

Before the  
POSTAL REGULATORY COMMISSION  
Washington, DC 20268-0001

Statutory Review of the System :  
For Regulating Rates and Classes : Docket No. RM2017-3  
For Market-Dominant Products :

REPLY COMMENTS OF THE GREETING CARD ASSOCIATION

*Introduction.* The Greeting Card Association (GCA), comprising more than 200 greeting card publishers and other companies, files these Reply Comments pursuant to Order No. 5337.

GCA is among the signatories to the *Explanation of Options for a Financially Stable Postal Service*, filed on February 3, 2020. That filing includes prominently the statement that expanding the Postal Service’s rate authority is both “risky” and “unnecessary.” Accordingly, GCA does not favor the creation of supplemental rate authority. We urge the Commission to bear that fact in mind when assessing these Comments. Assuming for argument’s sake, however, that the Commission will persist with the supplemental rate authority proposals in Order 5337, GCA offers some suggestions, particularly in response to the criticisms propounded in the Postal Service’s initial comments.

I. DENSITY DECLINE; THE TWO-FORMULA METHOD

If the Commission decides that it will continue to propose the supplemental rate authority for declines in mail density, GCA suggests that it re-think the rationale for the system it offered in Order 5337. The Commission’s proposal attempts to protect captive mailers from undue impositions under the density decline mechanism, by undertaking to calculate density decline in two ways: for all mail, and for Market-Dominant mail only.

Depending on the respective rates of density decline in the Market-Dominant and Competitive sectors, the formula used would vary: if Market-Dominant density declined faster, the all-mail formula would be used, while if the converse happened only Market-Dominant density would be counted. This system is rationally designed, so far as the arithmetic is concerned, to maximize protection for users of monopolized products. That is an appropriate goal in this rulemaking, and – again assuming *arguendo* that the final rule will include density rate authority – the Commission should continue to espouse it.

The Postal Service<sup>1</sup> argues in favor of a single formula incorporating both Market-Dominant and Competitive Mail, to be used regardless of the relative rates of density decline. That some of its arguments are at least superficially persuasive is due mainly to the way in which the Commission explained the basis for the two-formula system.

*The cross-subsidization issue.* The Commission stated that

. . . By statute, Market Dominant products are prohibited from cross-subsidizing Competitive products. To prevent cross-subsidization, the Commission calculates the density rate authority two ways: first, using the change in density based on total volume (total density); and second, using change in density based only on Market Dominant volume (Market Dominant density). The lesser amount of these two calculations would be the authorized amount of density rate authority.<sup>[2]</sup>

And in fn. 150, the Commission cites secs. 3633(a)(1) and 3622(b)(9) as authorizing this approach.

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<sup>1</sup> *Initial Comments of the United States Postal Service in Response to Order No. 5337 (“Postal Service Comments”)*, pp.22 et seq.

<sup>2</sup> Order 5337, pp.72-73 (fns. omitted).

The Postal Service devotes several pages of its Initial Comments<sup>3</sup> to attacking the two-formula proposal. It argues that the issue the Commission's proposal addresses has nothing to do with cross-subsidy; consequently, it says, the purported basis for the proposal does not really exist.

In a strict sense – perhaps too strict for the needs of this issue – the Postal Service is not wrong to emphasize the distinction. It relies on the standard method of testing for cross-subsidy, i.e., the incremental cost test. It says that this is the *only* method of testing for cross-subsidy of Competitive by Market-Dominant products, which is prohibited by sec. 3633(a)(1) and (2). It cites the Commission's Order 3506 for the proposition that it would not go beyond that technique to check for cross-subsidy.<sup>4</sup> All this depends on the conventional definition of cross-subsidy as overcharging customers using one product to finance another product which does not recover its attributable cost. It is, or should be, corrected by adjusting the second product's price so that it recovers (at least) attributable cost.

What the Commission is trying to do here, however, is not prevent one or more Competitive products from being priced below incremental cost, but to protect Market-Dominant mailers from paying for (overall) unit delivery cost increases caused exclusively by a decline in Competitive density. In other words, it is not attempting to create a new method of enforcing sec. 3633(a)(1) and (2), but redesigning part of the Market-Dominant ratemaking system to provide improved protection for captive mailers. This is a legitimate goal under sec. 3622(d)(3). Whatever view one may take of the desirability of allowing extra pricing authority for declines in mail density, it is at least clear that – if it is going to be done – it is rational to do it in a way that protects against exploitation of the monopoly.

