

Oral Argument Scheduled for February 7, 2012

No. 11-1117

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 an Order of the Postal Regulatory Commission

BRIEF OF INTERVENORS L.L.BEAN, INC.,
VALPAK DIRECT MARKETING SYSTEMS, INC., AND
VALPAK DEALERS' ASSOCIATION, INC.

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December 7, 2011

**DISCLOSURE OF CORPORATE AFFILIATIONS
AND FINANCIAL INTEREST**

L.L.Bean, Inc. (“L.L.Bean”) is a privately owned company organized under the laws of Maine and having its principal place of business in Maine, in which no publicly-held company has a 10 percent or greater ownership interest.

Valpak Direct Marketing Systems, Inc. (“VPDMS”) is a wholly-owned subsidiary of Cox Target Media, Inc., which is a wholly-owned subsidiary of Cox Media Group, Inc., which is a wholly-owned subsidiary of Cox Enterprises, Inc., a privately-held corporation organized under the laws of the State of Delaware.

Valpak Dealers Association, Inc. (“VPDA”) is an incorporated association of the franchisees of VPDMS, having no parent company, but affiliated with VPDMS. No publicly-held company or corporation has a 10 percent or greater ownership interest in VPDA. (VPDMS and VPDA are referred to herein collectively as “Valpak.”)

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

(A) Parties and Amici. All parties, intervenors, and amici appearing in the agency proceedings and before this Court are listed in the Brief of the United States Postal Service.

(B) Ruling Under Review. References to the rulings at issue appear in the Brief of the United States Postal Service.

(C) Related Cases. This matter has not previously been before this Court or any other court. Counsel for intervenors are unaware of any related cases pending before this Court or any other court.

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GLOSSARY OF ABBREVIATIONS

ACMA	American Catalog Mailers Association
CPI	Consumer Price Index
ACD	Annual Compliance Determination
ACR	Annual Compliance Report
L.L.Bean	L.L.Bean, Inc.
PAEA	Postal Accountability and Enhancement Act, Pub. L. 109-435
PRC	Postal Regulatory Commission
USPS	United States Postal Service
VPDA	Valpak Dealers' Association, Inc.
VPDMS	Valpak Direct Marketing Systems, Inc.

STATEMENT OF THE ISSUES

The intervenors adopt the Statement of the Issues set forth in the Brief for Respondent Postal Regulatory Commission (“Commission”). In addition, the intervenors identify the following issue:

1. Whether the Postal Service’s Issue III is properly before this Court?

STATUTORY PROVISIONS

All applicable statutes are contained in a Statutory Addendum to the Brief for Respondent Postal Regulatory Commission.

STATEMENT OF FACTS

In each of its last three Annual Compliance Determinations, the Commission found that the Standard Flats product (one of the six products within the Standard Mail class) has been priced below its attributable costs, with a cost coverage (calculated as revenues divided by costs) of well less than 100 percent.¹ Moreover, the Commission has observed that the cost coverage gap has widened over the last three years due to the Postal Service’s below-average price increases for this below-cost product, producing an aggregate \$1.4 billion shortfall in contribution as shown in the following table:

¹ See Annual Compliance Determination, Docket No. ACR2010 (“FY 2010 ACD”), p. 106 and n.16.

Standard Flats — Cost Coverages and Losses

Docket	Fiscal Year	Cost Coverage	Losses (in millions)
ACR2008	FY 2008	94.4%	\$ 217.8
ACR2009	FY 2009	82.4%	\$ 615.6
ACR2010	FY 2010	81.6%	\$ 577.0
	Aggregate		\$1,410.4 ²

Although the Commission expressed deep concern about this underwater pricing in prior annual compliance reviews, it was not until Docket No. ACR2010 that the Commission made its finding of “noncompliance” and required the Postal Service to take remedial action. FY 2010 ACD, pp. 106-107.

Missing from the Statements of Facts presented by the Postal Service and intervenor American Catalog Mailers Association (“ACMA”) are the pricing actions of the Postal Service over the last four years that precipitated the Commission’s compliance determination. The Postal Service has implemented four Consumer Price Index (“CPI”)-based rate adjustments under the Postal Accountability and Enhancement Act (“PAEA”): Docket No. R2008-1, filed February 11, 2008; Docket No. R2009-2, filed February 10, 2009; Docket No. R2011-2, filed January 13, 2011; and, most recently, Docket No. R2012-3, filed October 18, 2011. In each of these four adjustments, the average class-wide price

² FY 2010 ACD, pp. 81, 106.

increase for the Standard Mail class was set as close as practicable to the allowable rate-cap increase in the CPI. However, over that period, the aggregate price increase for the Standard Flats product has been well below the class-wide CPI average.³

The Postal Service's justification for these below-average increases for below-cost Standard Flats has been essentially unchanged since 2008. This rationale is exemplified by the Postal Service's Notice of Market-Dominant Price Adjustment in Docket No. R2011-2, filed during the pendency of the Commission's Docket No. ACR2010 proceeding under review here:

The price change for the *Flats product* is lower than the price cap: 0.835 percent. This continues efforts to moderate the increases for catalog mailers, whose volume fell considerably between FY 2008 and FY 2010. Catalog mailers use this product, as well as the *Carrier Route product*.... Although FY 2010 data shows that Standard Mail Flats had a cost coverage below 100 percent, the Postal Service is mitigating the price increase to maintain the viability of the catalog industry (Factor 3). For Standard Mail Flats, a cautious approach is warranted because the *catalog industry, which depends heavily on Standard Mail Flats*, is in a delicate financial position. [Postal Service Notice of Price Adjustment, Docket No. R2011-2 (Jan. 13, 2011), pp. 16-17 (footnote omitted) (emphasis added).]

³ See Docket No. ACR2010, Valpak Initial Comments (Feb. 2, 2011), p. 48, JA 184.

