Oral Argument Has Not Been Scheduled

No. 12-1221

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

UNITED STATES POSTAL SERVICE,

Petitioner,

v.

POSTAL REGULATORY COMMISSION,

Respondent.

On Petition for Review of Orders of
the Postal Regulatory Commission

REPLY BRIEF OF THE UNITED STATES POSTAL SERVICE

MARY ANNE GIBBONS
Executive Vice President & General Counsel

DAVID C. BELT*
Office of the General Counsel
United States Postal Service
475 L'Enfant Plaza, SW
Washington, D.C. 20260
(202) 268-2945

Of counsel:
R. ANDREW GERMAN
Managing Counsel
MICHAEL J. ELSTON
Chief Counsel
United States Postal Service
475 L'Enfant Plaza, SW
Washington, D.C. 20260

Attorneys for the United States Postal Service

Counsel of Record

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TABLE OF CONTENTS

Table of Authorities iii

Glossary..... v

Summary 1

I. THE POSTAL SERVICE HAS STANDING TO CHALLENGE THE RESULT OF THE PRC'S RULEMAKING BECAUSE IT RESTRICTS THE POSTAL SERVICE'S PRICING FLEXIBILITY GOING FORWARD. 3

II. THE PRC'S APPLICATION OF 39 U.S.C. § 3622(e) TO LIMIT THE PRICE DIFFERENCE OF SEPARATE PRODUCTS IS ABITRARY AND CAPRICIOUS. 5

A. The PRC's Interpretation of Section 3622(e) is Inconsistent with the Language and Structure of the PAEA and With the PRC's Previous Orders. 5

B. The PRC's Overly Broad Interpretation Frustrates Congress's Purpose in Enacting the PAEA. 14

C. The PRC's Suggestion that the Postal Service Can Reduce the Unwarranted Effects of Its Flawed Analysis By Creating a New "Metered Mail" Product is Inconsistent With the Statute And Does not Solve The Problem That Its Flawed Analysis Creates 15

III. EVEN IF THE PRC COULD USE THIS RULEMAKING TO REVISIT ITS EARLIER FINDING THAT SINGLE PIECE AND PRESORT FIRST-CLASS MAIL HAVE DISTINCT COST OR MARKET CHARACTERISTICS, THAT FINDING WAS CORRECT AND CONFIRMS THAT THE TWO PRODUCTS ARE NOT IN A WORKSHARING RELATIONSHIP. 18

A. Single Piece and Presort Have Distinct Market Characteristics 19

B. Single Piece and Presort Have Distinct Cost Characteristics. 21

IV. THE PRC CONTINUES TO DEFINE "WORKSHARE DISCOUNTS" BEYOND THE FOUR TASKS SET FORTH IN THE STATUTE.. 23

A. The Postal Service is Aggrieved by the PRC's Arrogation of the Postal Service's Authority to Set Prices, Including Non-Worksharing "Discounts" or Price Differentials.. 23

B. The PRC's Expansion of Worksharing to Include Non-Worksharing Characteristics of the Mail is Contrary to the Statute and Should Be Set Aside. 25

Conclusion 29

Certificate of Compliance 30

Certificate of Service 31

TABLE OF AUTHORITIES

CASES

Ass'n of Am. R.Rs. v. Dep't of Transp., 38 F.3d 582 (D.C. Cir. 1994).....4, 5

Chevron U.S.A. Inc. v. NRDC, Inc., 467 U.S. 837 (1984).....15

Continental Airlines, Inc. v. Dep't of Transp., 843 F.2d 1444 (D.C. Cir. 1988) 15

Florida Power & Light Co. v. FERC, 85 F.3d 684 (D.C. Cir. 1996).....15

Gustafson v. Alloyd Co., 513 U.S. 561 (1995).....9

Int'l Bhd. of Elec. Workers v. ICC, 862 F.2d 330 (D.C. Cir. 1988) 4

Richards v. United States, 369 U.S. 1 (1962) 9

Sea-Land Serv., Inc. v. Dep't of Transp., 137 F.3d 640 (D.C. Cir. 1998).....4

Telecomms. Research & Action Ctr. v. FCC, 917 F.2d 585 (D.C. Cir. 1990) 4

STATUTES

39 U.S.C. § 101(d) 12

*39 U.S.C. § 102(6) 6

39 U.S.C. § 102(8) 7

39 U.S.C. § 3622 .....7, 9

*39 U.S.C. § 3622(b) 7, 14, 17

39 U.S.C. § 3622(c) 12, 14

* Authorities upon which we chiefly rely are marked with asterisks.

39 U.S.C. § 3622(d) 7, 16

*39 U.S.C. § 3622(e) 1, 2, 4-6, 8-10, 12, 14-18, 24-26, 28

39 U.S.C. § 3633(a) 12

39 U.S.C. § 3642 .....6, 11, 13, 17, 18

39 U.S.C. § 3642(a) 11

39 U.S.C. § 3652 9

39 U.S.C. § 3652(b) 9

39 U.S.C. § 3663 25

DECISIONS OF THE PRC

FY2010 Annual Compliance Determination, Docket No. ACR2010 (P.R.C. Mar. 29, 2011) 12

