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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Rate Adjustment due to Extraordinary or Exceptional Circumstances	))	Docket No. R2010-4

REPLY COMMENTS

OF

VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS' ASSOCIATION, INC.
(September 2, 2010)

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I. THE NPMHU EXPLANATION OF THE PAEA "EXTRAORDINARY OR EXCEPTIONAL" TEST FOR AN EXIGENT RATE CASE IS COGENT AND PERSUASIVE.

Several commenters[1] discuss at length the meaning of 39 U.S.C. section 3622(d)(1)(E) that an exigent rate case must be "due to either extraordinary or exceptional circumstances." Unfortunately, much of their commentary was predicated upon either linguistic generalities or unsupported conclusory assertions of policies supposedly undergirding the Postal Accountability and Enhancement Act ("PAEA").

Markedly different, however, were the Initial Comments of the National Postal Mail Handlers Union ("NPMHU"), which provided the Commission with a careful review of the statutory language and a thorough analysis of the evolution of the final text through the legislative process. From this review, NPMHU concluded that "an overly restrictive reading of section 3622(d)(1)(E) is unjustified, and that the economic circumstances currently faced by the Postal Service fall squarely within the statutory requirements…." NPMHU Initial Comments, p. 2. NPMHU concluded its submission by contrasting the statements of a Congressional sponsor of PAEA at the time the law was enacted with statements of recent vintage. Importantly, NPMHU set out the legal principles restricting the weight that can be given to contemporaneous statements of a bill's sponsors, and why such statements of legislative intent coming long after enactment of the bill cannot be relied upon at all.[2]

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[1] *See, e.g.,* Comments of the Affordable Mail Alliance ("AMA"), pp. 8-14, Initial Comments of the Greeting Card Association, pp. 4-12.

[2] Mailing interests that ask the Commission to subordinate its collective judgment to the current opinion of one Member of Congress as to the meaning of a statute enacted in 2006 by 535 members of Congress, and signed into law by the President of the United States, are asking the Commission to undermine its role as an "independent" body created within "the executive branch" of the United States Government. *See* 39 U.S.C. § 501.

Here, the terms used by Congress — "extraordinary" or "exceptional" — are neither technical nor terms or art, but ordinary language. Ordinary words must be given their ordinary meanings. Perrin v. United States, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning."). If the Congressional drafters intended a definition of these terms other than their ordinary meanings, they could have defined them as they do various other terms. *See*, *e.g.*, 39 U.S.C. §§ 102, 404(e)(1). Both the Postal Service and NPMHU have demonstrated that "extraordinary" means "beyond what is usual, ordinary, regular, or established," while "exceptional" means what is "unusual" or what occurs as the "exception or rare instance." *See* Postal Service Response to the Affordable Mail Alliance Motion to Dismiss (Aug. 2, 2010), pp. 11-12; NPMHU Initial Comments, p. 2.

It matters not a whit whether a mailing interest believes that literal application of the statutory text would set a bad precedent for future exigent rate cases.[3] It is a settled principle of statutory construction that if the terms of a statute are plain and unambiguous, as here, then a court must apply the statute according to its terms without further inquiry. *See, e.g.*, Carcieri v. Salazar, 555 U.S. __, 129 S.Ct. 1058, 1063-64 (2009); Dodd v. United States, 545 U.S. 353, 359 (2005). Selection of the statutory test was made by Congress; those mailing interests who believe that the language of PAEA does not reflect some overriding Congressional purpose should take their grievance with the statute to Congress, not the Commission.

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[3] *See*, *e.g.*, "Even worse, approval of this exigent rate increase is likely to lead to further exigent rate increase proposals during the decade." AMA Comments, p. 17.

II. SEVERAL COMMENTERS FAIL TO APPRECIATE THE PERFECT FINANCIAL STORM CONFRONTED BY THE POSTAL SERVICE.

A. It Is Not Necessary that Commenters Agree about the Principal Cause of the Postal Service's Liquidity Crisis.

Comments by two parties, Newspaper Association of America ("NAA") and National Postal Policy Council ("NPPC"), address the cause of the liquidity crisis of the Postal Service. They not only discount the significance of the Postal Service's loss of 20 percent of its business over a two-year period, but also dismiss the burden imposed by the Congressional requirement to prefund the Postal Service Retiree Health Benefits Fund ("PSRHBF").

Newspaper Association of America stated:

> Nor can the financial problems associated with the obligation to prefund the retiree health benefits be considered extraordinary or exceptional — indeed, they were **mandated by Congress** in the PAEA itself.... [NAA Comments, p. 5 (emphasis added).]

NAA apparently believes that the legislative mandate to fund the PSRHBF, no matter how unrealistic and out of line with the Postal Service's cash flow, could never constitute an "exceptional" or "extraordinary" circumstance under 39 U.S.C. section 3622(d)(1)(E). However, NAA cites no rule of law or persuasive rationale supporting the notion that Congress cannot itself impose a burden which turns out to be "extraordinary" or "exceptional." Substantial evidence now exists to support the conclusion that the Congressionally-imposed burden to prefund PSRHBF is "extraordinary or exceptional," particularly when that burden is imposed on top of a Postal Service suffering a 20-percent loss of volume. *See* Statement of Joseph Corbett, Docket No. R2010-4, pp. 11-15. *See also* discussion in section I, *supra*, on meaning of "extraordinary or exceptional" standard.

The National Postal Policy Council stated:

> There is nothing "extraordinary or exceptional" about a funding obligation that has been in the law **since 2006**…. [NPPC Comments, p. 7 (emphasis added).]

NPPC apparently believes that no burden imposed in 2006 could be considered "extraordinary or exceptional" in 2010. NPPC's argument reveals that it interprets "extraordinary or exceptional" to impose an implicit requirement that circumstances also must be "unexpected." This is similar to the argument made by the Affordable Mail Alliance in its Motion to Dismiss, p. 16 n8. The best response to this criticism is that, if Congress wanted to say that a cost had to be "unanticipated" to be considered "extraordinary or exceptional," it would have so stated.[4]

Actually, the Postal Service has relied heavily on the precipitous decline in mail volume as the principal cause of the liquidity crisis, while tending to understate the role of PAEA-imposed burdens. Postal Service Request, pp. 6-7. Many parties responded to, and seemed to agree with, that focus on the decline in mail volume, while devoting comparatively little attention to the burden imposed by PSRHBF. *See, e.g.,* Comments of AMA (pp. 64), Envelope Manufacturers of America (p. 2), Greeting Card Association (p. 7), Public Representative ("PR") (pp. 17-18), and Publishers Clearing House ("PCH") (unnumbered p. 2).

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[4] Indeed, in adopting the "extraordinary or exceptional" standard, Congress rejected proposals that used the test of "unexpected and extraordinary" for exigent rate cases. *See* Senate Report 108-318, p. 101. Ultimately, however, Congress rejected that language.

On the other hand, Valpak's Initial Comments (pp. 3-12) took the position that, while the Postal Service demonstrated itself able to manage costs to adapt to the remarkable 20-percent reduction in volume, it was simultaneously unable to generate enough sufficient excess cash to cover the extraordinary PAEA burden. Without the mandate to fund the PSRHBF, Postal Service management could have navigated the current recession successfully, with no need to increase rates in excess of the Consumer Price Index ("CPI"). However, Valpak explains that the Postal Service could not simultaneously manage to meet the second threat it faced — a perfect financial storm — manifesting itself in 15 consecutive quarters of mail volume decline. *See* Tr. 1/18, ll. 13-14.