The Postal Service's brief in this case does not mention its prior pricing actions, nor does it mention its purported concern for the well-being of the catalog industry as the basis for those actions. However, the Postal Service acknowledged in its justification for its Docket No. R2011-2 price adjustments cited above that catalog mailers do not use the Standard Flats product exclusively, but also use the Carrier Route product extensively.⁴ The following table compares the Postal Service's price adjustments under PAEA for the Standard Flat and Carrier Route flats products with the CPI-based class-wide average increase for the Standard Mail class as a whole:

Standard Mail Price Adjustments under PAEA⁵

Docket	Standard Flats	Carrier Route	Standard Mail Class
R2008-1	0.86%	2.99%	2.88%
R2009-2	2.31%	4.31%	3.78%
R2011-2	0.84%	1.38%	1.74%
R2012-3	2.21%	2.43%	2.04%
Cumulative	6.35%	11.55%	10.84%

⁴ To qualify for the Carrier Route product, a mailer must mail to at least 10 addresses on a delivery carrier's route. Postal Service Domestic Mail Manual, section 343.6.3.2. Less dense mailings may qualify for the Standard Flats product.

⁵ Docket No. R2008-1, Order No. 66, p. 31; Docket No. R2009-2, Order No. 191, p. 43; Docket No. R2011-2, Order No. 675, p. 22; Docket No. R2012-3, Order No. 987, p. 19.

In each instance, Carrier Route received a larger price increase than Standard Flats. Cumulatively, the Carrier Route increase has been nearly double that for Standard Flats, and even above the class-wide average, whereas the increase for Standard Flats has been well below that average. As the Commission found in its ACD at issue in this case, the Carrier Route product is profitable for the Postal Service, generating a cost coverage of 143.0 percent, compared to the (below cost) coverage of 81.8 percent for Standard Flats.

Intervenor ACMA recently has reported that Carrier Route is by far the more widely used product in the catalog industry. On October 18, 2011, eight days prior to the filing of its initial brief in this case, ACMA issued a bulletin to members and non-members concerning the Postal Service's proposed price adjustments filed with the Commission that same day (in Docket No. R2012-3), in which the Postal Service raised Standard Flats prices by 2.21 percent, while raising Carrier Route prices by 2.43 percent. ACMA stated:

While we are appreciative that the significant financial turmoil of the catalog sector is recognized, we would have preferred to see the range flipped given the *more significant role of Carrier Route for catalogs today*. ACMA estimates are that only a quarter to a third of books [catalogs] are mailed in SM flat [Standard Mail Flats] with two thirds or more being entered as Carrier

Route (see the ACMA survey project below that will give us precise data on this mix).⁶

ACMA's new concern for Carrier Route was echoed in its recent comments to the Commission in Docket No. R2012-3 on November 7, 2011, where it stated that: "In fact, we might have *expected* the increase amounts applied to Carrier Route and Standard Flats to have been *reversed*, and we wonder why Carrier Route received a higher increase percent."⁷

Lastly, the Postal Service's Statement of Facts does not point out that the Postal Service has no current earnings and no retained earnings from prior years.⁸ Therefore, every dollar which the Postal Service loses due to underpricing a product such as Standard Flats must be recouped by imposing higher prices on products used by other Standard Mail class users — such as intervenors L.L.Bean, a significant user of Standard Mail Carrier Route,⁹ and Valpak, a significant user

⁶ ACMA Washington Bulletin (Oct. 18, 2011), p. 2 (emphasis added). <http://www.catalogmailers.org/clubportal/clubdocs/2129/ACMAAlert-NewRatesAnnounced,Oct.18,2011.pdf>.

⁷ Statement of the American Catalog Mailers Association, Docket No. R2012-3 (Nov. 7, 2011), p. 3 (emphasis added). <http://www.prc.gov/Docs/77/77468/ACMA%20Comments%20R2012-3.pdf>.

⁸ FY 2010 ACD, p. 22, Table IV-1.

⁹ Initial Comments of L.L.Bean, Inc., p. 1, JA 71.

of Standard Mail Saturation Letters.¹⁰

SUMMARY OF ARGUMENT

The Postal Service's Petition for Review asserts, in effect, that the Postal Accountability and Enhancement Act bestows upon the Postal Service the unfettered power – unreviewable by the Postal Regulatory Commission – to set and maintain below-cost prices for selected market dominant mail products indefinitely, resulting in other profitable products paying higher-than-otherwise-necessary prices to cross-subsidize money-losing products. Contrary to the Postal Service's view, 39 U.S.C. section 3653 clearly confers on the Commission both the responsibility and authority to identify such abusive pricing and declare it noncompliant with section 3622(c)(14) for violation of the policies of Title 39, including 39 U.S.C. section 101(d).

The Postal Service's core legal argument – that compliance with section 101(d) is beyond the Commission's authority because that section is not within chapter 36 – is based on a misconstruction of the statute. Among the "factors" that the Commission "shall take into account" under section 3622(c) of chapter 36 is

¹⁰ Motion of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. for Leave to Intervene (May 27, 2011), p. 1.

subsection (c)(14): “the policies of this *title* as well as such other factors as the Commission determines appropriate.” 39 U.S.C. section 3622(c)(14) (emphasis added). This requirement to consider the “policies of this title” clearly includes 39 U.S.C. section 101, captioned “Postal policy.” Section 101(d) requires:

Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.

The Commission’s clear reading of the statute should have come as no surprise to the Postal Service and intervenor ACMA. Over the course of its last three annual compliance determinations (Docket Nos. ACR2008, ACR2009, and ACR2010) and an intervening order in a rulemaking proceeding (Order No. 536, Docket No. RM2009-3), the Commission has consistently held that its annual compliance review authority encompasses violations of 39 U.S.C. section 101(d). Moreover, in each of these three compliance determinations, the Commission specifically stated that the Postal Service’s continued below-cost pricing of Standard Flats constituted a cross-subsidy imposed on other Standard Mail users that implicated section 101(d). Yet over the course of these proceedings before the Commission, the Postal Service never challenged the Commission’s view that section 101(d) was within the ambit of its annual compliance review authority.

