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Annual Compliance Report, 2017	)	Docket No. ACR2017

INITIAL COMMENTS OF THE AMERICAN CATALOG MAILERS ASSOCIATION (ACMA)

(February 1, 2018)

Pursuant to Commission Order No. 4323, "Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments" (Jan. 2, 2018), ACMA is pleased to submit these comments, with workbook ACMA_ACR2017_Workbook.xlsx.

I. Introduction

Generally, catalogs are mailed in a continuum of 52 Commercial categories that are, after being combined with an equal number of Nonprofit categories, reported in the CRA as (a) MM Flats, (b) MM Carrier Route, and (c) MM High-Density and Saturation Flats and Parcels.[1] The mail in a specific mailing event usually falls into several

[1] In these comments, MM refers to USPS Marketing Mail. MM High-Density, High-Density, and HD refer to the sum of MM High-Density Flats and MM High-Density Plus Flats. Carrier Route and CR refer to MM Carrier Route (which contains flats and a limited number of letters and parcels). An EDDM component exists in the Saturation category, but is not used by catalogers. DDU entry is not available to some categories and is used in limited degree by catalogs.

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different rate categories. Volumes sent, then, usually depend on weighted averages of a collection of rates.

II. Revenue and Cost Results for FY2017

Because MM Flats functions in considerable degree as a residual category to Carrier Route, their combined profitability relates most closely to the market. High-Density is also important. And using the estimates in USPS Folder 27, Nonprofit can be pulled out, which allows a focus on Commercial.[2] Cost coverages for these categories are shown in Table 1, which includes the results for FY 2016 in brackets.

Table 1

Commercial Cost Coverages FY 2017 [FY 2016]

MM Flats + Carrier Route	**100.7%** [105.1%]
High-Density Flats	**156.6%** [173.1%]

Catalogs, then, cover their costs. An increase in the volume of catalogs, mainly MM Flats, Carrier Route, and High-Density, would increase the Postal Service's net

[continued]

Most catalogs are automation compatible and most qualify for the IMb discount. A majority are co-mailed. Most are on pallets. Some are sent as Bound Printed Matter. Catalog sales generate volume in other categories, including both First-Class Letters and Parcels used for fulfillment. Some small-format catalogs use MM Letters. "Brick and mortar" retailers sometimes send both catalogs and Saturation products. Postal regulations exist for each category.

[2] In reply comments in Docket No. ACR2015, ACMA explained that the history of the Nonprofit rates, including guiding legislation, is consistent with all mailers together funding the Nonprofit rates (at 8-14). Further, it is difficult to square the behavioral characteristics of the current arrangement with the apparent intent of Congress. In its 2015 ACD, the Commission responded to this matter by saying that ACMA could "petition the Commission to consider such issues in another proceeding" (at 77). However, for purposes of assessing the rates being paid by Commercial mailers and by catalogers specifically, no changes are needed. There is no bar to considering the cost coverages shown in these comments.

income. A rate increase limited to MM Flats would have effects on Carrier Route and High-Density as well, due to the joint nature of mailings and to co-mailing activities.[3] We believe that the Postal Service is concerned about these relationships, and that it should be. The relationships we would choose might be different from those the Service would prefer, but we understand that it having some flexibility is in order.

Table 2 shows the same results at a lower level of aggregation.

Table 2

Flats-Category Cost Coverages FY 2017 [FY 2016]

	Commercial	Nonprofit	Product Total
MM Flats	**81.7%** [86.7%]	**50.3%** [53.4%]	**73.9%** [79.7%]
Carrier Route	**127.5%** [140.7%]	**85.8%** [88.8%]	**124.1%** [131.1%]
High-Density Flats	**156.6%** [173.1%]	**90.6%** [94.5%]	**157.1%** [168.3%]

The volume changes that occurred in 2017 are shown in Table 3. In Carrier Route, Nonprofit volume increased much more than Commercial volume (24.8% v. 6.1%). This contributed to the decrease in coverage of Carrier Route. Due to a portion of FSS volume returning to Carrier Route, a large volume reduction occurred in Commercial MM Flats. Catalogs are believed to account for the lion's share of the volume of Commercial MM Flats and Carrier Route, and a lesser portion of

[3] No information is available on the cross-elasticity between MM Flats and Carrier Route. *See* USPS demand equations filed January 19, 2018. It is clear, however, that the two categories are connected by more than ordinary consumer preference. Also, no quantification is available of the elasticity of co-mailed volume with respect to any rate difference, though it is well-known that co-mailing is sensitive to rate differences.