Op. & Rec. Decision, Docket No. R2000-1 (P.R.C. Nov. 13, 2000) 22

Op. & Rec. Decision, Docket No. R2006-1 (P.R.C. Feb. 26, 2007) 21

Order No. 43, Docket No. RM2007-1 (P.R.C. Oct. 29, 2007) 13

GLOSSARY

AADC	Automated Area Distribution Center
ACD	Annual Compliance Determination
Benchmark Order	PRC Order No. 1320, Order Resolving Technical Issues Concerning the Calculation of Workshare Discounts, Docket No. RM2010-13 (P.R.C. Apr. 20, 2012)
BMM	Bulk Metered Mail
PAEA	Postal Accountability and Enhancement Act, Pub. L. No. 109-435, 120 Stat. 3198 (2006)
PRA	Postal Reorganization Act
PRC	Postal Regulatory Commission Postal Rate Commission (prior to 2006)
Workshare Order	PRC Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, Docket No. RM2009-3 (P.R.C. Sept. 14, 2010)

SUMMARY

The PRC wrongly accuses the Postal Service of seeking to undermine or ignore the "workshare discount" limitations set forth in 39 U.S.C. § 3622(e). Under the Postal Service's interpretation, Section 3622(e) has a meaningful role in the pricing regime established by the PAEA. Specifically, it provides that, when the Postal Service offers a price discount to a mailer for doing tasks that the Postal Service otherwise would have to do, the discount it offers – and thus the price difference between the workshared and non-workshared version of the service – cannot exceed the costs the Postal Service saves from not having to perform the tasks itself. This interpretation of Section 3622(e) is faithful to the section's language, but also places the section in the context of the PAEA as a whole, recognizing that Section 3622(e) is one component of a larger statute designed by Congress to replace a cost-based pricing model with a market-based model.

Rather than limiting Section 3622(e) to its terms, PRC interprets Section 3622(e) to apply well beyond those situations where the Postal Service offers a "rate discount[] . . . to mailers," 39 U.S.C. § 3622(e), for performing a worksharing task. Under the PRC's wildly expansive view of this seemingly narrow statutory provision, Section 3622(e) potentially applies any time the Postal Service charges two different prices for two different services – regardless of whether one purports to be a discounted version of the other, and regardless of whether the two services

have distinct market or cost characteristics that would explain the difference in price. So long as it is possible to speculate that a mailer may choose between those services, the PRC concludes, then the gap in price between the services cannot exceed the gap in costs, even where the two services serve different markets, have different cost characteristics apart from any worksharing, or both.

Supporting this theory requires the PRC to read Section 3622(e) in isolation from the other simultaneously enacted parts of the PAEA, to overlook several explicit statutory provisions, and to ignore without explanation its own previous orders. It remains unclear what purpose is served by its tortured reading of the statute, other than to preserve a cost-of-service pricing system that the PAEA replaced or to recapture pricing authority that the PAEA gave to the Postal Service. But the effect of the PRC's interpretation is clear: if upheld, the workshare discount limitation drives virtually all prices within First-Class Mail. Specifically, the rate charged for Presort First-Class Mail – the Postal Service's largest and most profitable product – cannot be based on the market demand or the costs of processing those letters, but rather must derive entirely and mechanically from the price charged for Single Piece First-Class Mail, a separate product with its own demand and cost characteristics. This is not what Congress intended. Because the PRC's interpretation of Section 3622(e) is inconsistent with the text and structure of the PAEA, frustrates Congress's purpose in enacting it, and contradicts the

PRC's previous orders without explanation, the PRC's interpretation is arbitrary and capricious and must be set aside.

I. THE POSTAL SERVICE HAS STANDING TO CHALLENGE THE RESULT OF THE PRC'S RULEMAKING BECAUSE IT RESTRICTS THE POSTAL SERVICE'S PRICING FLEXIBILITY GOING FORWARD.

Until last month, there was no real question but that the Postal Service was aggrieved by the analytical framework that the PRC established in the rulemaking under review. On October 11, 2012, six months after the completion of the rulemaking, the Postal Service filed with the PRC a notice of price adjustments for its market-dominant products. *See* Notice of Market-Dominant Price Adjustment, Docket No. R2013-1 (Oct. 11, 2012) (*available at* http://www.prc.gov/Docs/85/85334/Notice%20Package.pdf). Because the rates proposed in that notice "comply with the workshare-discount provision as construed by the Commission," PRC Br. at 18, and because the Postal Service did not specifically allege that it would have proposed different rates "but for the Commission's orders under review," *id.*, the PRC now contends that the October filing deprived the Postal Service of the standing it previously possessed to challenge the outcome of the rulemaking. Put differently, because the Postal Service played within the rules established by the Commission, it somehow forfeited the opportunity to challenge those rules here.

The PRC cites no authority for the proposition that a regulated entity must violate the rules established in a rulemaking in order to challenge them. If that were the law, then rulemakings – which are necessarily prospective – could rarely be challenged directly. But it is not the law. *See Sea-Land Serv., Inc. v. Dep't of Transp.*, 137 F.3d 640, 648 (D.C. Cir. 1998). Indeed, standing may exist even where the agency has applied the challenged policy in the challenger's favor. *Telecomms. Research & Action Ctr. v. FCC*, 917 F.2d 585, 588 (D.C. Cir. 1990); *Int'l Bhd. of Elec. Workers v. ICC*, 862 F.2d 330, 334 (D.C. Cir. 1988).