In its first two annual compliance determinations, the Commission stopped

short of a noncompliance finding, instead urging the Postal Service to take corrective pricing action on its own initiative. The Postal Service, however, continued to implement below-average (and below-CPI) increases for Standard Flats that widened the cost coverage shortfall and increased the cross subsidy. The Commission finally decided that it had to make its first noncompliance determination and direct remedial action.

Lastly, the Postal Service's Issue III, which asserts that the Commission refused to consider an argument raised below about the possible effect on Postal Service finances of increasing prices for underwater products under a cap regimen, ignores the fact that the argument was neither made before the Commission by the Postal Service — a fact it acknowledged implicitly on brief — nor by ACMA. The Postal Service's seeks to remedy the lack of record support for its position by an extra-record hypothetical about how pricing choices by the Postal Service could be skewed to its own disadvantage. The argument is not properly before the Court, and its hypothetical is, in any event, deeply flawed and ultimately meaningless.

ARGUMENT

I. THE COMMISSION PROPERLY CONSTRUED SECTION 3653 TO ENCOMPASS REVIEW UNDER SECTION 101(d).

A. Section 3653 Requires Review under Section 101(d).

The Postal Service argues that 39 U.S.C. section 3653(b)(1) governing Commission Annual Compliance Determinations gives the Commission authority to determine only whether rates were in compliance “with applicable provisions of *this chapter* [36] (or regulations promulgated thereunder)...” (Emphasis added.) Since 39 U.S.C. section 101(d) is in title 39, but not within chapter 36, the Postal Service believes that section 101(d) cannot be the basis for a finding of noncompliance. *See* USPS Br., p. 28 (emphasis added). This argument misreads the statute and ignores the basis of the Commission’s position.

The Commission explained that among the “factors” the Commission “shall take into account” under section 3622(c) is subsection (c)(14): “the policies of *this title* as well as such other factors as the Commission determines appropriate.” PRC Br., pp. 22-25; *see also* FY 2010 ACD, p. 15, J.A. 37 (emphasis added). This requirement to consider the “policies of this title” clearly encompasses 39 U.S.C. section 101, captioned “Postal policy,” which includes subsection (d) that provides:

(d) Postal rates *shall* be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis. [Emphasis added.]

Yet another reason undergirds the Commission's analysis: 39 U.S.C. section 3653(b)(1) grants the Commission authority to review rates for compliance not only with the "applicable provisions of this chapter," but also with the "regulations promulgated thereunder...." The Commission has promulgated such regulations. These regulations are included in 39 CFR chapter 3050 on Periodic Reporting,¹¹ and specify as their statutory authority: 39 U.S.C. section 503, and three sections in Chapter 36 — sections 3651, 3652, and 3653 — the last of which governs the Commission's "Annual determination of compliance."

Those regulations require that the Postal Service's section 3652 report present information on product compliance with the provisions and public policy objectives of title 39, so that the Commission can make its determination under section 3653 based on that report:

The Postal Service's section 3652 report shall include an analysis ... in sufficient detail to *demonstrate* the degree to which ... each of its products (market dominant and competitive) *comply* with all the applicable provisions of *title 39* ... and promote the public policy objectives set out in *title 39*.... Its analysis shall be applied to products individually.... [39 CFR § 3050.20(a)-(b). *See also* 39 CFR § 3050.21(a) and (j) (emphasis added).]

¹¹ 74 *Fed. Reg.* 20850 (May 5, 2009).

The Commission's regulation requiring the Postal Service to "demonstrate" that each of "its products," expressly including market dominant products, "comply" with *title 39* demonstrates that the Commission would be evaluating the sufficiency of such claimed compliance. The Postal Service never objected to these Commission regulations as being *ultra vires*. Even if the Postal Service's curious reading of the text of 39 U.S.C. section 3653(c) regarding "this chapter" were assumed to be correct, it has not explained why the Commission's regulations authorized by the same statute should be considered ineffective in specifying that the Commission's review encompasses all of *title 39*, including all of its "applicable provisions" and "public policy objectives," of which 39 U.S.C. section 101(d) is certainly an important part.

B. The Commission Has Consistently Held that Compliance with Section 101(d) Is Encompassed within Its Annual Compliance Reviews.

ACMA argues that the Commission's Determination was "internally contradictory" because of its alleged "abrupt shift" in Docket No. ACR2010 to reliance on 39 U.S.C. section 101(d) as a basis for its noncompliance determination. ACMA Br. at 43-45. That claim is demonstrably false. The Commission has repeatedly and consistently held that section 101(d) applies during its Annual Compliance Review. Neither the Postal Service nor ACMA has

objected to that holding before the Commission, raising it for the first time in this appeal.

In each of the last three ACR proceedings, the Commission has found that Standard Flats were being priced below cost. The Commission's FY 2008 Annual Compliance Determination noted concern with the Standard Flats product's cost coverage, and stated: "The lack of a sufficiently high cost coverage may be inconsistent with the policy set forth in 39 U.S.C. § 101(d), which directs the Postal Service to apportion the costs of the Postal Service on a fair and equitable basis...." Commission Annual Compliance Determination, Docket No. ACR2008, p. 61 (footnote omitted). The following year, in Docket No. ACR2009, the Commission urged the Postal Service to begin moving in the direction of full cost coverage, expressly noting that this continuing below-cost pricing constituted a cross-subsidy by other Standard mailers and specifically invoking 39 U.S.C. section 101(d) as its authority:

For flats to have covered FY 2009 costs, the rates of flats would have needed to be 21 percent higher, ignoring elasticity effects. *The lack of a sufficiently high cost coverage directly implicates the requirement of section 101(d), which directs the Postal Service to apportion the costs of the Postal Service on a fair and equitable basis and section 3622(b)(5), which requires that rates must be set to ensure adequate revenues to maintain financial stability.* [Commission Annual Compliance

Determination, Docket No. ACR2009, p. 86 (emphasis added).]