Table 3 FY 2017 Volume (in thousands) and Percent Change from FY 2016			
	Commercial	Nonprofit	Total
MM Flats	**3,800,321**	**1,143,742**	**4,944,063**
From 2016	**-25.4%**	**-5.68%**	**-21.6%**
Carrier Route	**6,563,481**	**569,522**	**7,133,003**
From 2016	**+6.1%**	**+24.8%**	**+7.39%**
High-Density Flats	**2,021,755**	**151,166**	**2,172,921**
From 2016	**+14.3%**	**+18.4%**	**+14.6%**
Total	**12,385,558**	**1,864,431**	**14,249,989**
From 2016	**-5.1%**	**+3.8%**	**-4.0%**

Commercial High-Density. However, despite this importance, the situation appears to be that the volume of catalogs is not measured, either in total or by product. We cannot, therefore, track catalog volumes over time.

Also notable and disturbing is a persistent multi-year increase in reported costs for all flat categories. Viewed over a period of years, reported contribution percentages for flats continues to worsen. This is discussed further below.

III. The Situation in which MM Flats Finds Itself Is the Result of a Series of Interdependent Developments. Its Cost Coverage Should Not Be Assessed in Isolation

The cost coverage of MM Flats, Commercial and Nonprofit combined, has received a great deal of attention, particularly since the Commission found it too low to

be in compliance in Docket No. ACR2010. Due to a series of developments, however, it has become more an empty-nest parent than a principal component.

High-Density is a category that has received volume from both MM Flats and Carrier Route. To realize lower rates, mailers have worked hard to get into High-Density. This has included co-mailing and adjusting lists.

Since 1998, unlike the volume **decreases** of MM Flats, Carrier Route, and Saturation of 67.9 percent, 42.1 percent, and 27.0 percent respectively, the volume of High-Density has **increased** 65.9 percent.[4] It is likely that a billion or more pieces of this growth came from MM Flats and Carrier Route. The mail shifting was undoubtedly low-cost mail,[5] causing, for both MM Flats and Carrier Route, increases in average costs and reductions in cost coverages.

The unit cost of MM Flats over this period, corrected for changes in mix, has increased 163.5 percent, despite initiatives by the Postal Service and improvements in mail preparation by mailers. This increase is well beyond what can be explained by shifts to Carrier Route and High-Density. Increases in factor prices (mainly wage rates) are another reason for increases in unit costs, but factor prices have increased

[4] The 27.0-percent figure does not include Every Door Direct Mail, which has grown rapidly. Unless otherwise indicated, numbers and graphs in these comments are developed on various tabs of ACMA_ACR2017_Workbook.xlsx. Most of the figures are discussed further *infra*.

[5] Much of the mail moving to High-Density would be mail that already has a high number of pieces per route, and probably a maximum number of pieces per bundle. It would be effectively containerized. Similarly, co-mail operations would select mailings of considerable volume with good processing characteristics.

only 69.8 percent.[6] The question becomes, then, how, during a period when innovation is occurring and mail preparation is improving, can costs increase 93.7 percentage points more than factor prices? (163.5 – 69.8 = 93.7)

MM Flats is not the only category to see extraordinary cost increases. Since 2008, the first year of good data for it, the unit cost of Carrier Route has increased 44.8 percent, about 4 percentage points less than the corresponding increase for MM Flats.[7]

The putative explanation for these increases is that scale economies are being lost. This explanation, however, runs counter to the assumption often made that there are no scale economies in the upstream, which supports a common presumption that the remnant of mailers left in the upstream will not be hurt by losses in upstream volume. More to the point here, it is assumed that negative volume trends, additional worksharing, co-mailing, and shifts to Carrier Route and High-Density will not lower the cost coverage of MM Flats. It appears that this assumption may be wrong.

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[6] *Factors of production* are inputs to production processes. Prices paid for factors of production are termed "factor prices." Obviously, factor prices are important determinants of costs. In the Postal Service, the main factors are labor, transportation, and equipment. If the weighted-average of the prices paid for the factors used increases 10 percent, for example, and nothing else changes, one would expect the cost to increase 10 percent. If the cost increases less than 10 percent, it would normally be because of technical innovation and productivity increases. An all-inclusive index of factor prices for the Postal Service is one of the outputs of the Total Factor Productivity (TFP) work.

[7] And Periodicals, another flats category, has also seen cost increases. Section 708 of the PAEA directed the Commission and the Postal Service jointly to look at, essentially, the growth in the costs of Periodicals. It asked specifically about the "quality, accuracy, and completeness of" Periodicals costs. A Report was issued in September of 2011. The Report found Periodicals costs to be "reasonably accurate for ratemaking purposes" (at 1) and warned against comparing Periodicals costs with non-flats costs (at 2). However, because the Report did not correct for product mix, but only guessed at it, and guessed wrong, it failed to see that Periodicals costs have risen inordinately, just as MM Flats and MM Carrier Route. Specifically, the ACMA cost index shows that the unit cost of Periodicals has risen 133.8 percent since 1998.