It is not necessary for either commenters or the Commission to agree upon a single cause of the liquidity crisis, as at least two major causes clearly existed. The important fact is that neither cause was the fault of the Postal Service, so no mailer can honestly assert that the Postal Service was not operating "under best practices of honest, efficient, and economical management" as that term is used in 39 U.S.C. section 3622(d)(1)(E). Nothing requires that the cause be unanticipated, and therefore it is irrelevant that the burden of prefunding PSRHBF was imposed in 2006, and likewise irrelevant that some economist somewhere may have anticipated a near-collapse of the American economy and the loss of 20 percent of Postal Service volume. Nor could this decline be attributed principally to diversion to electronic media, as some seem to believe. *See* AMA Comments, p. 12. Rather, the Postal Service has known about diversion and managed to adjust to it for over 10 years.

B. The PR and AMA Correctly Recognize that, without Congressional Relief, the PAEA Mandate to Fund the PSRHBF Will Create Recurring Liquidity Crises and the Likelihood of Recurring Exigent Rate Cases.

Much of AMA's comments consist of a misdirected effort to avoid a rate increase by focusing blame on postal management for the legislatively-exacerbated liquidity crisis. AMA Comments, pp. 14-23. However, AMA, along with the PR, recognizes that without any change in the funding requirement for the PSRHBF, **liquidity crises** will be a **recurring event** at least through 2016, and can be expected to create a **need for recurring exigent rate cases**.

Comments by the Public Representative include the following predictions:

> The Public Representative concludes that the Postal Service's financial condition is **indicative of systemic problems** that go **well beyond** what might be resolved by **this exigent rate request**…. The Public Representative believes that the additional revenue generated as a result of the proposed rate adjustment only will provide short-term relief to the Postal Service. The magnitude of the request is wholly insufficient to ensure the Postal Service's long-term survivability. Finally, without outside intervention (by Congress or a dramatic economic improvement), **this insufficiency may force** the Postal Service to seek additional funding by filing **a second exigent rate request in FY 2011.** [Public Representative Comments, pp. 28-29 (emphasis added).]

Comments of the Affordable Mail Alliance espouse a similar view:

> Even worse, approval of this exigent rate increase is likely to lead to **further exigent rate increase proposals during the decade.** [AMA Comments, p. 3 (emphasis added).]

Given the times in which we live, no one could completely reject the possibility of a future exigent rate increase. Reinforcing this outlook, in fact, the Postal Service acknowledges that even if Congress were to defer $4 billion per year over the next three years, it nevertheless would face a continuing cash shortfall and liquidity crisis because of the mandate to fund the balance of the PSRHBF. *See* Postal Service Response to Oral Request at Aug. 11, 2010 Hearing for Mr. Masse, Tr. 2/215 (Aug. 18, 2010). Without any deferral (or other relief from Congress), further exigent rate requests prior to 2016 cannot be ruled out. What may occur in the future, however, has no bearing on the legality of what the Postal Service is proposing in the present. In the event of "extraordinary or exceptional circumstances," the Postal Service has the right and responsibility to propose an exigent rate case under PAEA, despite the fact that Valpak and other mailers would prefer not to have any increase at this time.

C. Aside from More Aggressive Use of Pricing Flexibility, Virtually All Relevant Changes to the Postal Service's Business Plan to Improve Profitability Require Congressional Approval.

One of the Congressional authors of PAEA recently has advised the Postal Service publicly that it should change its business model in ways that would increase its cash flow and profitability without increasing rates.[5] (That advice correlates perfectly with Comments filed by AMA, pp. 14-15.) Nevertheless, the direction in which Congress desires the Postal Service business model to be changed has never been clear. Succinctly, in order to increase net cash flow, the Postal Service needs to **increase revenues** from other sources materially, **reduce costs** substantially, or both.[6]

With respect to increasing **revenues** from other sources, federal postal law limits the Postal Service to selling postage stamps, stamped paper, cards, envelopes, philatelic services,

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[5] Letter from Senator Susan M. Collins (R-ME), Aug. 9, 2010, commenting on the Postal Service Request in this docket.

[6] In addition, the Postal Service can certainly make more aggressive use of its pricing flexibility to avoid losses on underwater products and to incentivize highly-profitable mail along the lines discussed in Valpak's Initial Comments, pp. 43-44.

and ancillary items. *See* 39 U.S.C. § 102(5). PAEA also limits the Postal Service's ability to offer non-postal items. *See* 39 U.S.C. § 404(a)(4-5).

With respect to achieving a substantial reduction in **costs,** PAEA and Congress appear to impose obstacles to virtually all changes to the Postal Service's business model that would substantially reduce costs. For example:

- The Congressional rider prohibiting the reduction in mail delivery from six to five days a week is still in force, awaiting a recommendation by the Commission and approval by Congress.

- It is unlikely that Congress will reduce the Postal Service's annual contribution to the PSRHBF until sometime near the last day of the fiscal year (if then).

- No action has been taken by Congress to reduce the Postal Service's contributions to an over-funded retirement fund.

- The 2003 Presidential Commission advocated giving the Postal Service additional control over labor costs, but as of yet arbitrators are not required to consider the financial condition of the Postal Service.

- Strongly advocated by the Affordable Mail Alliance is the elimination of retail and nonretail facilities. Valpak and the Government Accountability Office ("GAO") are among those that have long supported such moves, but Congress has regularly interfered with these steps.[7]

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[7] For example, Congress failed to adopt S. 1285, introduced by Senator Thomas Carper in 2003 (108th Congress). A predictable reaction of Congress to Postal Service cost-cutting is reflected in the following Senate appropriations report language:

> The Committee is aware that the Quincy, Illinois AMP [Area Mail Processing plant] is among the facilities for which a possible realignment feasibility study has been announced. The Committee is concerned about the impact on the community and postal customers of eliminating job or transferring functions. The Committee directs the Postal Service to **provide the Committee with a detailed explanation of the criteria used to select the Quincy AMP** for a study no later than 30 days after enactment. The Committee further directs the Postal Service to not proceed with the Quincy AMP study or any other related actions to implement that study during fiscal year 2010. [S. Rept. 111-43,

- A proposal by the Obama Administration to reduce Postal Service contributions to employee health premiums and life insurance was dropped because of concerns that it would it violate collective bargaining.[8]

In view of these constraints, it is difficult to see how AMA or any Member of Congress can blame postal management for not changing the business model to increase profitability without increasing rates.

D. AMA Fails to Recognize that Some Income is Better Than No Income at All.

AMA argues that since increased revenue from the exigent rate case will not **totally** solve the Postal Service's financial problem, the Commission therefore should disregard the fact that it solves **some** substantial portion of the problem. AMA Comments, pp. 4-8. The non sequitur in such reasoning should be obvious on its face. No rate adjustment generates substantial revenues immediately, as it takes time to accumulate cash reserves from a rate adjustment. Just because the exigent rate increase is not the entire solution does not mean that it cannot or should not be part of the overall solution as proposed by the Postal Service in its March 2, 2010 plan.

Financial Services and General Government Appropriations Bill, FY 2010, p. 131 (emphasis added), quoted in Congressional Research Service Report, The U.S. Postal Service's Financial Condition: Overview and Issues for Congress (July 29, 2010), p. 12 n44.]