There is no “inconsistency” by the Commission. The Commission stated in its ACDs for FY 2008 through FY 2010 that section 101(d) applied. The only difference is that in the past the Commission opted to give the Postal Service another chance to begin rectifying the below-cost pricing on its own initiative. When the Postal Service, however, disregarded the Commission’s urgings and moved in the opposite direction by favoring below-cost Flats with below-average price increases — widening rather than narrowing the cost-coverage gap and the cross-subsidy within Standard Mail — the Commission took action.

The Commission again addressed the applicability of 39 U.S.C. section 101(d) to annual compliance determinations in its Order No. 536 in Docket No. RM2009-3, issued September 14, 2010. On brief, both the Postal Service and ACMA cite Order No. 536, an order that related to workshare discounts, with respect to the application of pricing standards to products, and both overlook the Commission’s clear statement in that order that section 101(d) is relevant to its Annual Compliance Determinations. Referring to the distinction between the statute’s quantitative factors such as compliance of rates with the statutory rate cap, and its qualitative factors such as compatibility with section 101(d), the

Commission stated:

In addition to these few, clear “out-of-bounds” lines [e.g., rates that violate the statutory class-wide rate cap], the system that the Commission has established requires that market dominant rates be developed with consideration for the qualitative rate and classification objectives and factors identified in sections 3622(b) and (c). Consistent with the PAEA’s directive, the system that the Commission has developed requires that each objective and factor be considered by the Postal Service in conjunction with the others. Under that system, *rates should also be consistent with the more general qualitative standards found in 39 U.S.C. 101(d), 403(c) and 404a(1).* [Order No. 536 at 17 (emphasis added).]

The Commission then distinguished its review of Postal Service price adjustment filings with its more in-depth review in Annual Compliance Determinations.

Because of the “very short time frame required by the statute” to consider price adjustment filings, its scrutiny of rates for compatibility with the qualitative pricing factors such as section 101(d) is “typically light.”

Consequently, reviewing market dominant rates for consistency with the PAEA’s many qualitative pricing standards is largely deferred by the Commission until after-rates are implemented, in its Annual Compliance Determination. *See* 39 U.S.C 3653. [*Id.*]

Further, Commission Order No. 536 specifically rejected the notion that “pricing flexibility” is an “overarching standard” that “trumps ... the other qualitative standards of the new law”:

Because each of the PAEA's qualitative standards is conditioned upon all of the others, and because they are largely confined to post-implementation review, the qualitative standards usually remain in the background when the Postal Service selects and implements market dominant rates.... To afford the Postal Service this degree of latitude in pricing, there is no need to posit the existence of an overarching standard of "*pricing flexibility*" that trumps not just the other qualitative standards of the new law, but its quantitative standards as well. [*Id.* at 17-18 (footnote omitted) (emphasis added).]

In the Docket No. ACR2010 proceeding below, the applicability of 39 U.S.C. section 101(d) was addressed in the initial comments of both L.L.Bean and Valpak, which pointed out that this preferential below-cost pricing of Standard Flats constituted "an unfair or inequitable apportionment of costs" among Standard Mail users under section 101(d), favoring the below-cost product to the detriment of others in the class, and also that Order No. 536 clearly contemplated consideration of such issues in annual compliance determinations. *See* L.L.Bean Initial Comments, p. 11, JA 81; Valpak Initial Comments, pp. 23-24, 30, 49-51, JA 159-60, 166, 185-87. Neither the Postal Service nor ACMA addressed this issue in their reply comments. Nowhere did the Postal Service or ACMA claim before the Commission — either in Docket No. ACR2010 or previously — that section 101(d) was inapplicable to annual compliance determinations. The only "abrupt

shift” is the Postal Service’s belated decision to wait until now to raise the issue on appeal.

II. THE POSTAL SERVICE’S CLAIMS THAT THE COMMISSION HAS ACTED ARBITRARILY AND CAPRICIOUSLY TO CURTAIL ITS SUPPOSEDLY UNREVIEWABLE PRICING FLEXIBILITY ARE WITHOUT SUPPORT.

A. The Commission’s Compliance Determination Does Not Impair the Postal Service’s Legitimate Pricing Flexibility.

The Postal Service claims that the Commission’s action below impairs its broad pricing flexibility. However, the Postal Service, which enjoys either a *de jure* or *de facto* monopoly power over at least portions of Market Dominant Products,¹² was never intended to have unfettered pricing flexibility over its captive products. Reviewing Postal Service pricing for compliance with PAEA is one of the principal responsibilities vested in the Commission. The need for the Commission’s role is demonstrated by the fact that on brief the Postal Service never expressed any qualms about forcibly extracting \$1.4 billion from other Standard Mailers in three short years to subsidize Standard Flats users. The Postal Service says its dominant concern is maximizing its own revenues under a cap regimen. USPS Br., p. 34.

¹² See, e.g., 39 U.S.C. §§ 601-606.

Although the Postal Service has portrayed the Commission as usurping its pricing authority, the truth is that the Commission has shown remarkable restraint in addressing the below-cost pricing of Standard Flats. In the two ACR proceedings prior to the docket under review, ACR2008 and ACR2009, the Commission found that Standard Flats not only were failing to cover cost but also that the losses were increasing due to the Postal Service's below-average (and below-CPI) price increases. Although it urged the Postal Service to take corrective pricing action, the Commission did not order it to do so. The Postal Service ignored the Commission by continuing to implement below-average increases for Standard Flats that widened the cost-coverage gap, and that, under the price-cap mechanism, drove up prices for other Standard Mail products.

In short, it was not a one-time problem, but rather the Postal Service's longstanding failure to exercise its pricing flexibility in a manner to rectify an ongoing cross-subsidy that finally required the Commission to step in and order remedial action.