The PRC does not seriously dispute that the PAEA was designed to give the Postal Service greater flexibility than it had under prior law to price its products to the marketplace. There is also no question but that the PRC's interpretation of Section 3622(e) reduces that flexibility by subjecting the prices of separate products to an additional constraint and an additional layer of regulatory review. This is alone sufficient to establish standing. A regulated party may be prospectively injured, for example, by an administrative policy that claims excessive agency authority, *Int'l Bhd. of Elec. Workers*, 862 F.2d at 334 (claim that agency lacked authority to review arbitration awards), or by a rule that imposes additional regulatory burdens than are permitted by statute, *Ass'n of Am. R.Rs. v. Dep't of Transp.*, 38 F.3d 582, 585 (D.C. Cir. 1994) (claim that agency rule improperly subjected plaintiff to otherwise inapplicable regulations). The mere

adoption of an improper rule is sufficient to cause such injury. *See id*. So the Postal Service need not categorically say that, but for the PRC's erroneous interpretation of Section 3622(e), it absolutely would have set rates for First-Class Mail differently in October 2012. It is sufficient to say, as the Postal Service discussed at length in its opening brief, that it would have considered a different rate design had it been not been improperly denied that choice.[1] Because it has been deprived of the choice of how to price its products, the Postal Service is aggrieved by the rules adopted by the PRC and has standing to challenge them.

II. THE PRC'S APPLICATION OF 39 U.S.C. § 3622(e) TO LIMIT THE PRICE DIFFERENCE OF SEPARATE PRODUCTS IS ABITRARY AND CAPRICIOUS.

A. The PRC's Interpretation of Section 3622(e) is Inconsistent with the Language and Structure of the PAEA and With the PRC's Previous Orders.

The PRC's brief does not dispute that, as set forth in the Postal Service's opening brief, the PAEA made significant changes to ratemaking and the relative roles of the PRC and the Postal Service. It added Section 3622(e), thereby

[1] As a practical matter, moreover, the Postal Service's dire financial circumstances preclude the defy-and-challenge approach that the PRC favors. As the PRC well knows, developing a rate design is a complex, time-consuming process. As the PRC also knows, the Postal Service is not in a position to forego revenue now – by proposing rates that it knows the PRC would reject – to demonstrate the capriciousness of the PRC's analysis later. It must take the revenue it can get under the price cap, and that revenue, for now, is available only by complying with the rigid pricing relationship between Presort and Single-Piece First Class Mail that this challenged rulemaking requires.

enshrining the "workshare discount" concept in Title 39 for the first time, but simultaneously made several more fundamental changes, including (1) replacing a cost-based "break even" pricing system with a market-based pricing system designed to improve the Postal Service's financial position within an overall price cap; (2) reducing the role of the PRC and enhancing the role of the Postal Service in setting prices; and (3) making the "product" rather than the "subclass" the primary classification within a class of mail for pricing purposes.[2] But the PRC's brief reads as though Congress enacted Section 3622(e) alone.

Although the PRC's brief attempts to ignore the term "product," there is no escaping its centrality to the PAEA's pricing regime. By the statute's plain language, a "product" – a term of art introduced by the PAEA – is a "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). Because pricing begins with the product, the first step in pricing under the PAEA is to identify the Postal Service's products. Once these products are identified and approved *by the PRC* pursuant to 39 U.S.C. § 3642, prices for market-dominant products are set according to the policies, factors and goals set forth in the "modern system" of rate regulation

[2] The PRC incorrectly characterizes the Postal Service's interpretation of Section 3622(e) as "novel." PRC Br. at 9. As noted in its opening brief, the Postal Service has taken a consistent position ever since the passage of the PAEA – that, under the PAEA, the "workshare discount" provisions do not apply to the price differences between separate products. The "novel" development was the PAEA's passage in 2006, not the Postal Service's interpretation of it.

established primarily in Section 3622. *See* 39 U.S.C. § 102(8) ("market-dominant product" is a "product subject to subchapter I of chapter 36" of Title 39, which includes Section 3622).

Because each product by definition has distinct market and/or cost characteristics from each other product, it necessarily follows that the price of any given product should take into account that product's unique characteristics. There are limits to this flexibility, of course, and thus necessarily some interrelationship between the prices charged for the Postal Service's various products. For example, price increases are subject to an inflation-based price cap that applies to each class of mail, 39 U.S.C. § 3622(d)(1)(A), and any pricing design must be "just and reasonable," *id.* § 3622(b)(8), which prevents the Postal Service from charging prices for its products that are divorced from any consideration of market demand or costs. Within those parameters, however, Congress plainly intended that the pricing decisions regarding separate products be made by the Postal Service and reflect the myriad cost and market considerations that normally drive pricing decisions. Nothing in the statute suggests that the price for one product must derive from, be dependent on, or be tied directly to the price of another product.

It is only once the products are established and their prices are set do the "workshare discount" limitations matter. Although the PAEA does not require the Postal Service to offer workshare discounts for its products, it allows such

discounts so long as the offered discount from the product price does not exceed the costs the Postal Service saves from not having to do one or more of the activities set forth in Section 3622(e). Accordingly, for example, Section 3622(e) applies to the three workshare discounts that the Postal Service offers for Presort First-Class Mail – for preparing mail destined to an AADC, for sorting mail to the first three digits of a ZIP code, and for sorting to all five digits of a ZIP code – and requires that they not exceed the costs the Postal Service saves from not having to do that processing.