A simple hypothetical may clarify our point. We use two products, MD (Market-Dominant) and C (Competitive). The hypothesized facts are these:

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<sup>3</sup> *Postal Service Comments*, pp. 22 et seq.

<sup>4</sup> *Id.*, pp. 23-24.

1) Unit delivery cost at time T is:

MD	\$0.10	C	\$0.15
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2) Volumes yielding those unit costs are:

MD	1,000	C	500
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Overall delivery cost at T, therefore, is  $(\$0.10 \times 1,000 = \$100) + (\$0.15 \times 500 = \$75) = \$175$ .

Averaged over the total volume, this comes to  $\$175.00 / (1,000 + 500) = \$0.11667$ .

3) Delivery cost is 40 percent volume variable and 60 percent fixed.

Now suppose that at time  $T_1$  unit delivery cost is unchanged, MD volume remains constant, but C volume declines to 300. Because delivery cost is 60 percent fixed, the loss of 200 pieces implies a cost reduction of only  $(\$0.15 \times 0.40) \times 200 = \$12.00$ , for a total delivery cost of  $\$175.00 - \$12.00 = \$163.00$ .

Average delivery cost is then  $\$163.00 / (1,000 + 300) = \$0.12538$ . Average delivery cost has thus increased by  $\$0.12538 - \$0.11667 = \$0.00871$  – an increase caused solely by the decrease in Competitive volume, but which would be paid by Market-Dominant pieces as well.

What is significant here is that none of this cost behavior depends on the relationship between attributable cost and price for either MD or C. If both contribute generously to institutional cost, the effect on MD of the density decline in C would be exactly as shown in the hypothetical.

Thus if one moves beyond the textbook definition of cross-subsidy, it becomes clear that the Postal Service's argument, though terminologically orthodox and internally coherent, is beside the point. The effect of the Commission's proposal (as distinguished from the rationale expressed in the Order) is not to enforce the anti-cross-subsidy provisions of sec. 3633 but to improve the Market-Dominant ratemaking system established under sec. 3622(a) and now being reviewed under sec. 3622 (d)(3).

Once this is admitted, it is clear that the two-formula proposal would effectuate certain sec. 3622 objectives better than the Postal Service's counterproposal of a single all-inclusive formula.

*Objective (b)(8).* This objective requires establishment and maintenance of a just and reasonable rate schedule. The operative term here is "just," which the Commission has said designates a rate not excessive for the customer.<sup>5</sup> A Market-Dominant rate which is increased solely because the volume of one or more Competitive products has declined is not, in this sense, a just rate and the schedule incorporating it is not a just and reasonable schedule. Improving the achievement of objective (b)(8) is a proper goal in this rulemaking. GCA believes that this fact would by itself justify retaining the two-formula method (should the Commission finally enact density rate authority).

*Objective (b)(9).* Since the costs affected by the density rate authority are institutional, the objective requiring institutional cost to be appropriately allocated between Market-Dominant and Competitive products is prima facie relevant.

The Postal Service cites Order No 4257 as establishing that objective (b)(9) and the appropriate institutional cost share required by sec. 3633(a)(3) are effectively one and the same. For argument's sake, we will assume, first, that the Postal Service characterizes accurately what the Commission said in that Order.

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<sup>5</sup> Order No. 5247, p. 113, fn. 213; pp. 114, 119 et seq.

However, if we bracket the proposition that (b)(9) and the appropriate share are indistinguishable, it seems clear that a set of rates which compelled Market-Dominant mailers to pay institutional costs no longer being recovered by Competitive products because their density has decreased would not constitute an appropriate allocation of institutional cost. Institutional costs, by definition, cannot be linked to products by reliable causal relationships. Appropriate allocation of those costs, consequently, would have to be guided at least in part by concepts of fundamental fairness. The market behavior of Competitive (i.e., largely unregulated) products should not, under those concepts, be allowed to impose additional burdens on Market-Dominant mailers. And this is true even when the Competitive sector is recovering at least the currently-designated appropriate share under sec. 3633(a)(3).

GCA has in the past argued for a construction of (b)(9) under which it would have a role independent of the sec. 3633(a)(3) appropriate share. The Commission did not adopt our view, but has said, instead, that (b)(9) is satisfied when the appropriate share is being recovered.<sup>6</sup> It is significant that when this view was expressed the “two-for-formula/one-formula” issue had not arisen. GCA suggests that while it may be adequate as a practical matter to treat (b)(9) as being satisfied by recovery of the appropriate share when no apparently inappropriate allocation of institutional costs is present, it is not adequate when such an impropriety is shown. And we submit that a situation in which Market-Dominant mailers were taxed because Competitive density had declined would be just such an inappropriate allocation.