In addition to any loss of scale economies, other things are going on. First, as noted above, mail leaving MM Flats is likely among the lower cost mail in that category, meaning that any reduction in cost is less than that shown by the averages. One might say that cherry picking is alive and well. Second, it is likely that the variability of mail processing costs is not as high as the costing methods assume. The Postal Service has presented evidence in the past suggesting this.[8] Third, the CRA-derived costs are probably "overinclusive" and thus do not represent actual effects.[9]

It appears, then, that MM Flats, which is the top layer in the continuum of MM Flats, CR, and HD, and which CR/HD mailers rely on for the less-dense portions of their mailings, has (a) been stripped of its best volume, (b) lost its scale economies, and (c) been hung out to dry. Still, it is expected to be there. And even if all this is viewed as "the way it goes," it is rather unfair and in no one's interest to respond by imposing above-average rate increases on MM Flats, which will lower volumes further and start another cycle. As noted, MM Flats is an important part of a continuum, and its viability should be preserved.

It might be thought that the net income of the Postal Service could be increased by above-average rate increases for MM Flats. But this is not likely the case. First,

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[8] The measure of the variability of mail processing costs is designed to be longer-run in nature. If scale economies exist, the measure must be below 100 percent, which means, since a measure near 100 percent is being used, that the attributed costs are lower than those being reported and the actual coverages are higher than those being reported. If the costs are lower than those being reported, then the products are more profitable than the current coverages suggest.

[9] *See* Postal Service Response to Question 1 of CHIR No. 3, Docket No. RM2017-10, Oct. 2, 2017, quoting the Commission. And, given the minute detail of the costing models and the magnitude of the "CRA Proportional Adjustment" factor at 1.445, the extent that the costs are overinclusive might be rather large. *See* Folder 11, "USPS-FY17-11 MM flats.xlsm," tab 'CRA ADJ UNIT COSTS.' Also, the application of piggyback factors tends to expand inclusiveness.

even including Nonprofit, MM Flats volume is only 6.3 percent of the volume of the MM class, and it will be less next year when more FSS volume is shifted back to Carrier Route. Using price-cap authority on volumes trending downward does not result in the revenues expected.[10] And above-average rate increases just make the volumes decline faster, which makes further rate increases needed. These are the ingredients of a death spiral. Second, changes in relative rates can help only when volumes shift and costs respond. We raise important questions about the responsiveness of costs.

All these reasons make the existing situation a difficult one, but it must be faced. The Postal Service should be given the flexibility to deal with it. If a concern over the reported cost coverage for MM Flats is used as a basis for extraordinary rate increases for it, the associated volume losses will extend to CR and HD as well. This is because mailers often look at average rates to make mailing decisions. Also, the volume losses will further cripple the Postal Service's ability to maintain an effective postal system.

Another matter that should be kept in mind is that some of the most vulnerable mail in the MM Flats category is that of mailers small and large that send to low density and rural areas, including small towns. Catalogs help residents in such areas by offering a variety of products that cannot be found locally. However, if above-average rate increases are directed to MM Flats, making the profitability of mailing to these areas evaporate, we believe we are at a point where mailers will trim addresses in these areas, which means the Postal Service might meet its Universal Service Obligation but bring no mail. Such unequal treatment of addresses, based on postal costs that appear

[10] Part of this is because *past* billing determinants are used in the price cap calculations whereas in the PRA era the analysis was rolled forward to a test year. However, attention to *all* future years is needed in this case. The Postal Service would be expected to consider these future years, and in fact would be derelict if it did not.

out of control, will contribute to geographic disparities and do nothing to help the nation rise together.

IV. Further Examination of Costing Matters Supports Concern for both MM Flats Costs and MM Carrier Route Costs

Unit Cost Index. Some of the outcomes cited above relate to inherent increases in costs, meaning increases for doing the same thing. The way to quantify such increases is to construct a unit cost index, which has the following form:

$$\frac{\sum_{i=1}^{N}(V_{i,1}\ x\ UC_{i,2})}{\sum_{i=1}^{N}(V_{i,1}\ x\ UC_{i,1})}$$

$UC_{i,j}$ is the unit cost of elemental processing activity i in period j. The summation is over N processing steps or activities. The weights, $V_{i,1}$, are the corresponding period-1 volumes and are the same in the numerator and denominator. A quotient of 1.05 would mean that the average unit cost for an unchanged product mix was 5 percent higher in period 2 than in period 1. It would be common to fix the index at 100 in period 1 and say that the level of unit cost in period 2 is 105. Since the price index used regularly in rate proceedings is of the same form, with *UC* replaced by *P* (price), this index and its properties are familiar.