The PRC's approach, by contrast, turns the entire statute on its head. By making Section 3622(e) the primary driver of the prices of the various postal products, the "workshare discount" tail wags the price-setting dog. The PRC bases its authority to dictate the price relationships of separate products primarily on the fact that the term "product" does not appear within Section 3622(e). But the Postal Service does not contend that Section 3622(e), read in isolation, cannot be applied across separate products. Rather, the point is that Section 3622(e) cannot be read in isolation; it must be read in conjunction with the other simultaneously enacted provisions of the PAEA. As the Supreme Court has explained, "a section of a statute should not be read in isolation from the context of the whole Act," and courts "must not be guided by a single sentence or member of a sentence, but should look to the provisions of the whole law, and to its object and policy."

Richards v. United States, 369 U.S. 1, 11 (1962) (citations omitted); *accord Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) (statutes "should not be read as a series of unrelated and isolated provisions"). Read in its proper context, "workshare discounts" can apply only within individual products – *i.e.*, when the Postal Service actually offers mailers a discount from the price of a product – and not between products. The absence of the word "product" within the four corners of Section 3622(e) is irrelevant.

The structure of the PAEA, and particularly the interplay between Section 3622 and 39 U.S.C. § 3652, confirms that "workshare discounts" are to be evaluated only within products. The former section sets forth the PAEA's pricing principles and limitations, and the latter gives the PRC the tools to enforce these principles and limitations. While the term "product" does not appear in Section 3622(e), it appears prominently in Section 3652(b), specifying that that the Postal Service shall provide data regarding "each market dominant product for which a workshare discount was in effect," including costs avoided "by virtue of such discount." The PRC's brief effectively reads this provision out of the statute, arguing (without support) that the phrase was intended merely to ensure that the Postal Service provides data "at a granular level." PRC Br. at 26. If that were all Congress wanted, it could simply have required the Postal Service to provide data on all mail, or on all mail services for which a workshare discount was in effect.

Instead, Congress used the term "product" in reference to workshare discounts, and it must be assumed that Congress – which introduced and defined the term in the very same enactment – meant what it said.

The PRC expresses concern that placing the "product" at the center of the pricing regime invites abuse by allowing the Postal Service to define its products in a way that will "evade" the workshare discount limitations under 3622(e). PRC Br. at 21-22. It goes so far as to argue that, under the Postal Service's view of the statute, "workshared versions of mail" could be designated as separate products. *Id*. That is nonsense. A discounted variant of a product shares the same market and cost characteristics of the base product itself. We know this because, if all costs avoided by worksharing are passed through to the mailer, both the "base" product and its workshared variant have the same unit contribution and the Postal Service is indifferent to which version a mailer chooses. The parties agree on this, and always have. Workshare Order at 21 n.13 (JA 338). "Cost characteristics" refer to intrinsic cost characteristics – *i.e.*, costs *other than* those avoided as a result of worksharing. In any event, the Postal Service has never sought to classify a workshared discount of a product as a product itself, so this professed concern is fictional.

Moreover, if the Postal Service ever did seek to define its products in an attempt to evade Section 3622(e) or any other statutory provision, the PRC would

rightly deny the request under 39 U.S.C. § 3642(a), which empowers the PRC to change, add, or remove market-dominant products. The PRC's brief neglects to mention Section 3642, which makes clear that the Postal Service does not get to define its products as it chooses and thus cannot manipulate its list of products to evade statutory requirements such as the workshare discount limitations. The PRC approves the list of products, and therefore can police any attempted "evasion."

For the same reason, the PRC's complaint that Congress's definition of the term "product" is too general to be given meaning, PRC Br. at 22, is unfounded. Congress has defined the term and has given the PRC the power to enforce it by approving, disallowing, or altering the Postal Service's proposed list of products. If the PRC believes that Congress has given it insufficient guidance, it should address those concerns to Congress. It is not free to ignore the definition. Also, the PRC's objection is in tension with the fact that the PRC's predecessor, the Postal Rate Commission, was able to define and give meaning to the term "subclass," which it defined as a mail service with distinct cost and market characteristics. *See* USPS Br. at 16. Because the Rate Commission had no trouble concluding that workshare discounts applied only within "subclasses" under prior law, it is not clear why it is unable to apply the analogous rule that workshare discounts apply within "products" under the PAEA.

Moreover, the PRC has previously given the term "substantive significance in the statutory scheme." PRC Br. at 24. As noted in our opening brief, the PRC placed great significance on the term "product" in the 2010 ACD when it invalidated the price of Standard Mail Flats, a market-dominant product, for failing to cover its attributable costs, FY2010 ACD, Docket No. ACR2010, at 106-07 (P.R.C. Mar. 29, 2010), even though the PAEA contains no such requirement.[3] The PRC's decision was premised on the notion that, where a market-dominant product does not cover its costs, its price is not "fair and equitable" under 39 U.S.C. § 101(d) – a provision that, like Section 3622(e), does not itself contain the term "product." The PRC now contends that its focus on a specific product was coincidental, PRC Br. at 25-26, but its brief to this Court in that case said otherwise: "Consistently underpricing one product at the expense of other products in a class results in an unfair and inequitable distribution of costs to users of the mail in violation of section 101(d)." *U.S. Postal Serv. v. PRC*, No. 11-1117, PRC Br. at 26 (D.C. Cir. filed Nov. 23, 2011); *accord id.* at 25-26 (arguing that the Postal Service "impose[d] a disproportionate institutional cost burden on other Standard Mail products" when it "used its pricing flexibility for above-average rate

[3] *Compare* 39 U.S.C. § 3633(a)(2) (requiring *competitive* products to cover their costs), *with id.* § 3622(c)(2) (each market-dominant "class" of mail must cover the class's costs).

increases for other Standard Mail products, while imposing below-average rate increases on Standard Mail Flats").

