deems distinctions in preparation requirements irrelevant for market definition purposes.

Viewed in this light, the “economic purpose” test is merely a pretext for preserving a cost-based linkage between Single-Piece and Presorted First-Class Mail to mitigate potential pricing increases on Single-Piece mailers. (No similar concerns apply in Standard Mail). Yet this goal of mitigating rate increases for Single-Piece mail also conflicts with the Order itself, which also held that there is no basis in the statute for protecting Single-Piece mail. (JA 319, 331). Thus, the Order is internally contradictory and therefore arbitrary and capricious.

**E. The PRC’s Claim That Subsection 3622(e) Allows It To Reach Across Products Is Erroneous**

The PRC raises a series of objections to the application of the plain language of subsections 102(6) and 3652 when construing subsection 3622(e). These arguments violate the basic canon of statutory construction that every word in the

statute should be presumed to have a purpose, and, if possible, given operative effect. *See Dole Food Co. v. Patrickson*, 538 U.S. 468, 477 (2003).

First, the PRC asserts that “[p]roduct” is a concept that plays a much less important role in the PAEA” than the Postal Service and others contend. Order at 24 (JA 341). The PRC disparages the statutory definition of the term “product” as “so general (‘a postal service with a distinct cost or market characteristic’) that almost any category of mail nominated would qualify.” *Id.* at 22 (JA 339) (citations omitted). It’s odd that the PRC would so denigrate a definition that Congress felt a need to add to the postal law in the PAEA. But this gains the PRC nothing. The policy choices reflected in the definition of the term “product” are decisions for Congress, not the agency to make.

Moreover, the PRC ignores that the answer to its concern that “almost any category of mail” could be a product resides in Section 3642, the PAEA provision governing mail classification. Simply put, Section 3642 prevents “almost any category of mail” from becoming a product. It does so by directing the PRC, when considering any proposed new product, to apply a statutory standard. It also directs the PRC to give “due regard” to three factors. One factor is “the views of those who use the product involved on the appropriateness of the proposed action.” 39 U.S.C. §3642(b)(3)(B). Presorted mailers would not view, say, 3-digit

Automated mail and 5-digit Automated mail as different products; rather, they are categories within the Presorted letters product.

Despite downplaying the term “product,” the PRC nevertheless places great significance in the omission of that very word from subsection 3622(e). It also contends that subsection 3622’s use of terms such as “mail,” “postal service,” “category” or “subclass” shows that Congress left the details to the agency by not restricting the groups of mail to which workshare discounts could apply. Order at 30 (JA 346). However, the omission of “product” is surprising only if it is reasonable to expect it to be there. It is equally, if not more plausible that Congress thought (1) it had addressed the matter fully in subsection 3652(b); or (2) it so obvious that workshare discounts should be based only on costs and rates within a product that it saw no need to say so explicitly.

Next the Commission insists that Congress used the word “product” only to “establish or re-establish the distinction between market dominant and competitive services.” Order at 25 (JA 342). This argument is wrong. Nothing in subsection 102(6) of the PAEA references the distinction between market-dominant and competitive products. Furthermore, subsections 102(8) and 102(9), also added in the 2006 PAEA, specifically define “market-dominant product” and “competitive product,” respectively. *See* 39 U.S.C. §§ 102(8) and (9). In Sections 3621 and 3631 Congress specifically designated various classes and products as either

market-dominant or competitive. *See* 39 U.S.C. §§ 3621 and 3631. The definition of the term “product” in section 102(6) adds nothing to these sections.

Finally, the PRC reads far more than is justified into the final clause in the definition of workshare discount: “the term ‘workshare discount’ refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission.” The PRC creatively interprets the “further define” clause as authorizing it not simply to refine the definitions of presorting, prebarcoding, etc., but also to redefine “the entire definition of worksharing discount.” Order at 30 (JA 347).

This delegation does not go nearly as far as the PRC imagines. In context, the “further defined” language in context applies only to the four types of rate discounts, not to the entire term “workshare discount.” Furthermore, the notion that Congress intended that this provision would grant the PRC broad powers to redefine “the entire definition of worksharing discount” is fundamentally inconsistent with the PAEA’s purpose of shifting ratesetting authority from the PRC to the Postal Service.

## **CONCLUSION**

For all these reasons, and the reasons set forth by the USPS in its brief, the petition for review should be granted.

Respectfully submitted,

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February 28, 2011

## **CERTIFICATE OF COMPLIANCE**

Pursuant to Fed. R. App. P. 32(a)(7)(C), I certify the following:

This brief complies with the type-volume limitation of Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure and D.C. Circuit Rule 32(a)(3)(B) because this brief contains 7,898 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii) of the Federal Rules of Appellate Procedure and Circuit Rule 32(a)(2).

This brief complies with the typeface requirements of Rule 32(a)(5) of the Federal Rules of Appellate Procedure and the type style requirements of Rule 32(a)(6) of the Federal Rules of Appellate Procedure because this brief has been prepared in a proportionally spaced typeface using the 2003 version of Microsoft Word in 14 point Times New Roman.

/s/ William B. Baker  
William B. Baker

**CERTIFICATE OF SERVICE**

I, William B. Baker, hereby certify that, on behalf of National Postal Policy Council, on February 28, 2011, I electronically filed this pleading with the Clerk of this Court via the appellate CM/ECF system. All parties are represented by registered CM/ECF users, and will be served by the appellate CM/ECF system.

/s/ William B. Baker  
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