Developing a unit cost index is ordinarily a considerable undertaking. However, in its Initial Comments in Docket No. ACR2011, ACMA showed that such an index can be closely approximated with an index developed from the price index and the cost

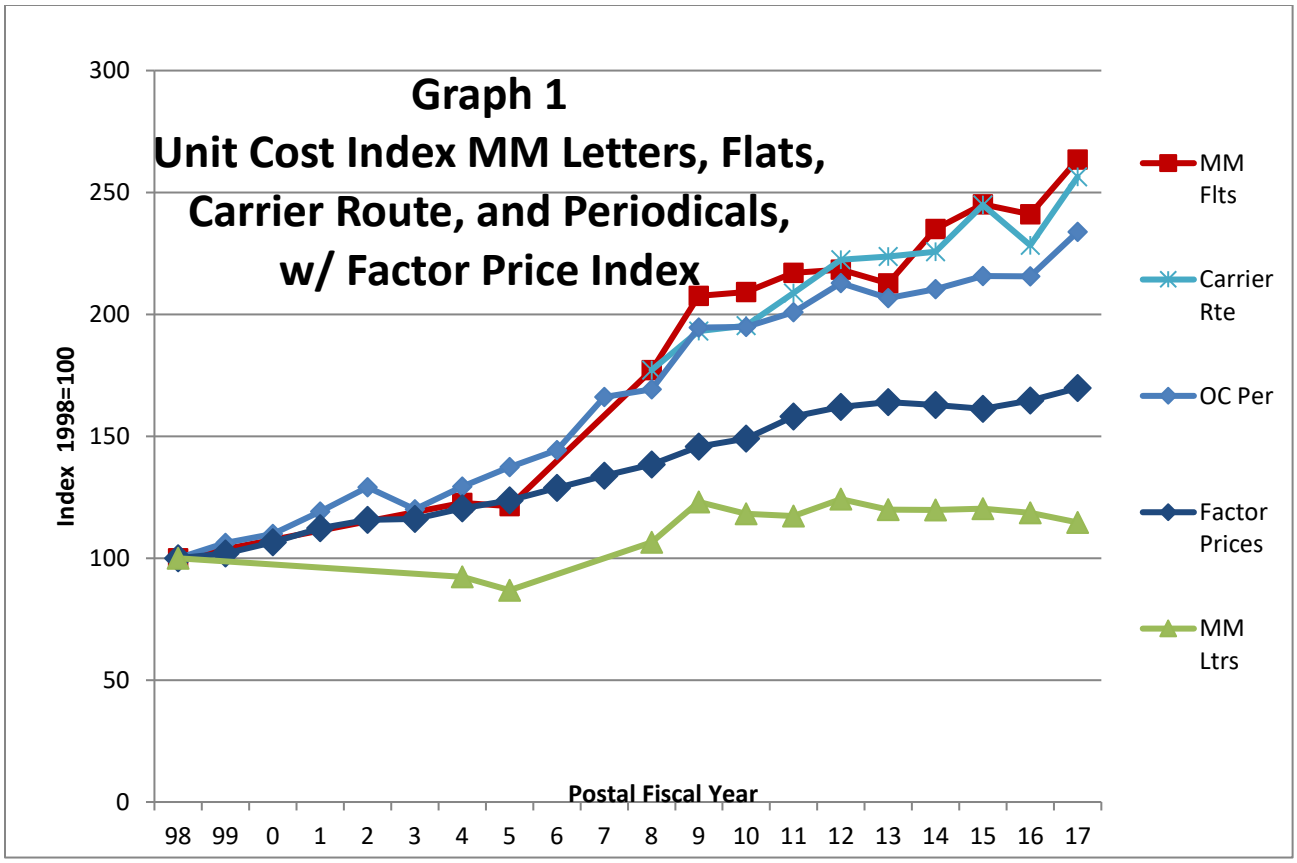
coverages.[11] In a number of proceedings, we have referred to this as the ACMA unit cost index.

