

Marketing Mail Flats product because their concern is for “catalogs,” and “catalogs are mailed in a continuum of 52 Commercial categories” of Market Mail.¹ ACMA Initial Comments at 1. ACMA argues that since Marketing Mail (i) Flats and (ii) Carrier Route products, on a combined basis, are covering the combined attributable costs of those two products at 100.7 percent (albeit not considering the nonprofit components of those products), Marketing Mail Flats prices cannot be found to be out of compliance with the PAEA. *Id.* at 2, 20. This argument has been suggested repeatedly by ACMA and has been repeatedly rejected by the Commission.² *See, e.g.*, FY 2012 ACD at 116.

When the “Marketing Mail Flats” product is evaluated on its own, as it must be, it can be seen that it set a new record for losses in FY 2017 spiraling to \$669 million. By way of comparison, these losses in FY 2017 are well in excess of the losses incurred when the product was found to be out of compliance with PAEA in the FY 2010 ACD. The same reasoning that led the Commission to reach that finding of noncompliance eight years ago apply again in FY 2017, and with even greater force, as losses mount. It is now beyond question that the Postal Service’s implementation of the Commission’s earlier remedial orders requiring the Postal Service to give the product above-average price increases, and to cut costs, so that the product

¹ ACMA admits that “volume of catalogs is not measured, either in total or by product,” and therefore, “[w]e cannot ... track catalog volumes over time.” ACMA Initial Comments at 4.

² Although the Commission looked at combined financial results in the FY 2016 ACR (*see* Public Representative Initial Comments at 32), it only did so as “a better comparison of cost, revenue, contribution, and volume changes over time because the influence of the migration between Flats and Carrier Route is eliminated when the data from the two products are combined.” FY 2016 ACR at 55. The Commission did **not** endorse ACMA’s view of looking at only whether commercial catalog mailers cover their costs.

not only covers its cost but makes a contribution to institutional costs, has not achieved the desired, or required, result. Moreover, if the remedial order is left unchanged, there is no reason to believe these losses will end ever.

II. NPPC, NAPM, and MMA’s Initial Comments Are Correct that the Commission Should Evaluate the FY 2017 ACR in Light of its Findings in the 10-Year Review Docket.

The Initial Comments of the National Postal Policy Council, the National Association of Presort Mailers, and the Major Mailers Association (“NPPC *et al.*”) all took the position that the Commission’s pending 10-year review of § 3622 (Docket No. RM2017-3) is closely related to this annual compliance review under § 3653, as there is significant overlap between the criteria used in each. *See* NPPC *et al.* at 2-7. In an annual compliance review, the Commission reviews whether prices in effect for FY 2017 were in compliance with Title 39, including the factors and objectives of § 3622. In the 10-year review, the Commission reviewed whether the price-setting system met the objectives of § 3622(b), taking into account the factors of § 3622(c). Thus, these commenters are correct that the Commission must consider the legality of pricing in FY 2017 in light of the Commission’s recent findings in the 10-year review docket.

With respect to the “justness” prong of 39 U.S.C. § 3622(b)(8) and the Commission’s analysis in the 10-year review, NPPC *et al.* notes correctly that “[g]iven that the Commission applied these analytical tools only last December, it would be reasonable to apply them now, only a brief time later, to assess the justness of the rates in this review.” NPPC *et al.* at 3. Valpak agrees fully, and would extend that application of the analytical tools with respect to the “reasonableness” prong of § 3622(b)(8).

Applying that same principle to Marketing Mail Flats, in its 10-year review docket, the Commission analyzed the annual losses that that product incurred under PAEA through FY 2016, and then determined, even without data yet available for FY 2017:

that the **rates were not reasonable** because they **threatened the financial integrity** of the Postal Service during the PAEA era. [Order No. 4257 at 235 (emphasis added).]

The continuation of losses incurred on that product in FY 2017 have only reaffirmed the validity of that finding of illegality. The Commission was exactly correct in stating that underpriced “non-compensatory products threaten the financial integrity of the Postal Service.” Order No. 4258 at 73. And, the Commission was exactly correct that this finding requires that in the future there be above-cap price increases ordered in the context of the 10-year review. However, Valpak urges the Commission not to wait for a system devised in that docket, but should employ the pricing tools given to it by Congress and order remedial pricing that will effectively increase the cost coverage of Flats.

Moreover, the Initial Comments of the Public Representative (“PR”) discussed the growing extent of Flats’ losses, pointing out “cost coverage for USPS Market Mail Flats fell by 5.8 percent from 79.8 percent in FY 2016 to 73.9 percent in FY 2017.” PR at 30. Even ACMA noted the “disturbing ... persistent multi-year increase in reported costs for all flat categories.” ACMA at 4. In its FY 2010 ACD, the Commission determined that the Postal Service pricing of Flats product violated 39 U.S.C. § 101(d) because, in part, it lost \$582 million in FY 2010, requiring other products to subsidize it rather than paying its way and making a contribution to institutional costs. Now, after seven years of the remedial steps ordered by the Commission, that one product lost even more money, a record \$669 million in

FY 2017. Losses on this one product have now increased every year for five straight years, nearly doubling from the \$376 million in FY 2013. *See* Table I-1. In the years since 2008, when the Postal Service first reported data using the new product categories under PAEA, the Marketing Mail Flats product has now lost an astounding amount — totaling over \$5 billion.

**Table I-1
Marketing Mail Flats Subsidies**

Fiscal Year	Subsidy (millions)
2008	\$217.8
2009	\$615.6
2010	\$577.0
2011	\$643.2
2012	\$527.9
2013	\$375.9
2014	\$411.0
2015	\$521.7
2016	\$602.0
2017	\$669.3
Total:	\$5,161.4

Source: ACR at 35.