[8] *See* Darrell A. Hughes, "Obama Admin Halts Plans To Alter US Postal Workers' Benefits," Wall Street Journal (online), May 11, 2009, at http://online.wsj.com/article/BT-CO-20009511-719565.html.

III. COMMENTS BY CERTAIN MAILERS OF FLATS AND PARCELS HAVE CHALLENGED THE ENTIRE POSTAL SERVICE COSTING SYSTEM FOR GENERATING COST ESTIMATES WITH WHICH THEY DISAGREE.

In the past few years, Postal Service costing systems measured the unit cost of flats as increasing faster than CPI despite (i) increased deployment of flats automation equipment by the Postal Service, and (ii) increased presortation and destination entry by flat mailers.[9] Displeasure at this development has manifested itself in frontal assaults on Postal Service management, the Postal Service's costing system, and in other ways.

Valpak can empathize with mailers wanting to question aspects of the costing system, as from time to time was done in rate cases under the Postal Reorganization Act of 1971 ("PRA"), as well as in annual compliance report ("ACR") dockets under PAEA. Valpak, too, has questioned existing costing approaches, and itself has proposed changes in costing methodology, but the criticisms of many commenters in this docket go too far.

A. Several Flats and Parcel Mailers Have Criticized the Postal Service's Cost System as Being Fundamentally Flawed and Completely Unreliable.

The **American Catalog Mailers Association** ("ACMA") challenges the validity of Postal Service costing and asks it be rejected:

> the costs of flats [in FY 2008] were 35.8 percent (51.6/38.0) higher than it was expected to be.... These results **raise disturbing questions about the validity of the costs....** [W]e see costs that **defy rational explanation**. These costs **should not be accepted** as meaningful.... [ACMA Initial Comments, pp. 4, 8 (emphasis added).]

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[9] Witness Kiefer explains that some of these seeming increased costs result from more accurate costing methodology. *See* Postal Service Response to Oral Request at the Hearing on Aug. 12, 2010 (Kiefer) (Aug. 19, 2010), Tr. 3/416-17.

DHL Global Mail offers the following comments concerning the reliability of costing models for Standard Parcels:

> We think the parties agree that USPS **does not have solid cost models for Standard Parcels** resulting in **uncertainty** that cost coverages relied upon are **accurate**. However they are being are acted upon <u>as if they are</u>.... If **reliable cost data is insufficient** for calculating cost avoidance for presort discounts how does USPS know how much to adjust a subclass (Machinable, Irregular or NFM) at a particular sort or destination entry level if it does not have the tools developed to make accurate assessments? [Comments of DHL Global Mail, pp. 1-2, (underscore original) (emphasis added).]

Halstein Stralberg poses fundamental challenges concerning cost causation and volume variability.

> Many of the costs that the Postal Service attributes to Periodicals **are not caused by** Periodicals, **are not volume variable**, and would not go away were Periodicals to disappear from the Postal Service mailstream.... A recurrent theme has been that as processing of other mail classes was automated, Periodicals continued to be processed in a more manual fashion. **Employees** freed up by the automation of other mailstreams **were kept busy handling Periodicals,** whose costs therefore skyrocketed. Additionally, **portions of indirect costs** that previously had been borne by other mail classes **were shifted to Periodicals by the Postal Service's cost attribution system.** [Comments of Halstein Stralberg in Behalf of Time Warner Inc. on Reasons Why the Large Periodicals Rate Increase Proposed in Docket R2010-4 Should be Denied, pp. 1, 3 (emphasis added).]

The **Parcel Shippers Association** ("PSA") also challenges volume variability.

> Finally, the Postal Service's Chief Financial Officer made clear at the August 10 hearing that when volume declines significantly, the Postal Service can't adjust its costs to the extent suggested by the Postal Service's cost systems, *i.e.*, **the costing systems overstate the variability of postal costs**. In such instances, **cost systems substantially overstate the attributable cost of**

> **individual products**. [PSA Comments, pp. 18-19 [renumbered] (emphasis added).]

Pitney Bowes states certain costs may be misclassified (a topic about which Valpak has been especially sensitive):

> The unit cost of Presort Flats is likely overstated because these **costs are being misclassified by shape**. Cost data suggest that some First-Class Mail Presort Letter costs are being counted as First-Class Mail Flats costs. [Comments of Pitney Bowes, p. 6 (emphasis added).]

Finally, **Users of Flat-Shaped Mail** ("UFSM") also challenge the volume variability of certain costs:

> the Postal Service has **grossly overstated the costs properly attributable** to these products **by ignoring the effect of excess capacity on cost causation** during the period until the proposed rates are raised again. Contrary to the Postal Service's assumption, Periodicals and Standard Mail Flats are **not the cause** of the large amounts of excess capacity in the operations where they are processed, and in fact cover the attributable costs they actually cause. [Comments of Users of Flat-Shaped Mail, p. 2 (emphasis added).]

Collectively, the above parties' comments allege that under Postal Service costing:

(i) volume variability is too high;
(ii) cost attribution is wrong;
(iii) certain costs are mis-classified; and
(iv) certain cost models are unreliable and depend upon insufficient data.

These are serious charges. Valpak takes no position in this case regarding the specific issues raised, but agrees that mailers should have the right to raise these and other costing issues, as long as it is done at the appropriate time. Costing methodology changes under PAEA are generally made in a dedicated docket. *See* 39 U.S.C. § 3653(e)(2); 39 C.F.R. § 3050.11. Neither an exigent rate case nor a "normal" rate cap case — nor an annual compliance determination, for that matter — is the appropriate place to investigate and litigate major new costing issues. An exigent case does not provide mailers with the right to file discovery of Postal Service witnesses, to cross-examine witnesses, to put on testimony, and to file briefs — but only the right to suggest questions and file comments. An exigent rate case is certainly not the forum to investigate these issues.

If any parties believe the Postal Service's costing system is completely unreliable, they can and should petition to open a rulemaking docket. *See* 39 U.S.C. § 3653(e)(2). All mailers had notice of an exigent rate filing on March 2, 2010, when the Postal Service presented its Action Plan for the Future, *Ensuring a Viable Postal Service for America.* No participant, however, petitioned the Commission to open a rulemaking docket to review cost attribution. Currently, there is no factual data for the sweeping attacks being made in this docket against the entire system of postal costing which has taken many capable people at the Postal Service, the Commission, and the mailing community 40 years to develop and refine, are without justification or support. Until changed, the existing system is the only vehicle we have and should be utilized to determine coverage and profitability of all products.

The fact that various parties do not like results of the established system for attributing costs provides no basis for jettisoning the existing costing system. "Throwing out the baby with the bath water" would be reckless. **All challenges should be heard**, with changes and improvements effected through the Commission's established rules, but those are issues to be resolved **another day**.

Energetic allegations of costing flaws give the Commission no justification whatsoever to allow underwater products to remain so — particularly Standard Flats. For Standard Flats to make the average after-rates contribution equal to that for Standard Mail of 158 percent (which they should), Standard Flats prices would need to be increased by over 81 percent[10] — miles above the 16.0 percent increase which witness Kiefer says would be required for this product just to break even, well above the 8.0 percent minimum proposed by Valpak, and well above the 5.1 percent proposed for Standard Flats by witness Kiefer.[11] No matter what flaws may exist in the costing system, Standard Flats are in no danger of carrying their share of the load, to say nothing of making up for the enormous subsidies previously given to this product in the past.