B. The Postal Service Misconstrues the Purpose of the Statutory Remedies for Below-Cost Pricing of Market Dominant and Competitive Products.

On brief, the Postal Service makes far too much of the fact that, while 39 U.S.C. section 3633(a)(2) provides that each *competitive* product must always be priced to cover its attributable costs, there is no parallel requirement for *market dominant* products. Although it is true that PAEA does not require that each market dominant product at all times be priced to cover costs fully, that statutory difference is rather irrelevant here, where the Commission acted under section 101(d). Moreover, in no way does it establish that the Postal Service enjoys the unreviewable discretion to maintain prices for selected market dominant products below costs substantially and indefinitely, exacting a cross-subsidy from other mail users within that class.

Sound policy reasons justify this somewhat different treatment of below-cost pricing of competitive and market dominant products. In the competitive product arena, the purpose of section 3633(a)(2) is to *protect competitors* of the Postal Service from unfair competition due to below-cost pricing of competitive products. Because such predatory underpricing by a government monopoly can have immediate adverse impacts on the competitive marketplace, such as driving a private sector competitor out of business within a matter of months, the statute

prohibits all competitive product pricing shortfalls, and if identified, requires that they be remedied promptly.

By contrast, the purpose of section 101(d) is to protect *other mail users* within a class from having to pay higher postal prices in order to cross-subsidize a preferred category of mail users with below-cost prices. Because that subsidy is spread over all users (of all other products) within a class, the impact on other mail users would be nowhere near as immediate and profound as in the case of competitive products.

Yet, for every mailer favored by Postal Service under-cost pricing, such as some members of ACMA, other mailers, such as L.L.Bean and Valpak, are victimized. Such a continuing cross-subsidy among market dominant products *does* adversely and significantly affect other mail users in the class who are required to pay higher rates as a result. The Postal Service's pricing has in three short years transferred \$1.4 billion from most Standard Mail class mailers to a subset of favored mailers. In such a case, as here, section 101(d), although not a complete proscription against below-cost pricing of market dominant products, is competent authority for the Commission to base its finding of noncompliance with PAEA, and its remedial order to rectify abusive Postal Service pricing resulting in a continuing intra-class cross-subsidy imposed on other mail users.

C. The Commission's Remedy Is Moderate, Preserving Significant Postal Service Pricing Flexibility while Mitigating Cross-Subsidy.

While the Commission had been patient since 2008 in confronting a serious problem that has plagued most Standard Mail users, its remedial order could be described as measured.¹³ In its prior ACR determinations, the Commission put the Postal Service and mailers on notice that continued below-cost pricing of Standard Flats implicated 39 U.S.C. section 101(d) and might require an adverse compliance determination if not addressed by the Postal Service.¹⁴ The Commission already has given the Postal Service and Standard Flats mailers several years to move toward full coverage at the Postal Service's initiative — plenty of time to have started a gradual transition that minimizes rate shock. Seeing no progress, the Commission has now reluctantly found the below-cost rates to be non-compliant. Yet, even now, the Commission's remedial actions are a model of reasonableness and restraint that still preserves proper Postal Service

¹³ While the Postal Service disparages 39 U.S.C. section 101(d) as a “vague, standardless policy statement,” Congress apparently believed that it had sufficient substance to provide that a complaint for its violation could be brought to the Commission and acted upon, even investing the Commission with authority to order that “unlawful rates ... be adjusted to lawful levels” or even “discontinue providing loss-making products.” See 39 U.S.C. section 3662(a) and (c). These are the same powers the Commission has in conducting its Annual Compliance Determination. See 39 U.S.C. § 3653(c).

¹⁴ An analysis of Commission discussion of this factor in previous dockets is set out in section I A, *supra*.

pricing flexibility.

First, the Commission's Determination does not direct how prices for other products should be adjusted. Its only direction is that the Postal Service begin to implement above-average increases for the below-cost Standard Flats product with the goal of bringing that product to full cost coverage over time. The Postal Service is free to decide which other Standard Mail products should get offsetting below-average price adjustments to comply with the class-wide CPI price cap.¹⁵

Second, the Commission's Determination does not require that prices for Standard Flats be raised to full cost coverage immediately. To the contrary, the Commission recognized the need for phasing the increases, "including the need to

¹⁵ In the proceeding below, two parties urged that the Commission direct the Postal Service to reduce Letter prices as an offset to increases in below-cost Flats prices. Intervenor L.L.Bean objected, pointing out that:

The core regulatory problem with Standard Flats is not the cost-coverage differential with Letters, but that Flats are priced below costs – resulting in higher-than-necessary rates for *all* above-cost products collectively, whether other flat or letter products.... Consistent with the intent of the new law, the Postal Service, in adjusting Standard Flats prices upward closer to full coverage, should be given discretion in determining how to adjust the prices for other Standard products, taking into account marketplace and other pricing factors. [L.L.Bean Reply Comments, Docket No. ACR2010, at 6, JA 269.]

The Commission declined to specify how price increases should be offset among the other cost-covering products, leaving that decision entirely to the Postal Service.

mitigate rate shock and to maintain predictable and stable prices.” FY 2010 ACD, p. 107. The Commission further explained:

In requiring the Postal Service to take remedial action, the Commission *does not impose a specific deadline*. However the Postal Service should move as promptly as practicable to eliminate this inequity. This process must begin with the next market dominant price adjustment. The Commission finds that, starting with the next Notice of Market Dominant Price Adjustment, the Postal Service must *begin the process of transitioning* Standard Flats prices to full cost coverage. [*Id.*, p. 107 (emphasis added).]

Given the history of the Postal Service’s intransigence on this issue, the Commission’s graduated remedy reflected great restraint and afforded the Postal Service an element of pricing flexibility in moving Standard Flats prices toward full cost coverage.