Graph 1 shows the ACMA unit cost index for MM Letters, MM Flats, Carrier Route, and Periodicals, along with the Factor Price Index. The Carrier Route index is pegged at the 2007 level of the MM Flats index, because earlier data for CR are not available. To allow a comparison, the index for MM Letters is also shown. Because it is another flats category, the index for Outside County Periodicals is shown.[12] Some of the changes, of course, are due to changes in costing method. The new city carrier costing system was the biggest of these, affecting 2015. But most of the changes are raw cost increases, reflecting the costliness of operations. The curve for MM Letters is within bounds and approximately what one would expect. It is below factor prices and thus shows technical change. But the curves for all three flats categories are inordinately high. They come at a time of significant investment in flats automation but suggest negative technological change on a grand scale. Some of the recent increases

[11] Although guidance is needed to get the formulation right, it is not difficult to see that cost-increase information is contained in the rate index and the cost coverages. The cost coverage is the revenue over the cost. If the rates increase, the revenue increases, which increases the coverage. If the cost increases, the coverage decreases. If the rate increase is accounted for, the reason left for a coverage decline is a cost increase. Mix changes are recognized in the numerator (because rates are weighted by volume) and the denominator (because elemental costs are weighted by volume).

Implicit in the ACMA cost index is a price-weighted quantity index. (This is because an index of unweighted total costs divided by a unit cost index is, by definition, a quantity index.) In its Reply Comments in Docket No. ACR2011, the Public Representative reasoned that a *cost*-weighted quantity index might relate more closely to workload. In its Comments in Docket No. R2013-1 (Nov. 1, 2012), ACMA developed a *cost*-weighted quantity index and showed that its behavior over time is substantially the same as the implicit *price*-weighted quantity index.

[12] Outside County Periodicals has been a well-defined product for a considerable period of time. Excellent data for it are available for more years than the MM categories. That the Periodicals curve tracks the MM flats curves tends to confirm their validity. High-Density is not shown because CRA reporting does not separate it from Saturation.



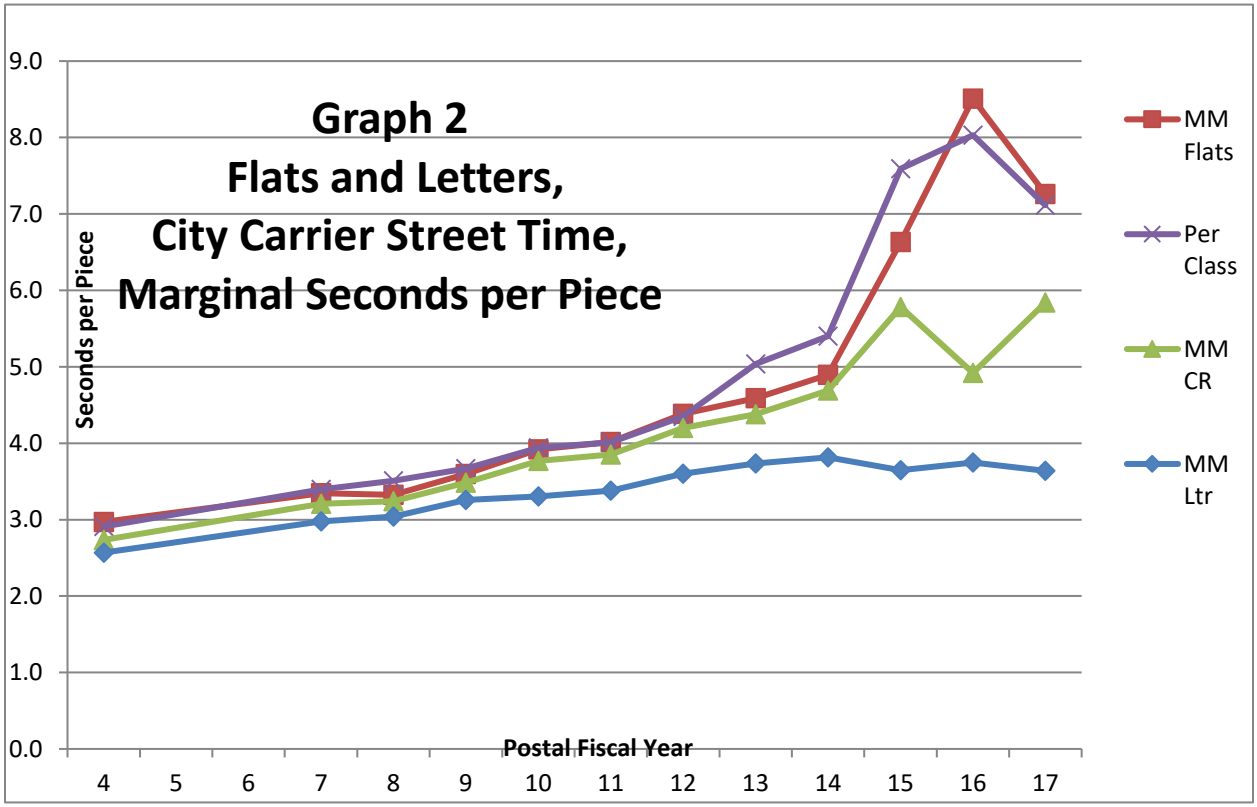
are due to the FSS, which, persistently, is imposing excessive costs on all mail it touches.[13] Regardless, this should not be happening. It has clearly pushed MM Flats below cost and had a significant negative effect on Carrier Route and High-Density.