The high costs of handling a flat may not be in its stars, but in itself. The size and weight of flat-shaped mail varies far more than letter-shaped mail, with the result that automating the handling of flats has turned out to be a difficult and drawn-out challenge. According to the Postal Service:

> Standard Mail Flats are largely handled today by carriers in the same manner they were in FY 1999. They are cased and pulled down in the office and placed in the mail receptacle on the street. [Postal Service Response to POIR No. 5, Q. 9.]

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[10] The 81 percent figure is calculated as follows. The FY 2011 after rates cost of a Standard Flat is $0.426 (according to witness Masse's attachments 11 and 12). For a product with that cost to generate a coverage of 158 percent percent, the average Standard Flats revenue per piece would have to be $0.67308. The average revenue for a Standard Flat in FY 2010 (before any rate increase) is calculated by witness Masse as $0.371. To move from an average revenue of $0.371 to $0.673 would require a rate increase of 81 percent.

[11] Of course, even this **average** Standard Mail coverage is well below the after rates coverages proposed by the Postal Service for **saturation mail** (High Density & Saturation letters — 224.9 percent, and High Density & Saturation flats — 244.6 percent). *See* Valpak Initial Comments, Table VI-1, p. 35. There is no particular reason why Standard Flats should not be required eventually to make **at least the average** Class contribution of 158 percent.

Manual handling. "When individual flats are sorted manually, the standard rate [for many years has been and] is 8 per minute, or 480 per hour." Response to POIR No. 5, Q. 8. The FY 2009 wage rate for a city carrier is $39.98 per hour. Response to POIR No. 5, Q. 9, Table 3. At the standard rate of sorting and the FY 2009 wage rate, the in-office cost for just **one manual sortation of a single flat** by a city carrier is approximately **8.3 cents**. That cost **excludes** all indirect and carrier street costs.

Machine processing. With respect to flats sorting, capital — in the form of the FSM 881 (now phased out), the FSM 1000, the AFSM 100, and now the FSS — is being substituted slowly but surely for labor. In an effort to automate handling and restrain costs, the Postal Service now has spent many billions to develop, purchase, and deploy flat sorting equipment. Over the long run, as labor costs increase, the increased automation enabled by these substantial capital expenditures probably will be a plus. It appears, however, that the **capital cost for sorting flats is an expensive proposition — far more so than the capital cost of sorting letters**. "From FY 1999 to FY 2007, costs for equipment depreciation, maintenance and supplies [for flats] increased by 67.5 percent on a unit cost basis."[12] Those increased capital costs in FY 2007 reflect full deployment of the AFSM 100, but none of the costs of deploying the FSS, which is a much larger and far more expensive piece of equipment. These **higher costs** could be **inherent in the nature of flats**, not flaws in the costing system, or the result of Postal Service mismanagement.

[12] *See* Postal Service Response to Oral Request at Aug. 11, 2010 Hearing for Mr. Masse, Tr. 2/229 (Aug. 18, 2010).

In sum, the task of sorting and handling a varied stream of flats, whether by hand or machine, simply appears to be inherently difficult and expensive. A concerted effort to get Standard Flats to the point where they begin to make a positive contribution in the future will include more efficient operations and more accurate costing — but the only lever before the Commission, which it is obligated to press, is the pricing lever — to reduce continued financial hemorrhaging from this inherently-expensive product.

B. ACMA and Users of Flat Shaped Mail Both Criticize the Postal Service for Using Accepted Longer-run Attributable Costs, but No Evidence Supports Using Short-run Attributable Costs to Determine Profitability of Any Product.

American Catalog Mailers Association states that:

> The questions being raised about costs are serious, and they are being raised at a time in history when the Postal Service is focusing on excess capacity and struggling to align costs with volumes. It seems possible that, particularly as volumes decline, costs are nowhere near as variable as the cost systems purport. This would suggest **low marginal costs** and a high cost coverage, consistent with the **"short-run" variable costs** being used by the Postal Service to analyze some of its incentive programs. [ACMA Initial Comments, p. 7 (emphasis added).]

Users of Flat-Shaped Mail devote four pages to demonstrate that "Periodicals and Standard Flats Cover their Short-run attributable costs." *See* Comments of Users of Flat-Shaped Mail, pp. 18-22.

Arguments by these users of underwater products — that the Commission should use short-run attributable costs to determine profitability of their products — are flawed for many reasons.

First, no "standard" or "accepted" short-run attributable cost methodology even exists. Although short-run costs were used (and accepted by the Commission) to justify certain price reductions in two summer sale dockets, approval was only for the particular summer months involved, and **the "methodology" differed** as between the two dockets — *i.e.*, short-run costs in the first summer differed from short-run costs in the second summer.

Second, the Postal Service never has asserted that short-run marginal costs could or should apply to any period outside of those **summer months**. Absolutely no basis has been established for asserting that short-run marginal costs should be applied over all 12 months of the year.

Third, the asserted reason why short-run marginal costs are less than long-run attributable costs is the alleged existence of **excess capacity** whose costs are not variable, but fixed over some short-run period. Although some excess capacity may have been asserted (and admitted) to exist, no accepted methodology has been established for determining the existence or extent of any excess capacity, either as regards labor or capital equipment. To the extent that excess capacity does exist, it may be in some facilities and not others. Moreover, excess capacity is a transient phenomenon — capacity that is excess this month may be in short supply next month. "Going forward, as **excess capacity is eliminated,** there should be some offsetting reductions."[13]

[13] *See* Postal Service Response to Oral Request at Aug. 11, 2010 Hearing for Mr. Masse, Tr. 2/229 (Aug. 18, 2010). *See also* Postal Service Response to Oral Request at Aug. 12, 2010 Hearing for Dr. Kiefer, Tr. 3/416-417 (Aug. 19, 2010).

Fourth, simply changing the rules for cost attribution so as to collectively "pretend" that underwater products like Standard Flats are profitable would do nothing to reduce actual costs and improve Postal Service profitability. Regardless of whether the costs in question are classified as fixed or variable, they would continue to exist. Standard Flats should be required to pay for some of these costs, even if they are truly institutional costs. Nor would it alter the fundamental business economics. For the Postal Service to continue nurturing products that are underwater when evaluated using long-run attributable costs will do little or nothing to restore the Postal Service to an appropriate level of profitability and make it a financially self-sustaining organization over the long run.

Fifth, if different short-run marginal costs somehow were to be used to evaluate profitability of products, application of that methodology would need to be uniform with respect to all products, not just underwater products. Doing that, however, would do little or nothing to change the relative profitability of products. To illustrate, although use of short-run marginal costs might result in some products now underwater appearing to be slightly above water, it also could result in other products having coverages well in excess of 300 percent. With such coverages, when the Postal Service needs to raise extra money via a rate increase, common sense dictates that it still would need to protect prices and volumes of its highly-profitable products by imposing a relatively large increase on prices of products with inelastic demand that contribute little or nothing to institutional costs.

Finally, no party has sought to open a rulemaking docket that would establish a basis for, or justify, using short-run marginal costs in lieu of long-run attributable costs when determining coverage and profitability. Valpak has had concern with short-run marginal costs being used in connection with the summer sales, and for the Postal Service to continue using them, such methodology must be established in a formal rulemaking docket. (Long-run mischief seems to be the most likely result of using short-run costs for summer sales.)

IV. INITIAL COMMENTS DEMONSTRATE THAT THE POSTAL SERVICE FLATS STRATEGY CANNOT BE RELIED UPON TO CUT COSTS FOR STANDARD FLATS.

