

Part II: Designing a Rate-Setting System



Bob Brinkmann
robert.brinkmann@rjbrinkmann.com

The initial results are in.

The Postal Regulatory Commission (PRC) has released its draft regulations on the new regulatory system, and they look good. Moreover, the Commission has done its job almost 10 months ahead of the schedule set by the new law, and a good two weeks ahead of the schedule that I had privately figured the Commission would follow. What is most important is that the Commission has created a regulatory system that truly embraces the regulatory philosophy of the new law, gives the Postal Service sufficient flexibility in pricing, protects the public and postal competitors, and is clearly designed to allow the Postal Service to control its own destiny.

I say, a job well done. I know that the Postal Service is pleased with it, for good reason, and I think most mailers are too.

The Commission called for public comments on the proposed regulations to be filed by September 14, 2007 and for reply comments by September 28, 2007. The Commission also asked the Postal Service to file a new Classification Schedule by September 14, and will allow comments on it by September 28, 2007. I do not anticipate major changes being made in the regulations before they become final. The Commission has done very good job.

Thus, once comments and reply comments are filed in September, I anticipate that the Commission will move to adopt the regulations as “final” by mid- or late-October, perhaps with some minor modifications. Once those these regulations are final, the Postal Service can use the new system to adjust rates and to conduct its business. The only thing that is not in place—and needs be there before the rules are fully functional—are regulations for new complaint procedures, including subpoena provisions, new reporting procedures, new experimental products, and some other odds and ends.

Here is how the system is going to work:

A. The Difference Between Market Dominant and Competitive Products

All products will now be considered either “market dominant products” or “competitive products.”

“Market dominant products” encompass pretty much everything the Postal Service offers except Priority Mail, expedited mail, bulk Parcel Post and bulk International Mail. The latter four are considered “competitive products.”

The new law does contain a bit of an anomaly, and that is that “single-piece” parcel and “single-piece” International Mail are considered market dominant products, at least initially. Since current classifications do sharply delineate bulk parcel and bulk international from single piece, the Commission has asked the Postal Service to file a new classification list by September 14 delineating what parcel products and international

products should fall where. While the final decision as to what is competitive and market dominant rests with the Commission, not the Postal Service, I assume that that the two will work through these issues fairly easily. Moreover, these initial delineations are only the initial cut, and the Commission can adjust the list of market dominant and competitive products in the future, as appropriate.



B. The Significance of the Market Dominant Competitive Product Distinction

Whether a product is considered market dominant or competitive is significant for the rates will be set differently, and the rates will have different limitations. For one, rates for market dominant products are capped at inflationary levels, while rates for competitive products are not. Thus, the Postal Service can price competitive products as high as the market will allow.

In terms of market dominant products and rates, the legislation assumes that rate increases will occur annually, and that while rates for market dominant products cannot exceed inflationary levels, there are provision for banking (which the National League of Postmasters helped negotiate and draft) that ensure that the Postal Service can “bank” any unused inflationary “points” that it decides not to use in a given year. Thus, if inflation is 3 percent in a given year, and the Postal Service only wants to raise rates by 2 percent, it can bank the other point, subject to certain limitations noted below. The PAEA also contained provisions (which the National League of Postmasters helped negotiate and draft) that provides for an emergency rate increase above inflation in exigent circumstances.

In terms of competitive rates, the statutory limitation on competitive rates are that 1) each competitive product must cover its attributable costs,¹ 2) competitive products cannot be subsidized by market dominant products, and 3) overall rates for competitive products should cover at least 5.5 percent of total institutional costs.²

The Commission has created two rate-setting schemes to deal with this bifurcated structure.

C. The Mechanics of Setting Market Dominant Rates

Market dominant rates, under the proposed regulations, will be set as follows. There will be three types of market dominant rate changes.

First, there will be the “normal” annual changes for the rates of general applicability. The PRC is calling this a Type 1 rate adjustment. This will allow the Postal Service to annually increase rates to inflationary levels, and to also use any banked inflationary points that it has set aside.³ “Banked” inflationary points are measured separately for each class of mail. To effectuate these rates changes, the Postal Service simply must file a notice of change in rates, and with it sufficient information to show that the rate changes do not exceed inflation and that certain other worksharing provisions of the law are met. The public will be allowed to file comments on the rate increase, but the Commission should not conduct a public proceeding on these type of rate changes, assuming nothing is significantly amiss.