The PRC's position that the "product" is irrelevant to the "workshare discount" limitations is also belied by its analysis underlying the Workshare Order now on review. As the PRC formulated the "factual inquiry" during the rulemaking, two groups of mail (the "base group" and the "workshared group") are in a worksharing relationship if they share "cost and demand characteristics" such that a mailer chooses between the two groups based on price alone. Workshare Order at 21 (JA 338). But separate products by definition do not share both cost and demand characteristics. In any event, with respect to the Single Piece and Presort products, the PRC has already made the relevant determination. When the Postal Service proposed treating Single Piece and Presort as separate products within the First-Class Mail class, the PRC approved the classification under 39 U.S.C. § 3642, concluding that they have distinct cost or market characteristics. Order No. 43, Docket No. RM2007-1, at 103-04 (P.R.C. Oct. 29, 2007) (*available at* www.prc.gov/Docs/58/58026/FinalRuleswithTOC.pdf).

The PRC does not disavow its earlier determination that Single Piece and Presort are separate products. Instead, it seeks to minimize that finding, arguing that, in approving the classification, it did not consider worksharing. As we noted in our opening brief, however, the PRC was made aware of the fact that its

decision on products had implications for worksharing, *see* USPS Br. at 35 & n.8, and it did not then deny the connection. It cannot do so now.

B. The PRC's Overly Broad Interpretation Frustrates Congress's Purpose in Enacting the PAEA.

The Postal Service's opening brief shows that its interpretation of Section 3622(e) advances Congress's expressed purposes in enacting the PAEA, as well as several other goals set forth explicitly in the state. USPS Br. at 12-15, 38, 57-61. The PRC's brief does not deny this, and does not share how its opposing interpretation advances the purposes of the statute. Rather, the PRC asserts primarily that it need not do so because, unlike the more "qualitative" goals of the statute, the workshare discount limitation is expressed in mandatory, "quantitative" terms and thus overrides what the PRC deems to be the statute's more amorphous purposes. PRC Br. at 36-38. But no one disputes that Section 3622(e) is mandatory. The question is when and to what it applies.

Scrambling to find some justification for applying Section 3622(e) to separate products, the PRC claims for the first time – in a single-sentence, and without a citation to its own order or any explanation whatsoever – that its "interpretation of the workshare-discount provision furthers several [by which it means two] qualitative objectives and factors, such as providing incentives to reduce costs and increase efficiency, 39 U.S.C. § 3622(b)(1), and accounting for the degree of preparation of mail and its effect upon the Postal Service's costs, *id.* § 3622(c)(5)." PRC Br. at 38. This

explanation comes far too late to be given weight. As this Court has explained, in order to be entitled to *Chevron* deference, an agency must "provide 'a reasonable explanation for its conclusion that [the interpretation] serve[s] the [statutory] objectives.'" *Continental Airlines, Inc. v. Dep't of Transp.*, 843 F.2d 1444, 1452 (D.C. Cir. 1988) (quoting *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 863 (1984)). The PRC never stated during the rulemaking that its interpretation of Section 3622(e) serves any listed goal or purpose of the PAEA, and the after-the-fact contentions of the PRC's lawyers cannot substitute for its own reasoned analysis and need not be considered. *Florida Power & Light Co. v. FERC*, 85 F.3d 684, 689 (D.C. Cir. 1996) ("the agency runs this regulatory program, not its lawyers; parties are entitled to the agency's analysis . . . , not post hoc salvage operations of counsel"). In any event, the PRC's sentence-long litigation position hardly passes as an argument – the PRC does not explain how its interpretation is better than the Postal Service's in advancing even the two goals it names. And the PRC never explains why it now abandons its earlier (and correct) view that the "principal" goal of the statute was to afford the Postal Service enhanced pricing flexibility to respond to market conditions. *See* USPS Br. at 13-14, 38.

C. The PRC's Suggestion that the Postal Service Can Reduce the Unwarranted Effects of Its Flawed Analysis by Creating a New "Metered Mail" Product is Inconsistent with the Statute And Does not Solve the Problem That Its Flawed Analysis Creates.

The result of the needlessly complex pricing regime produced by the PRC's overbroad interpretation of Section 3622(e) is one that Congress did not intend:

that the price of Presort mail, the Postal Service's largest and most profitable product, must be derived entirely from and tied directly to the price of a stamp rather than set based on its own market or cost characteristics. The PRC now assures this Court that the Postal Service can avoid this absurd outcome of its flawed analysis, but only if it introduces yet another layer of complexity. Specifically, the PRC contends, the Postal Service can (1) split Single Piece into two separate products (stamped mail and metered mail) with separate prices, and (2) have the Presort price derive from metered mail rather than Single Piece mail as a whole. PRC Br. at 39-40.

This is a stunning proposal coming from the PRC. It is true that creating a new and lower-price "metered" product could allow the Postal Service to lower the artificial price floor for Presort that the PRC's analysis otherwise imposes. But if the Postal Service were to tie Presort prices to a metered-mail product priced below the price of a stamp, this would create additional room to give the price of stamps – a category that would be untethered from the artificial price relationships between Presort and metered mail – a price increase well above the cap established in 39 U.S.C. § 3622(d)(1)(A).[4] Considering that this entire rulemaking arose from the PRC's concern that the Postal Service would charge too much for Single-Piece

[4] This is not to suggest that the Postal Service will inexorably reduce the price of Presort if the PRC's interpretation of Section 3622(e) is set aside. The Postal Service pursues this appeal not to enable a particular pricing strategy, but rather to protect the pricing flexibility that the PAEA provides.

mail absent strict price controls under Section 3622(e), it is bizarre that the PRC would suggest an escape hatch allowing the Postal Service to do what the PRC's otherwise rigid and mechanical regime was presumably designed to prevent.