The Postal Service nevertheless asserts that the Commission’s action undermines its essential pricing flexibility:

It would make little sense to allow price averaging within a class if Section 101(d) required the Postal Service to ensure that market-dominant products – such as Standard Mail Flats – cover their costs on a product-by-product basis rather than collectively as a class. [USPS Br., p. 24.]

In light of its own pricing actions to date, and considering the measured nature of the Commission’s remedy, this claim borders on the preposterous. Even with a transition to cost-based prices for Standard Flats, and with all products covering

costs, the Postal Service would retain substantial pricing flexibility within the Standard Mail class to adjust the pricing markups and cost coverages among the class's various products. Almost all of the other Standard Class products are currently priced well above costs, with cost coverages of the Saturation products used by intervenors L.L.Bean and Valpak running well *over 200 percent*. Thus, there is plenty of room for the Postal Service to exercise its pricing discretion, even (or especially) in the absence of the current cross-subsidy afforded to Standard Flats.

On the other hand, if the Postal Service's view of the statute were adopted, the Annual Compliance Review process would be reduced to a mechanical class-wide CPI-cap review (which would make it largely redundant to the analysis the Commission performs in price adjustment dockets) and little else. The Postal Service would then become free to implement below-cost prices for any product of its choosing for any reason, however flimsy or arbitrary, or for no reason at all. Such unfettered and unreviewable discretion to implement and maintain below-cost prices at the cross-subsidy expense of other mailers in the class goes far beyond any concept of "pricing flexibility." This, indeed, is the kind of mischievous and potentially abusive power that 39 U.S.C. section 101(d) was designed to preclude.

D. ACMA's Claims of Harm to the Catalog Industry as a Whole Are Overblown and Misdirected.

ACMA asserts that the Commission is “singling out the catalog mailing industry for disproportionate rate increases,” and that corrective above-average price increases for the below-cost Flats product “promises to be disastrous.”

ACMA Br. at 40-42. This overlooks ACMA's belated acknowledgment of the importance of the Carrier Route product to the catalog industry (*see* discussion in Statement of Facts, *supra*). Under the Postal Service's perverse pricing, the Carrier Route product has been hit with above-average price increases nearly double that for Standard Flats. Indeed, the catalog mailing industry as a whole has already suffered from the pricing approach heretofore championed by ACMA.¹⁶

The ACMA brief's parade of horrors is likewise unrealistic. It notes, for example, that catalog “prospecting mailings” to non-customers are the “least

¹⁶ ACMA finds it “hard to understand” why the Commission has singled out the Standard Flats product when it “did not require other products and even two entire Classes” to also cover costs. ACMA Br., p. 25, n.25. In fact, only one class (Periodicals) is below cost despite receiving the maximum allowable class-wide price increases under the statutory CPI price cap. The Commission has found that Periodicals prices cannot lawfully be raised to full cost coverage levels without violating the class-wide price cap. Aside from Standard Flats, the only other below-cost Standard product is Parcels and NFMs. There, because the Postal Service has been aggressively moving in the direction of full cost coverage with a series of well-above-average price increases, the Commission found that “[t]he Postal Service is taking action to address this problem,” and that its “phasing-in” approach to “reducing the intra-class subsidy is appropriate.” FY 2010 ACD, pp. 107-08.

profitable” and might be “reduced the most” in the face of price increases, thereby impairing acquisition of new customers and hurting future catalog volumes.

ACMA Br., p. 41. While prospect addresses in a cataloger’s mailing list are the most price sensitive, ACMA does not reveal that the product *most* used for prospecting is not Standard Flats, but Carrier Route, due to the higher mailing density achievable in prospecting. Yet under ACMA’s approach, it is Carrier Route — the product with by far the greatest catalog mail volumes and greater price sensitivity — that has suffered the greatest percentage price increases over the last four years. ACMA’s more candid statements in its October 18, 2011 bulletin to members and non-members, and in its November 7, 2011 comments to the Commission in Docket No. R2012-3, suggests that the time has come to “reverse” this upside-down catalog pricing scheme through above-average increases for Flats and below-average increases for other Standard products such as Carrier Route. Indefinite continuation of the current cross-subsidy pricing is not in the long-term interests of the catalog industry as a whole, nor is it truly in the Postal Service’s own interest.

III. NEITHER ISSUE III NOR THE POSTAL SERVICE'S "SIMPLE HYPOTHETICAL" IS PROPERLY BEFORE THIS COURT.

In its Statement of the Issues, the Postal Service asserts as its Issue III that the Commission's decision was arbitrary and capricious because the Commission *"failed to even address the argument* that its decision could result in the Standard Mail class as a whole making less contribution toward costs because the volume of flats is decreasing while the volume of letters is increasing."¹⁷ USPS Brief, pp. 7-8 (emphasis added). The reason that the Commission failed to address this argument is that it was never made by the Postal Service.

The PAEA is clear that a petition for review of the Commission's decision must be made "on the basis of the record before the Commission" (39 U.S.C. § 3663) and, since the Postal Service never made this argument below, any appeal on this issue fails.

¹⁷ The Postal Service's current argument that the Commission's failure to consider the "overall impact of the Standard Mail Flats order on the Postal Service's overall financial condition" under 39 U.S.C. section 3622(b)(5) was arbitrary and capricious (USPS Br., p. 34) is at direct odds with its prior position that section 3622(b)(5) was only one of the several objectives for the Commission to consider in establishing a modern system for regulating rates, "rather than [to consider in making] each pricing decision, or each rate cell, taken by itself..." Responses of the United States Postal Service to Questions 1-16 of Chairman's Information Request No. 1, Docket No. R2011-2 (Feb. 9, 2011), p. 8.

A. Issue III Is Not Based on the Record before the Commission Provided by the Postal Service.

The Postal Service's argument on Issue III asserts that it is "incredible" that the Commission disregarded the "*public record* that the Postal Service is in the midst of a *financial crisis* and has been for several years." USPS Br., pp. 32-33 (emphasis added). The Postal Service provided no citation whatsoever as to the record evidence it believes was disregarded, and, more importantly, failed to note that the Commission's ACD gave extensive consideration to the financial health of the Postal Service. *See* FY 2010 ACD, pp. 5-6, 27-39. Indeed, the Commission's direction to preclude the Postal Service from continuing to underprice Standard Flats is entirely consistent with achieving financial health for the Postal Service.