*The nature of the appropriate share.* In this connection, it is significant that the appropriate share is a floor but not a ceiling. This is a proposition the Commission has endorsed more than once – starting with Order No. 26 (¶ 3056). In practice, the Competitive sector has recovered more – often substantially more – than the current appropriate share. If the appropriate share were a ceiling as well as a floor, these over-recoveries would violate sec. 3633(a)(3) and objective (b)(9), yet the Commission uniformly

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<sup>6</sup> See Order 4257, pp. 243 et seq.

encourages them. Put otherwise: the appropriate share, so far as the contribution *actually generated* is concerned, is not a definite number and thus not an allocation.<sup>7</sup>

Since the appropriate share is not a ceiling on recovery by the Competitive sector of institutional costs, the incremental Competitive-sector recovery implied, under certain circumstances, by the two-formula method would not violate it.

The Commission, consequently, could explain that while under unproblematic circumstances objective (b)(9) is satisfied when the appropriate share is being recovered (or over-recovered), it may still rely on that objective to correct a *specific* inappropriate allocation revealed by actual results or necessarily implied by a rule of ratemaking. The Postal Service's one-formula proposal would produce such an inappropriate allocation in the event that Competitive density declined faster than Market-Dominant density. The Commission's proposed two-formula method would avoid this inappropriate allocation and thus promote achievement of objective (b)(9).

*The fairness question.* The Postal Service's other argument is that the two-formula proposal is a heads-I-win-tails-you-lose proposition. Its one-formula proposal would moderate Market-Dominant rate authority if Market-Dominant density declined faster but increase it if Competitive density declined faster. This approach it recommends as symmetrical.<sup>8</sup>

The first question, then, is whether symmetry as between regulated and largely unregulated products is warranted. The Market-Dominant ratemaking system is meant to protect customers against exploitation of monopoly, which by definition does not exist in the Competitive sector. The Postal Service's approach, as evidenced by its insistence on a comprehensive "reset" of Market-Dominant prices, is to exploit the monopoly

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<sup>7</sup> We made a very similar argument in Docket RM2017-1 (see *Reply Comments of the Greeting Card Association*, p. 3) in responding to a United Parcel Service argument which treated the appropriate share as a form of cost allocation.

<sup>8</sup> *Postal Service Comments*, pp. 25 et seq.

as far as it can.<sup>9</sup> The Service does not really address this issue; it speaks instead of unfairness – which assumes that identical treatment of regulated monopoly services and unregulated competitive ones is “fair” – and asserts that this perceived unfairness violates objective (b)(8).

Objective (b)(8) applies only to Market-Dominant pricing. The symmetry argument seems to assume that a mechanism which fails to protect Competitive products when Competitive density is falling faster than Market-Dominant density somehow violates it. The short answer is thus that (b)(8) is not there to protect Competitive products or the Service’s latitude in pricing them. Under sec. 3622(d)(3), the Commission’s task is to improve the Market-Dominant ratemaking system, and particularly to achieve more completely the objectives while taking account of the sec. 3622(c) factors. Creating theoretical “fairness” as between Market-Dominant and Competitive sectors is not an element of that assignment (except, perhaps, as regards objective (b)(9), discussed earlier and shown to *favor* the two-formula approach).

Most of what we have said applies also to the Postal Service’s somewhat unenthusiastic agreement that the Commission could also use a Market-Dominant-only formula by itself.<sup>10</sup> Its reasoning appears to be that “a fair and reasonable application of the concept would require it to operate symmetrically.” This is the same argument we have discussed in connection with the suggested one-formula system: lack of symmetry equals unfairness. But as we have said, “symmetry” as between Market-Dominant and Competitive sectors is not a value to be pursued in revising the Market-Dominant rate-making system. Excluding the Competitive sector entirely is the flip side of invariably including it, and the arguments rebutting the latter also rebut the former.

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<sup>9</sup> On this point, see section II, below.

<sup>10</sup> *Postal Service Comments*, p. 28.

To summarize: the Postal Service's arguments against the two-formula proposal are either insubstantial or beside the point. The Commission should retain the two-formula approach if it perseveres with the density adjustment, but in doing so should recognize that it is justified by statutory provisions other than those condemning cross-subsidization of Competitive products.