In any event, the PRC's solution solves the wrong problem. The fundamental problem with the PRC's approach is not that it chose the wrong product to which the price of Presort mail must be mechanically and artificially tied, but that it chose to mechanically tie Presort to some other product at all. Tying Presort mail to "metered" mail rather than to all Single-Piece mail still prevents the Postal Service from pricing its largest product based on the factors that Congress intended for it to consider when it replaced the cost-of-service ratemaking model that the PRC's analysis reinstates.

If the PRC wants to regulate the price that the Postal Service charges for Presort mail or the price relationship between it and another product, Congress has given the PRC statutory tools to do so – tools that the PRC does not contend are inadequate. It can evaluate whether the rates the Postal Service charges for its various products violate the "just and reasonable" rate requirement of 39 U.S.C. § 3622(b)(8). Or, if it believes that Presort no longer has cost or demand characteristics that distinguish it from other postal products, it can always revisit its earlier approval of Presort as its own product, with distinct cost or demand characteristics from Single-Piece mail, under Section 3642. What it cannot do is

what it did here: rewrite the statute to arrogate to itself the authority to set prices for postal products or dictate that the price of one product must be mechanically derived from the price of a separate product under Section 3622(e). Because this was not the pricing regime that Congress intended or designed, the PRC's imposition of it, driven entirely by its unduly broad interpretation of Section 3622(e), must be set aside.

III. EVEN IF THE PRC COULD USE THIS RULEMAKING TO REVISIT ITS EARLIER FINDING THAT SINGLE PIECE AND PRESORT FIRST-CLASS MAIL HAVE DISTINCT COST OR MARKET CHARACTERISTICS, THAT FINDING WAS CORRECT AND CONFIRMS THAT THE TWO PRODUCTS ARE NOT IN A WORKSHARING RELATIONSHIP.

As the PRC now frames the inquiry, two mail services are in a worksharing relationship if they are identical except for price – *i.e.*, if they share "cost and demand characteristics" such that a mailer chooses between the "workshared group" and the "base group" solely on price, and switches from one product to the other when the prices change. PRC Br. at 15, 20; Workshare Order at 21, 38-39 (JA 338, 355-56). Even if the PRC were free to use a rulemaking to revisit its previous order under Section 3642 (the proceeding that Congress provided to make such findings) that resolved this question in the case of Single Piece and Presort mail, the Workshare Order's implicit conclusion that the two products share the same cost and market characteristics is arbitrary and capricious. The PRC got it right the first time: these two products have distinct market or cost characteristics.

This alone precludes a finding that the two products are in a worksharing relationship.

A. Single Piece and Presort Have Distinct Market Characteristics.

The PRC continues to improperly define the relevant market in terms of the purpose of the mail, which its Workshare Order defined as "secure transmission of individualized, confidential, time-sensitive messages and documents." Workshare Order at 50-51 (JA 367-68). As noted in the Postal Service's opening brief, USPS Br. at 47, this remains a uselessly broad definition. The PRC further errs in framing the "factual question" regarding the relevant market in terms of whether "a group of mailers" would choose Single Piece or Presort, PRC Br. at 20, an inquiry that assumes rather than analyzes whether, in fact, the two products are part of the same market. The relevant question, which the PRC's discussion begs, is whether there is one "group of mailers" choosing between the two products or two groups of mailers, with each tending to use one product or the other.

More useful in answering the relevant question is the PRC's concession that Single Piece is a "retail" category of mail while Presort is a "wholesale" category of mail. PRC Br. at 28. This suggests not only that there are two separate markets – a wholesale and a retail market – but that mailers are in one or the other based not exclusively on the relative prices of the two products, but rather on the interaction of cost and the volume commitments required for Presort mail. The

PRC does not dispute that the vast majority of Single-Piece mailings include insufficient volume for a mailer to even consider the costs of converting to Presort.

The Commission responds that, regardless, a "substantial portion" of Single-Piece mail – metered mail – is nevertheless amenable to convert to Presort if the price discount were sufficiently great. PRC Br. at 32, 40. But the evidence it cites does not support the proposition. For example, it characterizes a Postal Service statement as "acknowledg[ing]" that metered mail "is the most likely to convert" to Presort, *id.* at 28, but the cited statement says merely that, *historically*, the parties *assumed* that, to the extent there is market overlap, it would be found *within* the metered mail group – not that such overlap encompasses the entire group, or that it persists today. *See* JA 75 ("In the past, the Postal Service and the Commission have assumed that the letter mail pieces most likely to convert from Single Piece to Presorted are found among those pieces which are entered as metered mail."). Similarly, the PRC's cites "discount elasticity" data showing merely that, in the past, there was a limited and intermittent degree of price-responsive movement from Single Piece to Presort, PRC Br. at 29-30, while ignoring more recent data strongly suggesting that changes in the price gap between the two products do not impact the volume of either.[5]

[5]Docket ACR2009, USPS Resp. to Questions 1-5 of Chairman's Info. Req. No. 8 (Mar. 8, 2010) (*available at* http://www.prc.gov/Docs/67/67109/Resp.ChIR.No.8.pdf *and* http://www.prc.gov/Docs/67/67109/ChIR.8.Q.5b.Attach.pdf).