Although Docket No. ACR2010 contained record evidence as to the financial problems of the Postal Service generally, that is quite beside the point. The Postal Service never argued the substance of its Issue III below, and never introduced record evidence necessary to establish it. Nowhere in Section III of its Brief addressing Issue III does the Postal Service reference any evidence or argument that it presented to the Commission on this point.

It was the Postal Service's responsibility to ensure that the record was complete. PAEA requires the Postal Service, within 90 days after the end of each

fiscal year, to “submit to the Commission a report”:

(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.... [39 U.S.C. § 3652(a)(1) (emphasis added).]

The Postal Service was certainly on notice that the Commission could make a finding of noncompliance in this docket, and issue a remedial order.¹⁸ Its filing addressed the Commission’s prior statements, and as discussed in section I *supra*, even invited the Commission to explore its remedial powers, as well as the “contours of its powers,” in the context of the ACD.¹⁹ If the Postal Service believed that the Commission’s decision could negatively impact “the overall financial condition of the Postal Service,” it was incumbent on the Postal Service to bring that concern to the attention of the Commission in its Annual Compliance Report — but the Postal Service did not do so. Further, even after the Commission issued its ACD, the Postal Service made no effort to seek

¹⁸ See, e.g., PRC Annual Compliance Determination, Docket No. ACR2009, pp. 15-17.

¹⁹ See, e.g., USPS Annual Compliance Report, Docket No. ACR2010, pp. 8-9, JA 14-15.

reconsideration by the Commission, based on this or any other ground.²⁰

Indeed, it was the Postal Service's burden, not the Commission's, to marshal facts "in sufficient detail" before the Commission to support the Postal Service's contention that the Commission decision regarding Standard Flats threatened one of the nine objectives in PAEA — "[t]o assure adequate revenues, including retained earnings, to maintain financial stability."²¹ See 39 U.S.C. §§ 3652(a)(1) and 3622(b)(5). Instead, having failed to present this issue to the Commission, the Postal Service now seeks to have this Court base its decision on a never-before-presented "hypothetical [to] show [what could] happen when the price-cap authority is used to raise prices on a product with decreasing volumes while no price increase is allocated to a product with increasing volumes."²² The Postal Service inserts the hypothetical into the Statement of Facts as if it already had been presented to the Commission below, but it was not. Such a post-hearing suppositional effort utterly fails to comply with the statutory mandate that the

²⁰ The Postal Service's only post-ACD motion filed with the Commission never addressed this issue. Motion of the United States Postal Service Requesting Stay of the Remedial Provisions Regarding Standard Flats Set Forth in the FY2010 Annual Compliance Determination (May 17, 2011).

²¹ See USPS Br., pp. 7-8.

²² See USPS Br., p. 33. On its merits, the Postal Service argument is based on faulty factual assumptions discussed in the PRC Brief, pp. 37-39, and in section III B, *infra*.

Postal Service employ the “methodologies” as prescribed by the Commission “to demonstrate all products ... complied with all applicable requirements of this title,” including the section 101(d) mandate that “postal rates ... be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.” *See* PRC Br., pp. 37-39.

B. Issue Number III Finds No Support in ACMA Comments in the Record.

Having completely failed to introduce facts or argument undergirding its Issue III into the record before the Commission, the Postal Service seeks to bootstrap its contention by reading new meaning into a single comment made by ACMA before the Commission. *See* USPS Br., p. 13. Whatever point ACMA might have been making in its confusing comment, it certainly does not provide record support for Issue III. First, ACMA’s comment discusses a class of mail with “more than one (c)(2) category” — which appears to mean more than one underwater product. Although Standard Mail had two underwater products (*i.e.*, Standard Flats, and Standard Parcels and NFM’s), the Postal Service brief makes no mention of how this could be relevant to Issue III. Second, ACMA asserts that the overall effect of rate changes depends on various elasticities, but the Postal Service’s post-hearing hypothetical assumes the opposite — that all elasticities

will be zero. *See* USPS Br., pp. 14-16. Third, ACMA asserts without any evidence or support that the net effect of rate changes would be no more than a “small fraction of the shortfall,” a point not mentioned by the Postal Service. Lastly, ACMA concludes by stating “[i]t is obvious, then, that (c)(2) does not highlight money that is available to improve the Postal Service’s net income position.” Far from obvious, these intervenors have no idea what this comment means, and the Postal Service does not even try to address it. Certainly in this paragraph there was no discussion by ACMA of increased pricing of underwater products undermining the “financial stability” of the Postal Service, as the USPS brief has presumed. *See* USPS Br., pp. 33-34.

Indeed, in its Statement of Facts, the Postal Service felt compelled to rewrite the ACMA comment — as the Postal Service states, to “[p]ut [it] another way” — to try to make it support the proposition that the “implement[ation] [of] above-average price increases on one product and below-average increases on other products within the class in order to comply with the price cap ... is *not necessarily* an improvement in the overall contribution that the class of mail makes toward attributable costs.” *See* USPS Br., p. 14 (emphasis added). Even with the Postal Service’s remedial gloss, a statement that a particular pricing approach would “not necessarily” be an improvement is well short of its Issue III contention that the

Commission wholly ignored the statutory objective “to assure adequate revenues, including retained earnings, to maintain financial stability.”