[13] Meaningful comparisons between FSS and non-FSS costs are still few and far between, or perhaps just difficult to find and interpret. The costs (end to end) filed in USPS Folder 30 for the PHI NSA appear to show the following costs for pieces that qualify as Carrier Route:

Unit Cost for Carrier Route Piece	
If sequenced by carrier	17.1¢ to 19.2¢
If sequenced on the FSS	27.3¢ to 28.1¢
If shifted to MM Flats and sequenced on the FSS	47.7¢ to 48.6¢

File "FY17 30 ACR_NSA.xlsx," tab '1_Cost Calc.'

City Carrier Street Costs. In the FY 2016 Compliance Review, we looked at the city carrier street costs for several categories, and cast them in terms of seconds per piece. These costs are designed to be marginal in nature. On reply, the Postal Service commented on our work, helping to interpret it in some respects.[14] We have updated our analysis to 2017, and added street support costs and piggyback factors. The marginal times for MM Letters and three flats categories are shown in Graph 2.



[14] *See* USPS Reply Comments, Docket No. ACR2016, Feb. 13, 2017, at 34-36.

The Postal Service states that "ACMA artificially constructs (but does not measure) possible trends for marginal street times" (at 34). We have no idea what that means. We think it is the case that the costs we use are the costs that go into the cost coverages. Also, the formats have not changed over the period. The Postal Service also states that ACMA's "calculations depend upon a series of assumptions and approximations that undermine the trend's potential accuracy" (at 34), but does not say what these assumptions and approximations are. The figures are from the actual accounts and our calculations were straightforward. Nothing is difficult or hidden about dividing a cost by a wage to get a time. We agree with the Postal Service that the figures cover more than "picking through an additional flats case at a stop and handling an additional tray when the volume change is large" (at 34). However, if trays remain full and effectively utilized, a reduction in volume and in the number of trays should not affect the per-piece cost of handling a tray. Most of the Service's interpretation of ACMA's figures comes after it says "Even if they were ['accurate']" (at 35).

The effects of the new carrier costing system can be seen in 2015. Recognizing that, however, does not makes the results less disturbing. If it seemed reasonable in 2007 for a letter to take about 3 seconds and a flat to take from 3.2 to 3.4 seconds, why would it seem reasonable now for an additional flat to take twice as much additional time as an additional letter? The Postal Service acknowledges that this question was asked but does not respond to it. *Id*. at 34-35. It could provide an insightful discussion of why this much attention is needed. The only answer seems to be: we have modified our delivery system and have a new analysis. The peak time for an MM Flat is 8.5 seconds, which is about a second below the record for the 100-yard dash. Turning to a phrase that that has been applied to railroads, this is no way to run a postal service.

An MM Flats piece could be cased or FSS-processed, and would arrive on the street in either a cased group or an FSS-processed group. A Carrier Route flat would have the same path—it too could be cased or FSS-processed and it too would arrive in either a cased group or an FSS-processed group. The resulting times are shown in Table 4.

Table 4

Marginal Street Time and Proportions FSS-processed

	FY 2016	**FY 2017**
MM Flats	8.5 seconds	7.2 seconds
MM Carrier Route	4.9 seconds	5.8 seconds
Percent MM Flats FSS-processed	38.4%	28.6%
Percent CR FSS-processed	3.9%	15.2%

Proportions FSS-processed from "UDCInputs" files (tab '7.0.8') in USPS Folders 19. The Postal Service's explanation for these differences is that the "times per piece are incurred by bundle *type*" (*Id*. at 36). It notes that the times "from the econometric model" are 2.8 seconds for cased mail and 5.2 seconds for FSS-processed mail (*Id*.). These times do not include street support time or the piggyback factors, but, given the proportions FSS-processed, as shown in the bottom half of the table, they explain the relationships.[15] And, because the flats have been previously seen and prepared by the carrier, it makes sense that the time would be lower for cased flats. But it seems a serious operating problem if a piece in a tray of FSS-processed mail takes almost twice as long as a piece in a tray of cased mail.