It may be true that, at the margins, a small group of mailers may be persuaded to move from Single Piece to Presort if it were given sufficient price incentives. But this does not support the proposition that there is substantial market overlap, let alone that there is only one market. More important, the PRC does not assert, let alone support, that *any* Presort mailers would revert to Single Piece in response to a change in their relative prices. Absent that finding, the PRC cannot legitimately claim that the two products are substitutes,[6] and its finding that they are is arbitrary and capricious.

B. Single Piece and Presort Have Distinct Cost Characteristics.

Even if the two products were substitutes in the same market, the PRC cannot and does not even attempt to dispute that they have different intrinsic cost characteristics. Instead, it breaks Single Piece into two subgroups – stamped mail and metered mail – and baldly asserts that the cost characteristics of metered mail and Presort mail are the same except for those due to worksharing. PRC Br. at 31. The Postal Service's opening brief already demonstrates why that cannot be the case – the gap in per-unit contribution between Single Piece and Presort is growing

[6] *See* Op. & Rec. Decision, Docket No. R2006-1, at 129, 133-34 (P.R.C. Feb. 26, 2007) (worksharing relationship requires categories in which mailers would both "convert" to worksharing and "revert" to the benchmark in response to relative price changes).

even though (1) the relative prices charged for the two products have remained constant, and (2) the ratio of metered mail to stamped mail has not changed.[7]

The PRC brushes aside this analysis entirely, instead suggesting that one cannot use unit contribution as a means of determining whether two groups of mail share the same cost characteristics. PRC Br. at 30-31. This argument is new. The PRC's workshare discount methodology has always been (and continues to be) premised on the idea that, where two groups of mail are in a worksharing relationship, the Postal Service is indifferent to which group a mailer chooses to use because each contributes the same amount to institutional costs. *See* Op. & Rec. Dec'n, Docket No. R2000-1, at 234 (P.R.C. Nov. 13 2000) (*available at* http://www.prc.gov/Docs/26/26350/R2000-1-V1.pdf) ("when discounts pass through 100 percent of avoided costs to the workshare mailer, . . . workshare mailers and non-workshare mailers provide the same contribution"). Because that is not true here – even if one defines the relevant groups as Presort and "metered" mail – then those two groups cannot be in a worksharing relationship. Put simply, the Postal Service is *not* indifferent to the choice between Presort and metered mail because the former is more profitable. Accordingly, the two groups have cost

[7]The PRC speculates that the changing mix of metered mail may mean that stamped mail is moving into metered mail while other metered mail is moving simultaneously to Presort. PRC Br. at 33. If that were happening, the ratio of stamped mail to metered mail would be shrinking and the unit contribution of Single Piece as a whole would be growing relative to Presort. Neither is occurring.

differences apart from those relating to worksharing, and thus cannot be in a worksharing relationship as the PRC defines it.

IV. THE PRC CONTINUES TO DEFINE "WORKSHARE DISCOUNTS" BEYOND THE FOUR TASKS SET FORTH IN THE STATUTE.

A. The Postal Service is Aggrieved by the PRC's Arrogation of the Postal Service's Authority to Set Prices, Including Non-Worksharing "Discounts" or Price Differentials.

The PRC plainly misinterprets the Postal Service's primary argument in asserting that the Postal Service is not aggrieved by its atextual definition of worksharing. It is only because the PRC has swept non-worksharing tasks (such as address hygiene and mail density) into its definition of "worksharing" that it even attempts to argue that products such as Single Piece and Presort are in a worksharing relationship. Once these non-worksharing tasks are appropriately viewed as what they are – illustrations of why the two products have distinct cost or market characteristics – even the PRC would agree that its entire analysis collapses. For this reason alone, the Postal Service is aggrieved by the PRC's misreading of the scope of the workshare discount definition.

Even apart from this aspect of the Postal Service's challenge, it is nevertheless aggrieved by the PRC's expansion of the workshare definition. The PRC focuses on the fact that including non-worksharing tasks gives the Postal Service additional "cap room" to distinguish the prices of Single Piece and Presort mail. PRC Br. at 44-45. But the problem is that these tasks are now subject to a

cap where they should not be. The statute prohibits the Postal Service from offering a workshare discount greater than the costs avoided when a mailer does one of the four tasks listed in 39 U.S.C. § 3622(e)(2). By including unlisted mail characteristics in the definition of worksharing, the PRC has effectively prohibited the Postal Service from offering a rate differential that is more than 100 percent of the cost savings that result from those mail characteristics.

For example, if hypothetical pre-mailing activities reduce the cost for processing the mailer's items by two cents per piece, there is nothing in Title 39 that should prevent the Postal Service from offering mailers who engage in these activities a rate that is three cents lower than the rate charged to mailers who do not engage in those activities. While it does not always make sense to offer a rate discount for a non-worksharing activity that is greater than the cost the activity saves the Postal Service two cents, the Postal Service may well want to offer such pricing if, in its business judgment, it will result in sufficiently increased volume that in turn will generate more total contribution toward its costs. If, in the right circumstances, offering such a per-piece price break can increase the Postal Service's net revenue, it should be free to offer such an incentive.