III. The Commission Need Not Await its 10-Year Review.

ACMA asks the Commission to do nothing. ACMA Initial Comments at 20. In the 10-year review, the Commission concluded: “there **was not an adequate mechanism** to maintain reasonable rates during the PAEA era because certain products and classes threatened the financial integrity of the Postal Service by failing to cover their attributable costs.” Order No.

4257 at 236 (emphasis added). However, there has always been a mechanism in place for the Commission to fix the problem; the Commission thus far has declined to take advantage of it. Once a determination of noncompliance is made, PAEA requires Commission to treat it identically to a situation where a complaint was filed and found justified. The Commission is to “order that the Postal Service take such action as the Commission considers appropriate in order”:

1. “to achieve compliance with the applicable requirements” and
2. “to remedy the effects of any noncompliance.” 39 U.S.C. § 3662(c).

Furthermore, the U.S. Court of Appeals for the D.C. Circuit has ruled that once the Commission finds that a complaint is justified, it becomes “obligated” by section 3662(c) to provide an “adequate remedy,” one that fully redresses the wrong both by bringing the Postal Service into compliance with the law and by remedying any effects of prior noncompliance. *See Gamefly, Inc. v. Postal Regulatory Commission*, 704 F.3d 145, 149 (D.C. Cir. 2013). In Gamefly, the Commission “issued an order finding that the Postal Service was indeed discriminating against Gamefly,” in violation of 39 U.S.C. § 403(c), which, in pertinent part, requires the Postal Service to “provid[e] services and ... establish[] classifications, rates, and fees” that do not “make any undue or unreasonable discrimination among users of the mails.” *Id.* at 148. But the D.C. Circuit ruled that the Commission’s “remedy left much of the discrimination in place.” *Id.* at 146 (emphasis added). Indeed, the remedial order issued by the Commission in the Gamefly complaint docket, Docket No. C2009-1, was inadequate as it “could still require GameFly to ‘continue to generate more than double the contribution per piece than Netflix mail.’” *Id.* at 148. The D.C. Circuit ruled that the Commission’s order

was “arbitrary and capricious because it left discrimination in place without reasonable explanation.” *Id.* at 149 (emphasis added). Vacating the Commission’s order, the court remanded the case “for an adequate remedy,” instructing the Commission that it “must either remedy all discrimination or explain why any residual discrimination is due or reasonable under §403.” *Id.* at 149 (emphasis added). Most of the Flats price increases have been only slightly above average,³ with cost reductions virtually non-existent.⁴

It must be remembered that the Commission’s FY 2010 ACD pricing directive was not simply for barely above-average price increases for Flats and to consider ways to reduce costs in a leisurely fashion. Instead, **the directive was to increase the cost coverage for that product until it exceeds costs.** As demonstrated above, the cost reduction portion of that remedy has been nonexistent.

IV. Even ACMA Appears to Concede Cost Cutting Cannot Solve the Problem.

ACMA itself notes that the increase in unit costs of Market Mail Flats has occurred “despite initiative by the Postal Service and improvements in mail preparation by mailers.” ACMA Initial Comments at 5. As to future cost cutting, in its filing, the Postal Service identifies several operational efforts supposedly designed to improve coverage. ACR at 25-31. However, even ACMA fails to make a case that operational changes will have any more than a negligible effect on reducing the subsidy to Flats. ACMA Initial Comments at 5. Despite the

³ The Postal Service repeatedly stated its definition of “above average” to be a paltry 5 percent (not 5 percentage points) above average. *See, e.g.*, ACR at 26.

⁴ The Postal Service’s Flats Report of July 26, 2016 and subsequent filings have not been without value. Indeed, they conclusively prove that the remedy to underwater Marketing Mail Flats cannot be found in cost cutting.

Commission's repeated pleas for a meaningful estimate of the financial effect of the Postal Service's cost reducing efforts on which it could rely (*see* FY 2016 ACD at 56-57), again, "the Postal Service is unable to provide an estimate of the financial impacts of these operational initiatives at this time." ACR at 26. Clearly, there is no assurance and no basis to believe that any cost reduction efforts would be successful. *See also* Postal Service response to ChIR No. 5, Q. 6 (losses grew despite new operational changes).

V. The Commission Has the Tools Available To Adjust Marketing Mail Pricing.

Over the last decade, Marketing Mailers who use products other than Flats have been required to pay a total of over \$5 billion more in postage to cover losses incurred by Flats. At the end of that decade, this one product is now farther away from 100 percent cost coverage than it was in FY 2010. The Postal Service has not been able to improve the cost coverage of Flats as directed by the Commission over seven years ago (and as urged by the Commission beginning nearly a decade ago). Slightly above-average price increases have proven inadequate in eliminating or even mitigating the cross-subsidy. The prime directive of the FY 2010 ACD remedial order was "to increase the cost coverage of ... Flats ... until such time that the revenues for this product exceed attributable costs." Even the slightly higher prices in the last two years have proven inadequate for this purpose.

This ACR gives the Commission the opportunity to issue a further, remedial order to raise prices to remedy now the pricing illegality that it has repeatedly found to exist. Ordering significant remedial price increases to ... Flats would give room to allow for corresponding price decreases for high cost coverage HD/Saturation Letters whose coverage has been allowed to skyrocket solely to cover the losses incurred from underpricing of Flats.

Respectfully submitted,

/s/

William J. Olson

Jeremiah L. Morgan

WILLIAM J. OLSON, P.C.

370 Maple Avenue West, Suite 4

Vienna, Virginia 22180-5615

(703) 356-5070

Counsel for:

The Valpak Franchise Association, Inc.