## II. THE COMMISSION'S FORWARD-LOOKING APPROACH TO REVENUE ENHANCEMENT IS REASONABLE

In Order 5337, the Commission has improved upon its original scheme for promoting medium-term financial stability. In place of a fixed percentage increase in pricing authority, the present Order seeks to identify, measure, and take reasonable steps to counteract the main on-going sources of Postal Service deficits. Here again, the result is additional rate authority and hence GCA is not endorsing these measures. But in the event that the Commission perseveres with the plan to increase Market-Dominant rates to remedy shortfalls not caused by the ratemaking system, what it has proposed should at least be justified as against criticisms advanced by the Postal Service.

The Commission's assignment under sec. 3622(d)(3) is to find whether the Market-Dominant ratemaking system is achieving the statutory objectives and to revise it if its finding is negative. In Order 4257, the Commission found that the system had produced short-term stability, but not medium- or long-term stability. Its original proposals were designed put the Postal Service "on the path" to medium- and long-term stability, and those in Order 5337 are supposed have the same object.<sup>11</sup>

*Postal Service comments* The Postal Service expresses qualified approval of the new supplemental rate authority proposals, but objects to the fact that they supersede the flat two-percent add-on proposed in Order 4257. (It also argues, as it did then, that the two-percent add-on, based on its FY 2017 deficit, was much too small.) The main basis of its argument seems to be that the theory of price-capped ratemaking requires

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<sup>11</sup> Order 5337, pp. 11-12.

both a compensatory “going-in” or “baseline” rate level and a cap mechanism which will allow the firm adequate revenues “going forward.”<sup>12</sup>

This argument confuses two states of affairs which ought to be kept distinct: (i) *establishing* – from scratch – a price-cap system of ratemaking, and (ii) *amending* that system to make it more capable of achieving the statutory objectives which justified it in the first place. This review proceeding is an instance of the latter. The Commission’s first appreciation of the system’s shortcomings (Order 4257) was that it did not cope with volume erosion, the drastic retiree health benefit prefunding mandate, or the 2008-2009 recession and for that reason did not achieve medium- or long-term stability. It did not find – nor could it reasonably have found<sup>13</sup> – that the “baseline” rates were not compensatory. Hence the purpose of the two-percent additional rate authority proposed in Order 4257 was not to provide a (higher) “baseline” rate level but to establish a mechanism for coping with ongoing adverse trends.<sup>14</sup>

Thus when the Postal Service objects that Order 5337 takes a step backward by eliminating the flat two-percent add-on, it misinterprets the purpose of that earlier proposal. It was not an attempt to create a new “baseline” rate level (inadequate, in the Postal Service’s view) but a mechanism, which the Commission has now scrapped in favor of one it considers better, for dealing with the underlying causes of financial distress: volume erosion<sup>15</sup> and pressing retirement obligations. Order 4258 made this clear:

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<sup>12</sup> *Postal Service Comments*, pp. 7 et seq.

<sup>13</sup> Docket R 2006-1, though decided after PAEA was enacted, was conducted under the old (1970 Act) system and hence produced break-even rates. Thus the “baseline” rates in effect when price-cap regulation got underway were compensatory.

<sup>14</sup> See Order 4258, pp. 40 et seq.

<sup>15</sup> We subsume the effects of the 2008-2009 recession under this head, since if the recession had somehow affected every aspect of the economy except use of the mails, the Postal Service would have been no worse off for it. (It might even have benefited, if the recession had depressed the factor prices it pays its vendors.)

. . . [T]he proposed supplemental rate authority is not designed to provide sufficient revenue to cover costs in the same way as the revenue requirement of the Postal Reorganization Act's break-even regime. Instead, the proposed supplemental rate authority is designed to provide the opportunity to generate additional revenue that is sufficient, when combined with cost reductions and operational efficiency gains, to improve the financial stability of the Postal Service.<sup>[16]</sup>

That the then-proposed supplemental rate authority was not designed as a "true-up" or "reset" on which to base all future rates is also clear from its limited life. The Commission proposed two percent additional rate authority for a period of five years, after which it would expire.<sup>17</sup> Had it been meant as new baseline rate, it would necessarily have been permanent.

Consequently, the Postal Service's argument rests on a mistaken premise. The Commission has not withdrawn an earlier proposal to reset rates at a new baseline level, as the Postal Service assumes. It has withdrawn an earlier proposed method of improving the Market-Dominant rate system in favor of a method it considers superior.

March 4, 2020

Respectfully submitted,

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<sup>16</sup> Order 4258, p. 41.

<sup>17</sup> Id., p. 42.