A. MOAA and Time Warner Correctly Assert that the Flats Strategy Does Not Constitute a Serious Plan Likely to Result in the Postal Service Achieving Meaningful Reductions in the Attributable Cost of Flats beyond FY 2011.

Initial Comments by both Mail Order Association of America ("MOAA") and Halstein Stralberg (on behalf of Time Warner) provide critical assessments of the Postal Service's Flats Strategy (USPS-R2010-4/9).

MOAA explained how the Flats Strategy would not cure the problem of underwater **Standard Flats**, stating:

> That part of the Flats Strategy "plan" that is specifically limited to flats is so general that it is **impossible to determine** whether it offers any prospect of **Standard Mail "Flats"** covering attributable costs. For example, the discussion of FSS … **provides no quantification or timetable….**
>
> The just over the horizon promised benefits of the Flats Strategy, however, appears to be **more of a "hope"** than a "plan"….
>
> In sum, the Postal Service has not presented an adequate "plan" for the processing of **Standard Mail "Flats"** that will bring about lower costs under which that product would at least meet attributable costs. [MOAA Initial Comments, pp. 2-3 (emphasis added).]

Likewise, Halstein Stralberg finds little prospect of worthwhile cost reductions in the Flats Strategy as presented:

> not only has management failed to get behind [elimination of manual sorting of flats], they did not even include it in the long list of **loosely formulated** cost reduction ideas presented in this docket under the title "Flats Strategies." That document refers to … various ideas that are **not new at all,** but it fails to mention the one thing that could lead to an immediate sharp reduction in Periodicals cost coverage and that requires no investment other than the firm support and commitment of top USPS management….
>
> [Flats Strategies] is not something that has been guiding the Postal Service's flats policies. In fact, it was assembled only recently by various managers at headquarters "and their collective staff," for presentation in this docket. Tr. 303-304. And with two exceptions related to new technology, the various ideas listed in that document have **no cost analysis** and **no firm time line** and for that matter **no in-depth analysis** attached to them. [Comments of Halstein Stralberg in Behalf of Time Warner Inc. on Reasons Why the Large Periodicals Rate Increase Proposed in Docket R2010-4 Should be Denied, pp. 7-8, 11 (emphasis added).]

Both of these comments make excellent points about inadequacies of the Flats Strategy, and each set of comments reinforces Valpak's Initial Comments concerning the Flats Strategy. *See* Valpak Initial Comments, pp. 29-32. The Postal Service's Flats Strategy does not adequately respond to the Commission's directive for the Postal Service "to devise a plan to improve the cost coverage of the Standard Mail Flats product," including "operational or mail preparation changes" as well as "a specific timeline for achieving a positive contribution…." *See* FY 2009 Annual Compliance Determination ("ACD"), pp. 86-87.

B. Recent Postal Service Responses Reinforce the Conclusion that the Flats Strategy Cannot Be Relied Upon for Any Significant Reduction in the Attributable Cost of Standard Flats.

Postal Service responses to Commission inquiries submitted after initial comments were filed (on August 17, 2010) reinforce the negative assessments about the Flats Strategy made by MOAA and Stralberg (and Valpak).

Of the 30 initiatives in the Flats Strategy, we now have learned that only the FSS has a material effect on the attributable cost of flats. Net savings from **FSS** in FY 2010 and FY 2011 are said to be, respectively, **$43 and $242 million**. *See* Postal Service Response to Oral Request at Aug. 11, 2010 Hearing for Mr. Masse, Tr. 2/174, 227-28 (Aug.18, 2010). By way of comparison, net savings from **all other initiatives** in the Flats Strategy in FY 2010 and FY 2011 are, respectively, only **$10 and $2 million**. *See id.*, Tr. 2/228.

Another Postal Service response illustrates the vagueness of a number of the Flats Strategy initiatives. Of the 30 initiatives, **only three** have had a Decision Analysis Report ("DAR") prepared — which is required to demonstrate cost savings from significant investment initiatives — one of which is the FSS. Of the remaining 27, over half (*i.e.*, 15), are still in the first (conceptual) stage, and the other 12 **could** lead to potential DARs (at some unspecified time in the future).

Additionally, the Postal Service views many of the Flats Strategy initiatives as part of ongoing day-to-day management activities, **not limited specifically to flats opportunities**. It would seem fair to state that, other than the FSS, the Postal Service has no significant plan focused on reducing the attributable cost of flats. *See* Postal Service Response to Oral Request at Aug. 12, 2010 Hearing for Mr. Neri, Tr. 3/315 (Aug. 19, 2010). Only nine of 30 initiatives are specific to flats. *See* Postal Service Response to POIR No. 5, Q. 18 (Aug. 25, 2010).

Indeed, the Postal Service now admits that it has no real expectation for reducing costs so as to move badly-underwater Standard Flats to a coverage that exceeds 100 percent:

> It is **highly doubtful** that cost savings from the Fats Strategy initiatives alone **would close the gap**, in the short run, or **even the medium run**. Cost reductions, on their own, are **unlikely to be sufficient** to advance **Standard Mail flats** to **full cost coverage**. [Postal Service Response to Oral Request at Aug. 12, 2010 Hearing for Dr. Kiefer, Tr. 3/462 (Aug. 19, 2010) (emphasis added.).]

The Postal Service's Flats Strategy surely cannot be relied upon by the Commission to justify further deferments in proper pricing of Standard Flats.

C. Requests for Yet Further Delay in Rate Increases for Standard Flats Based on a Joint Report Should Be Rejected Out of Hand.

Comments by **Users of Flat-Shaped Mail** invoke the perennially "forthcoming" Joint Report on flats costs, and urge the Commission to use that as an excuse to delay yet again. Comments of Users of Flat-Shaped Mail, pp. 16-17. Of course, each previous delay in proper pricing has contributed significantly to worsening the Postal Service's financial condition. It is not clear how or why Users of Flat-Shaped Mail expect that long-anticipated report to go beyond the Flats Strategy and suddenly shine a bright new light on ways to reduce the attributable costs of handling flats, most especially flats that are entered in sacks, have comparatively little presortation, and require substantial handling. The Commission should rely on actual data and ignore all such pleas until underwater Standard Flats at least cover their attributable costs and begin to make some contribution to institutional costs.

PAEA eliminated the forward-looking test year and replaced it with a backwards looking review system of compliance, and that is what must be done in connection with each successive ACR. Then, the Commission will be able to look at actual data for the entire year and make its determination with respect to coverage of attributable costs. We hope that over time we will see greater efficiencies and reduced costs as a result of Postal Service strategies. Witness Kiefer stated that a 16 percent increase for Standard Flats would be required to get the product to cover costs (Kiefer Statement, p. 30, ll. 6-7), but his proposed below-average price increase was only 5.1 percent, in part hoping against hope for cost savings to be achieved. On the basis of (i) data sponsored by Mr. Masse, and (ii) the lack of any substantial cost reduction that can be expected from the Flats Strategy, it appears to be abundantly clear that Standard Flats which were badly underwater in FY 2009 will fail to break the surface — not only in FY 2010 or FY 2011, but also for the indefinite future — unless the Commission acts now to require increases of a minimum of 8 percent.

V. FAILURE TO EXERCISE PRICING FLEXIBILITY TO MAXIMIZE CASH FLOW AND SATISFY THE PAEA MANDATES INVITES SELECTIVE REJECTION OF THE PROPOSED RATE ADJUSTMENTS.