There are two more matters that raise questions. First, the Postal Service argues that the marginal delivery times might increase due to volume loss and the "known economies of density in delivery" (*Id*. at 35). However, economies of density usually refer to unit fully-distributed costs, not marginal costs. For example, an airline's cost per passenger would decline as seats are filled, but the marginal cost of a passenger would remain relatively constant. Second, the Postal Service notes that its costs are developed to recognize additional "access" time (*Id*.). However, it is well established that the additional volume relevant to ratemaking is volume of the kind that would be **induced** by rate changes. Rate induced volumes are more likely to be

[15] Examine the changes from 2016 to 2017. For MM Flats, the proportion FSS-processed decreased (from 38.4% to 28.6%) and the marginal time decreased (from 8.5 sec. to 7.2 sec.). Similarly, for CR, the proportion FSS-processed increased and the marginal time increased. Note that if use of the FSS continues, the marginal time for CR, and thus the cost of CR, will be higher in FY 2018.

sprinkled across stops that already receive mail than equally across all stops.[16] It seems quite unlikely that the data used in the econometrics fit this requirement.

If the Postal Service is to offer mailers a low-cost processing and delivery system, it must set up and manage street time in a way that does not use too much of it. The times implied by the cost numbers are too high.

V. In the Delivery System Offered by the Postal Service, Neither Catalogs Nor Flats Generally Have Fared Well in Recent Years. Some Changes Are Sorely Needed

In 1998, the cost coverage of MM Flats was 102.5 percent, including Nonprofit. At 15.4 billion pieces, its volume was 25.3 percent **larger** than Carrier Route. The expectation was that (a) the Postal Service would continue investing in new technologies and (b) mailers would prepare mail to make those technologies effective. The future appeared bright.

The Postal Service did invest in new technologies, including a flats sequencing system, and mailers did invest in mail preparation. Along the way, the prices paid by the Postal Service for the factors of production increased 69.8 percent, 20.6 percentage points more than the CPI, and the rates for MM Flats increased 90.1 percent. Under these conditions, one would expect the per-piece contribution from MM Flats to increase. This same reasoning would apply to CR and HD.

But that was not the outcome. As shown in Graph 1, the unit cost of MM Flats increased 163.5 percent, 93.7 percentage points more than the factor price increase. With volume losses, this has led to a cost coverage of only 73.9 percent. And the

[16] We would agree that a rate induced volume increase for Saturation might require accessing <u>all</u> un-accessed stops on a route, and thus cause considerable additional cost.

volume of MM Flats, at 4.9 billion pieces, is now 30.7 percent **smaller** than CR, and will be even further below it next year.

If the cost reductions from technological improvements are assumed equal to the cost increases due to the new costing methods, these results argue that the costs increased 93.7 percentage points more than they should have. What happened?

Part of the answer is the growth of High-Density and co-mailing, which has shifted out some of MM Flats' lowest-cost volume. Another part is apparently the loss of scale economies in the upstream, which is often assumed to be something that will not happen. But these do not explain a gap of 93.7 percentage points, especially in costs that are treated as 100 percent volume-variable, because, at a fundamental level, the Postal Service has not changed its scale. The scheme of carrier operations is the same as before, with the same route time, fewer pieces, and less travel time. Mail processing is much the same, fewer machines but no change in scale. The explanations provided usually point to second-order things, such as scheme changes. Much more is needed. One cannot simply fit a curve to increasing costs and call it scale.[17]

It is true that volume reductions have made it appropriate for the Postal Service to realign its network, which is not a minor undertaking and which qualifies as a scale reduction for associated costs. It has also taken steps to remove costs associated with excessive postal facilities. Both of these tend mostly to come out of fixed costs.

[17] For example, Charles McBride, in "The Calculation of Postal Inframarginal Costs," a study of institutional costs done for the Commission, c. October 2014, states: "The constant elasticity function plays a major role in postal costing because it is a simple one-parameter function that can reflect the economies of scale and scope inherent in many postal activities" (at 5). An analyst could be forgiven for preferring simple functions *ceteris paribus*, but McBride is careful for another reason. A showing that economies of scale and scope are the cause of the observed behavior is required to justify selecting a curve that can reflect them and then concluding that such economies are lost. Without such a showing, the conclusion is as much conjecture as evidence.

To help identify the root causes of the cost increases, the Commission has asked for additional information, initially in Docket No. ACR2015 and more recently in Docket No. RM2018-1. The Postal Service has responded to several sets of questions. We are hopeful that further progress on this matter can be made.

From the point of view of MM Flats, its volume has declined, both absolutely and relative to Carrier Route, it has lost some of its lowest-cost volume, it has lost scale economies (which is inconsistent with a presumption of constant returns to scale in the upstream), and its costs have increased beyond reason. It is now a residual category, a shell of what it once was, linked with Carrier Route to form a complete offering. Its rates should not be singled out for above-average increases. We have explained that this will not likely help the Postal Service financially and that it will damage the viability of both the Postal Service's upstream product offering and the suite of flats products.