Second, the regulations provide for a change for market dominant rates for Negotiated Service Agreements. This they call a Type 2 change, and is similar to the “normal” type one change, except it applies to NSAs which are not rates of general applicability. Although the public will be allowed to file comments on the NSA, the Commission should not conduct a proceeding on these types of rate changes, assuming nothing is significantly amiss.

Consequently, neither of these rate changes should be litigated, and the Postal Service has the “right” to effectuate these rates changes pretty much as it sees fit so long as it meets the statutory standards.

Lastly, the rules provide for a third type of rate change. This is where the

Postal Service would ask the Commission for permission to break the price cap, because of exigent circumstances. This Type 3 change would not be automatic—not at all. Rather, the Postal Service would have to make a strong case that breaking the inflation cap is necessary due to either extraordinary and exceptional circumstances, and that the exigent rate adjustment is “reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind of quality adapted to the needs of the United States.”

Public participation, probably extensive, is contemplated in these circumstances and a full robust written process and oral hearing, stopping just short of cross-examination. The only caveat is that the Commission must act within 90 days. If there is an a request for this Type 3 exigency-based rate adjustment, it will be a big deal. I know for a fact that the Postal Service has no intention of using it, unless something goes very wrong.

Mechanically, for a Type 1 or Type 2 rate change, the Postal Service will give notice of a rate change a minimum of 45 days before the new rates would

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become effective, in order to allow the Commission to assure itself that the rate changes meet the statutory rate cap and the mandates of the statutory provisions on worksharing. After that 45 days, unless the Commission extends it for some reason, the new rates can go into effect. In reality, the Commission has urged the Postal Service to provide more than 45 days notice, and has noted that it may require a longer period in certain circumstances. The Postal Service, for its part, has indicated that it anticipates that it will give 90 days notice under normal circumstances for a Type 1 rate change, and more if major classification changes are in order. The

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rules, however, follow the wording of the law and provide for a minimum of 45 days notice.

Some parties submitting comments urged the Commission not to allow public comment. The Commission did not follow those suggestions, and I believe that the Commission made the right decision. The public should have the right to comment on any thing it wants to. The Commission doesn't have to listen to any comments, can ignore off-the-wall comments, and does not necessarily have to take any of the comments into account in any great detail in its deliberative process. But the public should have a right to say what it wants.

The PRC has also called for the Postal Service to provide a schedule for when it says it is going to change rates.

Sunshine is the best policy, as Justice Brandeis so aptly pointed out years ago, and that includes the ability to speak, not just the ability to see.

Technically, public comments must be filed within 20 days of the filing of the Notice, and the Commission has suggested that public comments address whether the announced rate adjustment is compliant with the inflationary cap and whether the announced rate adjustments are consistent with §3622 of the new law.

Public comments can, of course, say anything they want and the Commission will read them. The Commission has committed to make its determination about the consistency of the rate filing within 14 days from the close of the public comment period.

All this means that the Postal Service has to give 45 days notice before a rate change and that the Commission will issue its determination of compliance within 34 days of the filing of the Notice. That is a very short time-table, and exactly the type of time frame that the new law contemplated.

The proposed rules do call for a cer-

tain amount of supporting technical information and justification detail to be filed with a Notice of Rate Change, but much much less than is currently required. For one, there will be no "forecasting" of cost and volume changes, and all the gamesmanship that came with those practices should now be gone. That will be a big relief.

The PRC has also called for the Postal Service to provide a schedule for when it says it is going to change rates. In other words, pick the day and the timeframe in advance (more or less), and let everyone know that the rates will be going up around that date. The idea behind this is to further the idea that mailers should have regular and predictable notions of when rates are going up for market dominant rates and by how much. The new law gives the "how much"—inflation or less—and the Schedule of Regular Rate Changes is designed to give a bit of the "when."

The PRC wants the Postal Service to file the Schedule of Rate Changes within 90 days of the new rules taking effect. The Postal Service is not, necessarily, limited to this schedule but the Commission does want it to stick to a schedule and only deviate from it for "good cause." Again, I think this is another well thought out and pretty reasonable requirement.