C. The Postal Service’s Extra-Record Hypothetical Is Deeply Flawed, Proving Nothing.

For the reasons set out in section III A, *supra*, the Postal Service’s Issue III, based on its extra-record “simple hypothetical example” of a pricing tradeoff between the Standard Mail Flats and Letters products, is not properly before this Court and should be disregarded. Had this hypothetical been presented to the Commission on the record below, it would have been subject to critique in the proper forum for such debate established by Congress. Then, rebuttal hypotheticals could have been presented showing that the opposite financial result can be obtained readily by using more reasonable analyses and assumptions that properly take into account volume trends and price elasticity, as well as the effects when other Standard Mail products that are more price-elastic than Standard Letters are evaluated. The technical and complex nature of such issues is precisely why the Commission was created by Congress, and this Court is the wrong forum for consideration of the Postal Service’s extra-record hypothetical. Some major flaws in this simplistic hypothetical should be noted, however.

First, the Postal Service concedes that its hypothetical ignores price

elasticity (USPS Br., p. 14, n.2). For this reason, the hypothetical obscures the fact that a price increase on a below-cost product like Standard Flats will reduce the volume of this money-losing product and associated losses, whereas an increase on a profitable product will drive away volumes that otherwise provide a net positive contribution. This omission of the effects of price on volume, which the Postal Service euphemistically terms a “simplifying” assumption, is contrary to all economic logic and is completely unrealistic. This omission is particularly egregious considering that the comments of ACMA to the Commission, upon which the Postal Service exclusively relies from the record below, emphasized that “*the net effect [on the Postal Service bottom line] depends on the various elasticities.*” USPS Br., p. 13 (emphasis added).

Second, the Postal Service’s hypothetical assumes that volume trends for these products will continue linearly into the future. The passage of time has already revealed this to be a false assumption, as the decline of Standard Flats volume in FY 2011 was well less than one-half of the negative 10 percent trend assumed in the hypothetical, despite a rate increase for that product having occurred in April 2011. The Postal Service knew the unrealistic nature of its volume assumption at the time it filed its brief on October 7, 2011, as demonstrated by the fact that the Postal Service had filed volume data with the

Commission covering the first three quarters of FY 2011 on August 17, 2011.²³

Third, and most critically, the Standard Mail product that the Postal Service has chosen in its hypothetical for a pricing-tradeoff comparison to Standard Flats — Standard Letters — is the worst choice the Postal Service could have made if its objective were to optimize its finances, as it claims.²⁴ Standard Letters has shown a consistently positive growth trend recently. Moreover, it is understood to have a low price elasticity. Far better choices for an offset of increased Flats prices would be the more price-sensitive Standard products (*i.e.*, High Density/Saturation Letters, High Density/Saturation Flats & Parcels, and/or Carrier Route) where an offsetting price mitigation would have created a more positive volume and contribution effect than in the case of low-elasticity Standard Letters. If the Postal Service were operating in a business-like manner as it claims, seeking to maximize its bottom line under a price cap regime, it would surely consider

²³ These Revenue, Pieces, and Weight (“RPW”) reports are filed with the Commission at <http://www.prc.gov/prc-pages/library/detail.aspx?docketId=&docketPart=Documents&docid=74925&docType=Periodic Reports/Data Reports&attrID=&attrName=> (3rd Quarter FY 2011, filed Aug. 17, 2011); <http://www.prc.gov/prc-pages/library/detail.aspx?docketId=&docketPart=Documents&docid=78070&docType=Periodic Reports/Data Reports&attrID=&attrName=> (FY 2011, filed Nov. 25, 2011).

²⁴ The Commission’s non-compliance determination and remedial order did not require the Postal Service to apply pricing offsets to the Standard Letters product, but gave it flexibility to spread that offset as it chooses among all the profitable Standard Mail products.

relative price sensitivity in choosing one or more tradeoff products to maximize net contribution, rather than a product with a positive growth trend and low elasticity.²⁵ Any far-fetched outcome such as that envisioned by the Postal Service's hypothetical would be entirely of the Postal Service's own choice in the matter. It has more than enough flexibility to avoid such outcome, hence the proposition allegedly supported by its hypothetical is totally inapt.

The only conclusion that can be drawn from the Postal Service's extra-record "simple hypothetical" is that it is possible to make unrealistic and faulty assumptions and manipulate data to achieve almost any desired result in support of any argument.

²⁵ Indeed, if the Postal Service's objective were to maximize contribution while mitigating impact on the catalog industry, its hypothetical could have considered offsetting price increases for Standard Flats with price reductions for Carrier Route flats. As ACMA acknowledges, catalogs are mailed predominantly as Carrier Route flats rather than Standard Flats. *See* discussion in Statement of Facts, *supra*. In FY 2011, both of these products experienced volume declines, and as ACMA implicitly concedes on brief, prospect catalog mailings (which are primarily mailed as Carrier Route flats) are particularly price sensitive. ACMA Br., p. 41. By offsetting a price increase for underwater Standard Flats with a price reduction for profitable Carrier Route flats, the Postal Service would provide additional incentive for catalog mailers to find creative ways to increase their use of the profitable Carrier Route product relative to the underwater Standard Flats product, *i.e.*, under the circumstances, it would send mailers correct price signals vis-a-vis the attributable cost and contribution to overhead made by each product.

CONCLUSION

For the foregoing reasons, the Postal Service's Petition for Review should be denied.

Respectfully submitted,

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December 7, 2011

CERTIFICATE OF COMPLIANCE

It is hereby certified, pursuant to Rule 32(a)(7)(C), Federal Rules of Appellate Procedure, that the foregoing brief complies with the type-volume limitation of this Court's order of August 10, 2011 because it contains 8,030 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using WordPerfect 13.0.0.568 in 14-point Times New Roman.

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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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UNITED STATES POSTAL SERVICE,)	
)	
	Petitioner,)	
)	
v.)	No. 11-1117
)	
POSTAL REGULATORY COMMISSION,)	
)	
	Respondent.)	
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CERTIFICATE OF SERVICE

I hereby certify that on December 7, 2011, the foregoing Brief of Intervenor L.L.Bean, Inc., Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. was served upon counsel the following parties and intervenor by the Court's Case Management/Electronic Case Files system:

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