VI. Conclusion

Congress established third-class mail as a class in 1863. It became referred to as Bulk Rate Regular. In 1925 and 1928, its maximum weight was set at 8 ounces and its rate at 8 cents per pound, though not less than 1 cent per piece, implying a breakpoint of 2 ounces. Bulk Rate Nonprofit, a separate classification, was established in 1952, at the same rates as Regular, except with a lower minimum per piece. Rates were distance invariant and the same for letters and non-letters.[18]

In the late 1970s, the Postmaster General tapped the Postmaster of Louisville, Kentucky to lead a Headquarters task force to collect data that would allow mailers to

[18] Historical information taken primarily from (a) United States Domestic Postage Rates, 1789-1956, Post Office Department and (b) recent rate histories, *see* Rate History filed July 3, 2017.

prepare carrier-route bundles. A carrier-route discount was given in 1979. In 1991, dropship discounts and a lower Saturation rate were introduced, and letter rates were set below non-letter rates. High-Density rates were created in 1996. Also in 1996, CR, HD, and Saturation became housed in a category known as Enhanced Carrier Route, one for Commercial and another for Nonprofit.

More recently, volumes have declined broadly due to rate increases, the Great Recession, and electronic competition. A portion of the losses due to the Recession has returned. Also, a Flats Sequencing System has been knitted into operations, and has increased Postal Service costs substantially, as near as we can tell.

Though a lot of category names have been changed and re-changed, all these developments portended ill for MM Flats, the principal descendant (along with MM Letters) of Bulk Rate Regular, from which mailers may opt for a category in Enhanced Carrier Route.[19] Of the flats in Marketing Mail, 48.2 percent are in HD or Saturation, and another 30.6 percent are in CR. These proportions will be higher next year when all Carrier-Route qualified mail is reported in CR. Of Commercial flats, the proportions origin-entered are only 21.6 percent for MM Flats and even less at 1.8 percent and 1.6 percent for CR and HD/SAT, respectively. In total, MM Flats is only 6.3 percent of the MM class, and it will be less next year.

As a result largely of these volume shifts, as explained above, MM Flats has become a residual category to CR and HD, and has lost most of its identity. Due apparently to these shifts and to negative volume trends generally, it has lost much of its lowest-cost volume and scale economies in degree, and its costs have increased

[19] Mailers using Bulk Rate Regular (or Nonprofit) were required to prepare 5-digit bundles if they had sufficient volume. But Carrier Route (and other categories in Enhanced Carrier Route) have always been optional.

exorbitantly. Specifically, they have increased since 1998 by 163.5 percent, despite technical change, far more than the CPI or factor prices. In recent years, a part of this is due to the FSS. Large cost increases have also occurred for CR and HD.

We have explained in these comments that the common presumption that mail that remains after volume shifts will not be impaired is likely wrong. We have also explained that serious questions exist about the validity and applicability of the costs being reported and that they are too high to allow an effective Postal Service. Despite rate increases that were larger than the factor price increases, the cost coverages of HD, CR, and MM Flats have declined trend-like. There is no evidence of technological improvement. For Commercial flats, as shown in Table 1, they are now just above 100 percent. They have been much higher in the past. Something needs to be done. A decision to replace the FSS with carrier casing would be a big first step, but more is needed.

The questions surrounding MM Flats itself are not revenue matters for the Postal Service. We have explained that any net revenue effect is *di minimis*, if positive. We believe special rate increases for MM Flats would not be productive. MM Flats is needed as a part of the flats offering of the Postal Service. Also, the Postal Service needs a nationwide processing, transportation, and handling system, which must have volume to survive and be effective.

MM Flats is used heavily by mailers who do not have the density to prepare CR mailings. Much of this mail is sent to rural areas, small towns, and other low-density places. We explain that if MM Flats rates continue upward, mailers may prune these addresses from their lists, labeling them as unprofitable. These addresses might

continue to receive universal service, but receive no mail. We do not want to see this happen.

Under these conditions, the Commission should not step in with directed rate increases. The Postal Service should be given flexibility. And it may be that broad changes should be explored, such as a redesign of workflows, a streamlined way for mailers to direct bundles to carriers, or a ratesetting scheme that more nearly aligns mailer interests with Postal Service capabilities. What is clear is that this segment of the mail needs improvement. The demand is present, as catalogers want to mail more volume, but the costs constrain how much the Service might incentivize additional catalogs and certainly put upward pressure on rates.

Respectfully submitted,

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