D. The Mechanics of Setting Competitive Rates

Competitive rates will be set as follows. There will be two types of rate changes, those for rates of general applicability and those for rates not of general applicability (generally NSAs). For rates of general applicability, the Postal Service need only give 30 days notice of a rate change. For rates not of general applicability (e.g., NSAs), the Postal Service need only give 15 days notice. The notices for each must include an explanation and justification for the change, the effective date, and the record of the proceeding before the Board of Governors that the new law requires the Governors to publish in the *Federal Register* when they make changes in competitive rates. For competitive rate *decreases* of general appli-

cability, the Commission is requiring the Postal Service to file a bit more data, and make a bit more elaborate showing.

The Commission's task in examining these rate changes, particularly competitive rate *decreases*, will not focus on inflation, nor on worksharing as it would on the market dominant side of the house. Rather, it will focus: 1) on whether the rates for the competitive product will cover the product's attributable cost; 2) on whether competitive rates are being cross-subsidized by market-dominant rates; and 3) how much contribution competitive products are making to the institutional costs of the Postal Service. The Commission has said that if it feels it does not have enough information to make its determination, it may require the Postal Service to file additional information, if necessary to ensure that these conditions are met.

While a formal determination will not be issued by the Commission determining that all is in order for the competitive rate change, if it finds something amiss—such as the competitive rates appear not to cover the product's attributable costs—it could always step into the picture. It clearly has that power.

E. Moving Products between the Market Dominant and Competitive Lists

The determination of which products are market dominant and which are competitive is not something set in stone. The Commission has the power to move products back and forth, and to add new products to one of the lists. The regulations provide that the Commission can hold hearing if necessary, and that hearing could include full discovery and other litigation procedures and processes if necessary.

There is also a provision where users of the mail can urge the Commission to modify the product list by moving, adding or deleting products. This is an interesting provision since it is the Postal Service, not the Commission or a mailer, which is supposed to have charge of the direction of the Postal Service.

In any case, were any such effort by



a private party not agreed to by the Postal Service, I would think the chances of success would be minimal. We will see. It would be highly controversial if the Postal Service did not agree with it.

F. Complaint Process and Experimental Products

Overriding all of this is the fact that there will be strong complaint procedures created at the PRC for anyone to file a complaint and urge Commission action in regards to almost anything the Postal Service could do. Regulations for the complaint process are not among the draft regulations that have been released, and we will surely see draft complaint regulations within several months if not several

weeks. While the Act gives the Commission extremely broad jurisdiction in the complaint area, I would expect reasonable restraint by the Commission to be the norm.

Any litigation under the new act, where parties end up fighting the Postal Service, will probably stem from either a petition regarding the market dominant and competitive lists, or from a complaint.

G. Other Matters

Draft regulations on experimental products were not included in the initial release of the proposed regulations, but I anticipate that we will see those at some point fairly soon. While the PRC will be the keeper of the Classification Schedule, it will be up to the Postal Service to update it.

With the release of these proposed regulations, the PRC has put much of the meat on the bones of its regulatory scheme, and except for the complaint,

reporting, and experimental product regulations, and some other odds and ends in the competitive area, it has done the major work. The PRC is still working on the service standards issue—an extremely important matter—and we will see some activity in that sector in a few months.

The FTC will be coming out with a study on a variety of issues, and the Commission will have to react to that. The Treasury Department will releasing a study on costs and attribution, and the PRC may well revisit some of its technical issues dealing with market-dominant products cross-subsidizing competitive products in response to the Treasury's comments.

All in all, postal reform implementation has been a job very well done so far, and one done extremely efficiently and quickly. The PRC is to be commended. Next Stop, service standards, regulations for experimental products, and regulations setting complaint procedures and processes, including subpoena power. •

¹ In postal rate jargon, attributable costs are those costs that are "caused" by a particular type of mail. Institutional costs are all those costs that are left over and can truly be said to be caused not by any one type of mail. Blue mailboxes that the public uses to mail letters are First-Class costs. The PMG's salary is an institutional cost.

² The PAEA says that competitive products must make a reasonable contribution to institutional costs, and the PRC has decided that 5.5 percent of total institutional costs would be rea-

sonable, at least for now. Under current rates, competitive products cover about 6.5 percent of institutional costs.

³ The Postal Service can use its "banked" inflation points for up to five years. At the end of the five-year period, it will lose any banked points that it did not use. Also, regardless of how many inflation points it has banked, it cannot take rates more than two points above inflation in any given year without applying for a type 3—exigent circumstances—rate increase.

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