



Matter depending on their catalog size, target customer and circulation. These break out into 42 categories and require the application of 126 rate elements.

One might expect the Postal Service to view catalogs, or the associated flats categories, as an interdependent group, and to have some flexibility in setting its rates. Yet systems develop costs for disaggregate categories and workshare rules constrain the rate elements. The fact is that, presuming reasonably full passthroughs of cost differences, one rate can be selected for each of 5 groups (only 3 of which are used significantly by catalogs) and all 126 rate elements follow by implication. In other words, almost no flexibility exists.

In this docket, the Postal Service has honored the workshare constraints and proposed adjustments to all rate elements. As explained further below, this maze of structured rigidity may be killing off a wide swath of the service now provided. This may sound unduly pessimistic, but it is not. If the front legs of an animal are removed, the usefulness of the back legs is considerable reduced. To boot, the front legs in this case (the Flats product) not only work with the back legs, they tend to serve the lower-density mailers, the smaller mailers, the smaller towns, the poorer areas, and the rural areas.

The interdependency between the front legs and the back exists not only on the mailer side, but also on the Postal side. The Postal Service has developed a nationwide system, with service standards. It is designed to move letters, flats, and parcels, from facility to facility, transporting and processing them as needed. If the volume in the upstream is reduced substantially, the viability of the entire system will be impaired.

## II. Whither the Future

Flats (the product) has fared poorly. ACMA has studied its costs since 1998. Looking at average annual growth rates, the CPI has increased 2.29%, factor prices 3.03%, rates 3.62%, but volume-weighted unit costs 5.83%.<sup>1</sup> It is true that volume has declined, but given the high cost variabilities used in the costing, this does not account for anywhere near the cost increases. Furthermore, there have been technological advances and the preparation of the mail has been improved. For the shorter period for which they are available, the unit costs for Carrier Route have behaved similarly.

As would be expected from these costing results, the cost coverage estimated for Flats is down to 68.6%, including Nonprofit (which has a cost coverage of 45.3%). The Commission has expressed concerns over this cost coverage, and, in order to increase it, has directed the Postal Service to increase the rates for Flats at least 2 percentage points more than the price cap for the class. The Postal Service has done this, proposing an increase of 3.908%.

The outcome of this direction is not likely to be attractive. The volumes will continue to decline, getting to the point where the volume flows are anemic. Co-mailing will increase, tending to preserve the last mile of the Postal Service system. Carrier Route mailers, who use Flats for residual pieces, will be hurt. History suggests that factor prices will continue to outpace the CPI. If costs continue to outpace factor prices, and there is no evidence of gains from technological change, the cost coverage for Flats will continue to decline. Flats will become more a pocket than a product.

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<sup>1</sup> Unless otherwise indicated, figures herein are from suitable data developed and presented by ACMA in its comments (including ACMA\_ACR2018\_Workbook.xlsx), Docket No. ACR2018, February 14, 2019. In the workbook, see tabs for CPI, Factor prices, Flats, and Carrier Route.

It is clear that any problem with Flats is a cost problem, not a rates problem. As further evidence of this, ACMA found the marginal casing time for Flats has gone from 5.7 seconds to 9.4 seconds, that the marginal street time has gone from 2.9 seconds to 6.5 seconds, and that the cost of a 5-digit automation piece is an inexplicable 20.59 cents more than a Carrier Route piece. Continued increases in rates will just make things worse.

Beginning in its Compliance Determination for FY 2015, the Commission has pointed with specificity (and alarm) to the increases in flats costs, which go beyond just the Flats product. This matter has been pursued each year, and in-between, since. ACMA appreciates the Commission's efforts, but fruits are not evident. With or without help from the Commission, the Postal Service must clarify well-defined flow paths for flats and tighten operations around those paths.

Also, the Postal Service needs more flexibility in ratesetting. Tying rates to costs developed for narrower and narrower components of an interdependent system is not a prescription for success. Despite what ACMA views as a failure to control costs, the Service is dealing with a difficult situation. A presort tree shows relationships schematically, but it may be too much a vehicle for imposing rigidity.

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