A. Several Parties Correctly Assert that the Postal Service's Near Across-the-Board Price Increase Has Generated Certain Rates that Are Neither Reasonable Nor Equitable.

Several parties criticized the near across-the-board nature of the Postal Service's price adjustments as failing to constitute a "reasonable" or "equitable" rate design under 39 U.S.C. section 3622(d)(1)(E). Specifically, they challenge whether Postal Service's pricing provides proper incentives to encourage retention of highly-profitable mail, disincentives for underwater mail, and sufficient improvements in net cash flow relative to the pain inflicted.

Primarily with respect to First-Class Mail, the **American Bankers Association** ("ABA") commented on the Postal Service's failure to exercise pricing flexibility:

> In the USPS exigent request, it acknowledges that rate increases are **not equitable** and that some categories may remain **under priced**.... [T]he Commission should take into consideration ... the **inequitable** pricing that results, and require the USPS to establish rates that do not **unusually burden a category of mailers**. [ABA Initial Comments, p. 8 (emphasis added, footnote omitted).]

The **National Association of Presort Mailers** ("NAPM") noted that "any proposed pricing adjustment must be designed to preserve and grow the volume of First-Class Mail Commercial Letters, Cards and Flats. But the rate adjustments requested by the Postal Service fall short in this regard." NAPM Initial Comments, p. 3.

The **National Postal Policy Council** stated, "It is hardly "best practices" for a business to impose some of its highest rate increases on customers that provide it with its largest volumes and highest contributions, especially when doing so will cause those customers to reduce their mail volumes at an accelerating rate." NPPC Initial Comments, p. 8.

Pitney Bowes stated, "Taking all of the above into account, the Postal Service proposes a rate design that leaves the relationships between the various price tiers largely unchanged." Pitney Bowes Initial Comments, p. 5.

With respect to Periodicals, **Halstein Stralberg**, on behalf of Time Warner, addressed whether the rate structure sends proper signals:

> To really reduce Periodicals costs and thereby raise the cost coverage of the Periodicals Class, the Postal Service needs to effect meaningful **improvements** in the Periodicals **rate design**, so as to **encourage more efficient preparation**. But the rates it has proposed contain little improvement and seem designed to punish the most efficient mailers. [Halstein Stralberg Comments, p. 12 (emphasis added).]

With respect to Standard Mail, **Mail Order Association of America** addressed the lack of equity in pricing High Density and Carrier Route flats:

> Mailers of High Density and Carrier Route "flats" have obviously been hurt by the economic situation just as much as those catalog mailers using the Standard Mail "Flats" product, but the Service proposes to maintain high cost coverages for them.... It is ... important ... for the Postal Service to **price its profitable products to increase volumes**. **The proposal** for the Saturation/High Density flats and Carrier Route products are **inconsistent with that sound pricing strategy**. [MOAA Initial Comments, p. 7 (emphasis added).]

MOAA's comments regarding High Density and Saturation Flats and the Carrier Route product are equally true for the Saturation and High Density Letters product.

These comments from a wide range of mailers, relating to a wide range of products, demonstrate disappointment with the Postal Service's use of its highly-prized pricing flexibility to give mailers the same old spread-the-pain pricing of the past. The Postal Service's proposed price adjustments demonstrate (i) a high tolerance for badly underwater products (such as Standard Flats), and (ii) a refusal to incentivize highly-profitable mail (such as Saturation mail). The above excerpts from initial comments of other parties demonstrate that the Postal Service's embrace of a virtual across-the-board price increase is not just a distinctly un-business-like act of charity for some. It also is a missed opportunity to drive costs out of the system, and retain as much highly-profitable mail as possible.[14] Most important, it is a matter of falling below the exigent case statutory-minimum of "reasonable and equitable" rates for certain products such as Saturation mail. The Postal Service understands, and purports to believe, in these pricing principles, but its pricing fails to follow through in its pricing.

For example, in response to Presiding Officer's Information Request No. 5, question 14.b. (Aug. 25, 2010), witness Kiefer stated that the purpose of the Saturation and High Density Incentive Program is that "the Postal Service hopes to retain and increase high contribution mail," allowing "the Postal Service to improve contribution without further increasing base prices for these important categories." But if the Postal Service wanted to maximize contribution from Saturation mailers, it would reduce these rates for all users of the highly-profitable product, not just those few who may be able to take advantage of a narrow incentive program. *See* Valpak Initial Comments, p. 38.

The Postal Service fully understands that mailers will respond rationally to pricing signals. In response to a Commission question posed during his testimony, witness Kiefer explained that "the [higher Standard Flats] **prices** resulting from Docket No. R2006-1 **incented conversion** of smaller, lighter weight flats **to letter-shaped pieces**." Postal Service Response to Questions from the Bench at the Hearing for Dr. Kiefer, Tr. 3/462 (Aug. 19, 2010). As

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[14] During Commission hearings, Commissioner Hammond asked witness Neri "have you ever been asked to come up with anything … that could end up driving mail out of the system because the Postal Service consider[s] it unprofitable, and it would be much better if the mail were to [be] gone" and received the response "No, sir." Tr. 3/356, l. 22 - 357, l. 5. Since witness Neri was an operations witness, it is unclear whether the discussion related to pricing. However, if the Postal Service has never considered pricing which would reduce the volume of money-losing products, it reflects a distinctly un-business-like view of pricing.

expensive-to-handle Standard Flats, these pieces lost money for the Postal Service, but as inexpensive-to-handle Carrier Route flats or Standard Letters, these converted pieces make a meaningful contribution to institutional costs. And, the mailer pays a significantly lower rate. This is the type of win-win that can come from proper pricing signals. There is reason to believe that more flat-shaped catalogs would convert to Carrier Route or letter-shape if Standard Flats were not cross-subsidized. Indeed, witness Kiefer indicates that even after "smaller, lighter weight flats" converted to "letter shaped pieces," the "weight [of Standard Flats] also declined on a per piece basis." *Id*. The Postal Service understands the important pricing principles involved, but seems to need the Commission's encouragement to live by them.

With Saturation mail, the Postal Service not only has a highly-elastic product which would respond to low price increases, it has a high-coverage product that is already overburdened. Rather than incentivize additional highly-profitable volume by reducing the current inequity in rates, the Postal Service has proposed rates which would exacerbate inequity in rates (actually raising the coverage on both Saturation products) in a manner that could in no way be considered fair or equitable — particularly while other favored products are priced substantially below their attributable cost.

B. Parcel Shippers Association Correctly Understands PAEA's Limitation on the Commission's Power to Accept or Reject Prices Proposed by the Postal Service, but not to Modify Them.

The Parcel Shippers Association discusses the Commission's authority under PAEA to modify the prices proposed by the Postal Service if it finds that the rates are not "reasonable, equitable, and necessary":

> There appears to be **no statutory provision for a remedy** should the Commission determine that rate adjustments under either regular or exigent circumstances fail to comply with the law, other than the cost of living limitation or the "circumstances" test for exigent increases. [PSA Comments, p. 9 (emphasis added).]

Comparing the statutory provisions governing exigent increases from those that are cap-based, PSA notes that PAEA does provide for a specific Commission remedial action if it determines that a proposed price adjustment is not in compliance:

> it would appear that the **Commission cannot itself fashion the remedy** but must **put it back to the Postal Service** to provide the adjustments necessary to answer the Commission's findings of violation of the PAEA. [*Id.* (emphasis added).]