Put simply, the PRC's order arrogates to itself the authority to set prices and withdraws pricing flexibility from the Postal Service. Under the PRC's expanded definition of worksharing, the statutory prohibition on passing through more than

100 percent of the costs savings applies to a much broader category of potential rate differentials, including things that do not involve the sharing of work between the mailer and the Postal Service. This alone makes the Postal Service aggrieved by the PRC's order, and this Court has jurisdiction under 39 U.S.C. § 3663 to consider its challenge to the PRC's expansion of the term "workshare discount."

B. The PRC's Expansion of Worksharing to Include Non-Worksharing Characteristics of the Mail is Contrary to the Statute and Should Be Set Aside.

The PRC offers almost no rebuttal to the argument that its novel interpretation of worksharing is at odds with the plain language of the statute. The statute unambiguously defines "workshare discount" as "rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission." 39 U.S.C. §3622(e)(1). By expanding the definition of worksharing to include mail characteristics or mailer activities that do not involve performing work that the Postal Service otherwise would have to perform, the PRC's interpretation restricts the Postal Service's ability to offer price differentials for mail characteristics that are not listed in Section 3622(e)(1) but that save the Postal Service money. The PRC's brief sheds no light on how this can be consistent with the statutory definition of "workshare discount."

Even if the statute's listing of the four mailer activities could somehow be described as ambiguous, the PRC's interpretation is unreasonable because mailer activities that qualify for a "workshare discount" must, at the very least, involve worksharing, *i.e.*, must substitute for work that the Postal Service would otherwise have to do, thus allowing the Postal Service to avoid costs it would otherwise incur. That is why Section 3622(e)(2) refers to "the cost that the Postal Service avoids as a result of workshare activity."

The PRC admits in its brief that its new interpretation of "workshare discount" results in a calculation that is inconsistent with the requirements of the statute when it acknowledges that what it is doing is including "the value to the Postal Service of . . . ancillary task[s]" – that is, tasks not listed among those eligible for a "workshare discount" in Section 3622(e)(1) – "in the cost avoided by the worksharing relationship." PRC Br. at 43. The PRC's goal under the workshare provision of the PAEA should be to calculate avoided costs – specifically, "the cost that the Postal Service avoids as a result of workshare activity" – not total savings from the "worksharing relationship." By stating that its goal is to adopt a methodology that calculates *total savings* from the "worksharing relationship" rather than *costs avoided* from the "workshare activity," the PRC is rewriting the statute. Thus its "interpretation" is not only unreasonable but contrary to the plain language of the statute as well.

It is no answer to say that it is just too hard to calculate the costs avoided, as the PRC argues when it claims that its "methodology permits workshare discounts to reflect the value of characteristics, like density, whose 'cost impact cannot feasibly be isolated from the impact of the named worksharing activity.'" PRC Br. at 43. First, workshare discounts should not reflect the value of mail "characteristics" that do not involve a "named worksharing activity"; instead, they should reflect what the statute requires them to reflect: "the cost that the Postal Service avoids as a result of workshare activity." Second, if cost savings from ancillary activities are excluded from "costs avoided" where such savings can be measured and "isolated" from the activities named in the statute, then cost savings from equally ancillary activities should not be included in "costs avoided" solely because the PRC cannot calculate them. The PRC's cost calculations are as much art as science, and if it is too hard to calculate the separate impact of cost-saving "ancillary" characteristics, then such characteristics should be addressed outside of the context of the workshare provision. In other words, the Postal Service should have the flexibility to establish rates reflective of cost-saving mail characteristics without having to determine with precision whether those discounts meet, exceed, or fall short of a cost impact that the PRC claims cannot feasibly be calculated. Finally, even if theoretically it would be "better" to define a workshare discount to include all costs savings associated with the mailer's activities rather than just

avoided costs, the PRC cannot simply rewrite the statute; it should tell Congress that it cannot calculate what Congress told it to calculate. This Court should reject the PRC's attempt to substitute its judgment for Congress's as expressed in the plain language of the statute, set aside that portion of the PRC's order, and limit the PRC's Section 3622(e)(1) authority to the review of discounts for the four specified worksharing activities.

CONCLUSION

For the reasons stated here and in the Postal Service's opening brief, this Court should grant the petition for review and remand the matter to the PRC.

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Respectfully submitted,

MARY ANNE GIBBONS
Executive Vice President & General Counsel

/s/ David C. Belt
DAVID C. BELT
Office of the General Counsel
United States Postal Service
475 L'Enfant Plaza, SW
Washington, DC 20260
(202) 268-2945
david.c.belt@usps.gov

Of Counsel:

R. ANDREW GERMAN
Managing Counsel

MICHAEL J. ELSTON
Chief Counsel
United States Postal Service
475 L'Enfant Plaza, SW
Washington, D.C. 20260

CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to Fed. R. App. P. 32(a)(7), that the foregoing Reply Brief of the United States Postal Service uses proportionately spaced, 14-point type, and contains 6,977 words as measured by Microsoft Word, a word processing system that includes footnotes and citations in word counts.

/s/ David C. Belt
Attorney for the U.S. Postal Service
Dated: November 13, 2012

CERTIFICATE OF SERVICE

I hereby certify that on November 13, 2012, the foregoing reply brief was electronically filed with the U.S. Court of Appeals for the District of Columbia Circuit by using the CM/ECF system. I further certify that counsel for the respondent and intervenors are registered as ECF filers and that they will be served by the CM/ECF system.

/s/ David C. Belt
DAVID C. BELT
Office of the General Counsel
United States Postal Service
475 L'Enfant Plaza, SW
Washington, DC 20260
(202) 268-2945
david.c.belt@usps.gov