Valpak agrees with PSA's view that even if the Commission finds that the Postal Service's rates are not "reasonable, equitable, and necessary," the Commission has no statutory power to directly modify the Postal Service's rates. *See* 39 U.S.C. § 3622(d)(1)(C)(iv). Furthermore, Commission modification of proposed prices would be inconsistent with the specific power delegated to the Postal Service "to prescribe, in accordance with [Title 39], the amount of postage and the manner in which it is to be paid." 39 U.S.C. § 404(a)(2). The only express authorization of Commission changes to postal prices is in the complaint remedy provision of 39 U.S.C. § 3662(c), which is applicable both in complaint cases and in annual compliance reviews under 39 U.S.C. section 3653.

Valpak also agrees with PSA that the Commission's remedy in such circumstances would be to return the matter to the Postal Service — with instructions as to how to revise the rates to comply with Title 39. *See* Valpak Initial Comments, pp. 15-16.[15]

Should the Commission nevertheless decide that it does have the authority to modify the Postal Service's flawed rate adjustments, Valpak urges that it increase rates for Standard Flats by at least 8 percent. Moreover, it should give no increase (but certainly no more than a 2 percent increase) to High Density & Saturation Letters and High Density & Saturation Flats, as discussed in Valpak Initial Comments, pp. 39-45.

C. Untested Theories Cannot Rationalize Away Enormous Losses from Standard Flats.

Comments of several parties would have the Postal Service and the Commission rationalize losses on one product by incorporating into the analysis of profitability a "multiplier effect." For example, ACMA's Initial Comments state:

> **[M]ore attention is needed to multiplier effects.** It is understood widely that there are interrelationships among various postal products. For example, a catalog sale might result in associated First Class letters or in the use of a parcel category. Sometimes the multiples can be high. **More information on these relationships is needed**. The flats category is large enough to warrant inquiry.
>
> Further, we throw open the question of how best to use multiplier-effect information **if it becomes available.** Since some mailers in a category might have much larger (and more extensive) multiplier effects than others, there may be a way for

[15] Of course, the Governors cannot increase rates on an exigent basis without the Commission: "rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, **provided that the Commission determines** … that such adjustment is reasonable and equitable and necessary…." 39 U.S.C. § 3622(d)(1)(E) (emphasis added).

> the Postal Service to gain by segmenting existing categories and treating the segments differently. Here again, if a desired quantitative analysis is not available, flexibility to rely on informed judgment should exist. [ACMA Initial Comments, pp. 16-17 (emphasis added).]

ACMA is candid in admitting that no reliable information exists on multiplier effects[16] — they are a theory for which evidence, if any exists, has not been collected. Indeed, witness Kiefer confirmed that data in support of a multiplier effect was not very promising. *See* Response of James Kiefer to Presiding Officer's Information Request No. 6, question 3 (Aug. 9, 2010).

Users of Flat-Shaped Mail state:

> The Postal Service's proposed price increases for Periodicals and Standard Mail Regular Flats would drive out of the system not only flats-shaped mail but also this **derivative volume**. If periodical and catalog mailers are not mailing their flats, they will not be mailing these other pieces. The Commission has recognized the value of the "**multiplier effect**" provided by certain types of mail. In its shortsighted focus on the price of one category of products, the Postal Service is ignoring the broader impacts of its proposal. At a time when the Postal Service claims to be desperate for more money, driving away **customers who make a positive contribution** to the Postal Service's institutional costs is folly. [Comments of Users of Flat-Shaped Mail, p. 28 (emphasis added, footnote omitted).]

UFSM represents that the "Commission has recognized the value of the 'multiplier effect'" without providing any citation for this statement whatsoever. UFSM wants the Postal Service

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[16] Among postal products, interrelationships that exhibit a multiplier effect would be described by economists as "**complementary**," which means that the purchase and use of one product increases the purchase and use of another product. From an econometric perspective, this means that the two products have a **positive** cross-elasticity of demand. Reliable econometric data on cross-elasticities between postal products are lacking.

to evaluate whether **customers** make a positive contribution, but PAEA requires the Commission to evaluate whether **products** make a positive contribution.

Publishers Clearing House ("PCH") likewise states:

> **Volume Will Decline Across Multiple Mail Categories Given the Mail Multiplier Effect**
> Not only will PCH (and others') small parcel fulfillment volume decline as a result of the value based marketing proposition being less effective, but the margin squeeze from the exorbitant parcel rate increase will have a **negative multiplier effect** on the very profitable Standard Mail letter volume that promotes the merchandise and the very profitable First-Class response mail (sweeps response, order response, bills and payments) that result from these promotions. PCH has already had to reduce promotional letter volumes given the last three price increases. It baffles us that the Postal Service seems to ignore **the full complement of mail that its customers generate** and rather than leverage that, the pricing proposals become self defeating to the extent they discourage mail growth across multiple mail categories. Such self defeating actions cannot continue if the Postal Service expects to grow their business and attain financial health. [Publishers Clearing House, unnumbered pp. 3-4 (emphasis added).]

PCH introduces into the postal lexicon the concept of a "negative multiplier effect." PCH wants the Postal Service to consider not only profits from products that are complementary, but also profits from products that either are unrelated or are substitutes[17] — *i.e.*, the "full complement of mail that customers generate." Focusing on customers (not products) and their "full complement" is described herein as the "**agglomeration effect**."[18]

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[17] The interrelationship between postal products that are "substitutes" would be characterized by **negative** cross-elasticity of demand.

[18] With respect to this "agglomeration effect," it is altogether unclear why profits from one product (A, say) should be used to offset losses on another product (B, say) when A is a substitute for B. Moreover, to the extent that the "agglomeration effect" is given any

1. Neither the Multiplier Effect Nor the Agglomeration Effect Can Override PAEA.

Mailers benefitting from subsidized rates appear to be infinitely creative in finding new ways to retain their subsidy. In their Initial Comments, catalog mailers have rejected rate design principles underlying the Postal Service's entire case. They theorize that their mail really is not causing enormous losses for the Postal Service because of two approaches which they propose that the Commission should employ to override requirements of PAEA:

(A) the so-called "**multiplier effect**," and

(B) the "**agglomeration effect**," which claims that the Postal Service somehow should evaluate whether all mail from a particular **mailer** (or group of mailers) generates net income, rather than whether each **product** used covers its respective costs.

Neither of these two "effects" is recognized by law. Under PAEA, each product stands on its own and not only must cover its costs, but also make a reasonable contribution to institutional costs. *See* 39 U.S.C. § 101(d). Neither the Postal Service nor the Commission is at liberty to adopt a theory which undermines statutory principles of rate design.

2. The Multiplier Effect Can Create Problems.

Proponents of incorporating a multiplier effect into rate analysis apparently want to credit profits earned by one product against the losses suffered by another product. Essentially, they are asserting that one product is "primary," the other is "secondary," and without the primary product, profits from the secondary product would not exist. This curious doctrine raises two immediate concerns:

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consideration, instead of comparing revenues of the "full complement" of mail to their collective attributable cost, a more appropriate comparison would be coverage of the "full complement" with the systemwide coverage.

- The first concern is determining which product is primary and should receive "credit" for profits on other products. To illustrate, suppose some mailers claim Standard Flats are "primary" and generate product fulfilment by "secondary" Priority Mail shipments. Other Priority Mailers then may argue that their product is "primary" and should be priced below cost, while Standard Flats are "secondary" and should be priced to net a large return.

- Second, suppose profits from the "secondary" product somehow are credited to the "primary" product. The same profit cannot support coverages for two products. If Carrier Route Flats are "secondary" and their profit is seen to increase coverage on Standard Flats, then coverage of Carrier Route Flats drops to the point where its coverage and rates should be increased. (No proponent of the multiplier effect has urged higher rates for the Secondary Product, although this would be the only fair way to apply such a principle of rate design.)

3. Widespread Use of the Multiplier and Agglomeration Effects Would Obliterate Product Distinctions.

Proponents of the "multiplier effect" and the "agglomeration effect" clearly want to override the requirement that each product carry its own weight. Instead, they suggest that any losses from the primary product be ignored either because that product helps generate other profitable mail (*i.e.*, complementary secondary products with a positive cross-elasticity), or the mailer also uses other postal products that either are unrelated or are substitutes with a negative cross-elasticity. If the multiplier and agglomeration effects were such good ideas, they seemingly would have been embraced by the Postal Service at some point over the past two centuries — but that does not seem to have occurred. *See generally* Richard B. Kielbowicz, "A History of Mail Classification and Its Underlying Policies and Purposes" (July 17, 1995). http://www.prc.gov/prc-docs/library/refdesk/techpapers/Kielbowicz/hist-mail-class.pdf

4. The Multiplier Effect Cannot Be Confined to Money-Losing Products.

MOAA embraces traditional rate design principles and opposes consideration of any multiplier effect to support a reduction in the markup on the primary product (even if the primary product itself is highly profitable).

> Arguments are made that below cost rates are justifiable because, at least as applied to catalogs, other mail is generated. To the extent that the proposition is accurate, it applies equally to catalogs carried within the profitable mail products of Saturation/High Density and Carrier Route. In any event, the claimed benefit has not been quantified and appears to be relatively small. [MOAA Initial Comments, p. 4.]

Valpak agrees with MOAA that (i) the multiplier effect should be disregarded, but, if a multiplier effect somehow were to be incorporated into formal rate analysis, then (ii) it should be applied to all "eligible" products, not just those that are underwater and need a life preserver.

5. Pleas to Consider Multiplier and Agglomeration Effects Are Disguised Pleas for Continued Subsidization.

Catalogs sent as Standard **High Density & Saturation Flats** are enormously profitable for the Postal Service (244.6 percent coverage, after rates). Catalogs using **Bound Printed Matter** cover their costs and contribute substantially to Postal Service institutional costs (182.9 percent coverage, after rates, which exceeds the systemwide coverage). Catalogs sent using the Standard **Carrier Route** product cover their costs and make reasonably good money for the Postal Service (157.1 percent coverage, after rates).[19]

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[19] *See* discussion of profitability of catalogs introduced as High Density and Carrier Route Mail by members of MOAA. MOAA Initial Comments, p. 4.

However, catalogs sent as **Standard Flats** lose substantial money for the Postal Service and, obviously, contribute nothing to institutional costs (90.6 percent coverage, after rates). During the period FY 2008 though FY 2011, Standard Flats have lost and are projected to lose **$1.6 billion** for the Postal Service. *See* Valpak Initial Comments, Table IV-1, p. 20. In FY 2011 alone, Standard Flats are projected to **lose $310 million** for the Postal Service, even with the proposed rate adjustment. To put this number in context and illustrate the opportunity cost of nurturing such products, it is:

- much more than total revenue from **Bound Printed Mail flats** ($215 million);
- almost as much as the Postal Service earned from **Express Mail** in FY 2009 ($331 million),
- more than 10 percent of the Postal Service's annual **borrowing capacity** ($300 million), and
- about half of what the Postal Service spends each year on **vehicle maintenance**.

If anything has been learned in recent years, it is that mailers receiving subsidized rates come to rationalize away completely:

- lost revenues for the Postal Service,
- the fact that their losses contribute to the need for service cutbacks, and
- the fact that they are putting an unfair burden on other mailers.

Those subsidized mailers demonstrate little regard for the financial health of the Postal Service. Indeed, they even accuse Postal Service management — which has forced other mailers to cross-subsidize them for years — of near incompetence. *See generally* Affordable Mailers Alliance Motion to Dismiss, pp. 20-34, 38-40, 47-72; AMA Initial Comments, pp. 14-23.

VI. COMMENTS ABOUT THE TIMING OF RATE INCREASES IGNORE IMPORTANT REGULATORY CONSIDERATIONS.

Pitney Bowes and IDEAlliance both oppose January implementation of pricing adjustments and classification changes. "Pitney Bowes hopes this January price change is a one-time event and that future prices changes will revert to a May implementation date." Pitney Bowes bases its objection on certain logistical problems that "mailers, mail service providers, vendors, and software developers" will experience as the result of a January versus a May implementation. Comments of Pitney Bowes, p. 3.

IDEAlliance stated:

> we understand the USPS has suggested changing the annual implementation date of market dominant prices and classification changes in January. We suggest keeping the month of May as the preferred implementation time for rate adjustments to these mail classes as it significantly reduces the implementation costs placed on mailers and more closely aligns sortation and pricing changes with address correction (CASS) required changes. Moreover, it provides software development schedules to more closely align to mail production schedules. Comments of IDEAlliance, p. 3.

Valpak believes such views as to timing are important to consider, but that implementation of pricing changes always creates problems for mailers, and those who work with mailers, no matter when they occur. Moreover, in determining the timing of pricing changes, consideration also must be given to other factors which may override the "preferred implementation" date suggested by these comments.

Valpak has previously addressed a thorny problem created by the Postal Service's May pricing schedule — the difficulty of Postal Service pricing decisions being made just prior to having the benefit of the Commission's guidance from its annual compliance determination.

See Docket No. ACR2008, Valpak Initial Comments, pp. 4-5; Docket No. ACR2009, Valpak Initial Comments, pp. 61-64. The Commission recognized this problem in a previous Annual Compliance Determination. *See* FY 2008 ACD, pp. 100-101. (Neither Pitney Bowes nor IDEAlliance addressed these regulatory concerns in their Initial Comments.)

As the Commission previously acknowledged, PAEA does not give the Commission the authority to direct when the Postal Service changes rates. *See* FY 2008 ACD, pp. 100-101. Thus, while comments of this sort may be filed with the Commission, they also are directed to the Postal Service. (Pitney Bowes and IDEAlliance apparently understand this as well because they do not suggest the Commission take any action on their calendar preference.) However, as discussed below, the mailing community and the regulatory process may obtain greater benefits from a routine January implementation date.

The Postal Service fiscal year ends on September 30. PAEA requires the Postal Service to file its Annual Compliance Report within 90 days of the end of the fiscal year, or by December 29. The Commission then has 90 days to issue its Annual Compliance Determination, or by March 29. The last May rate increase occurred on May 11, 2009, and those rates were noticed by the Postal Service 90 days earlier, on February 10, 2009. It is obvious that rates noticed on February 10, 2009 follow by almost one full year the Commission's most recent guidance on costing and rate setting matters. (Rates go into effect 14 months after the Commission's ACD.) Within the PAEA regulatory scheme, for the Commission's ACD to have a meaningful effect on pricing, it would be far better for rates to be noticed by October 2 for implementation on January 2, incorporating the most recent guidance issued by the Commission in the preceding March.

Now that the Postal Service has shifted the schedule by having its 2011 price increase in January, it is urged to seriously consider the advantages of keeping to this schedule in future years.

Respectfully submitted,

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