

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

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POSTAL RATE AND FEE CHANGES

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DOCKET No. R2006-1

JOINT REPLY BRIEF  
OF  
MAIL ORDER ASSOCIATION OF AMERICA  
ASSOCIATION FOR POSTAL COMMERCE  
MAILING AND FULFILLMENT SERVICE ASSOCIATION

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**I. INTRODUCTION**

In their Initial Briefs, the Association of Alternate Postal Systems (AAPS), the Greeting Card Association (GCA), the Newspaper Association of America (NAA) and Valpak Direct Marketing Systems, Inc (Valpak) contend that the rates for Standard Mail should be increased. NAA and AAPS contend that Standard Mail ECR rates should be increased by shifting the revenue burden from First-Class Mail to Standard Mail, particularly ECR. GCA contends that the proposed First-Class Mail rate increases should be decreased by shifting the revenue burden to Standard Mail Regular. Valpak contends that Standard Mail ECR rates should be decreased by shifting the revenue burden to Regular.

The GCA and Valpak positions are most easily disposed of. Standard Mail Regular rate increases of the sizes supported by them would not serve the interests of mailers.

Given the continuing decline in First-Class Mail volumes to electronic alternatives, with which the Postal Service cannot compete on the basis of price, the future of the Service will depend increasingly upon maintaining the volumes of both Standard Mail ECR and Regular. Extreme rate increases for Regular would be unwise and unacceptable.

The Initial Briefs of NAA and AAPS are discussed below.

## **II. THE CONTENTIONS OF NAA ABOUT THE IMPORTANCE OF THE RELATIVE VOLUMES OF FIRST AND STANDARD MAIL ARE INCORRECT AS ARE ITS OTHER CONTENTIONS**

In its Initial Brief, the Newspaper Association of America (NAA) places virtually controlling importance upon the fact that as of 2005 the total volumes of First-Class Mail were exceeded by the total volume of Standard Mail, arguing that the prior volume dominance of First-Class has played a determinative role in past pricing decisions.

NAA proceeds to the conclusion that Standard Mail rates should be increased substantially in excess of the levels proposed by the Postal Service. The NAA analysis is entirely incorrect from its premise to its conclusion.

### **A. The Commission Has Not Based Its Pricing Decisions Upon Relative Volumes**

NAA alleges that past pricing decisions have been based upon the status of First-Class Mail “as a majority of the mailstream.” NAA Initial Brief at 25. NAA claims that the cost coverage of First-Class Mail has been set above the system-wide average for that

reason. *Id.* at 26. NAA relies upon brief excerpts from the Commission's decisions in R87-1, R90-1, and R2001-1. *Id.* at 25, 26. Those decisions, however, do not support NAA's contention that the relative volumes of First-Class and Standard Mail were the basis for the rates recommended by the Commission.

The Commission in Docket No. R87-1, devotes many pages to a general discussion of pricing. Op. and Rec. Dec. R87-1 at 360-404. Thereafter, the rates for First-Class Mail and Priority Mail are discussed. *Id.* at 405-415. There is nothing in those discussions which can be interpreted as a conclusion that the volume of First-Class Mail was a factor in determining rate levels<sup>1</sup>.

Similarly, in Docket No. R90-1, the Commission's discussion of pricing contains no hint that the dominant volumes of First-Class Mail had any role in pricing. In no part of the Commission's extensive discussion of the pricing for First-Class Mail is there any reference to relative volumes. Op. and Rec. Dec. R90-1 at IV-1-45.

Finally, nothing in the Commission's decision in Docket No. R2001-1 supports NAA's position that the then dominant volume position of First-Class Mail had any influence upon the rates recommended. Rather, the sentence quoted by NAA that the additional revenue resulting from the First-Class Mail rate increases "is essential to the Postal

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<sup>1</sup> The Commission does discuss the limited availability of alternatives to the Postal Service as of 1987 for the payment of bills and "computer transmission" and that "all mailers do not have ready access to these alternatives." On that basis, the Commission concluded that "holding First-Class Mail rates as low as possible remains an appropriate goal."<sup>1</sup> *Id.* at 412, ¶ 5024. Currently, however, many more mailers have "ready access to these alternatives" which presumably lessens the necessity of continuing the goal of holding First-Class rates as low as possible.

Service” is simply a truism. Op. and Rec. Dec. R2001-1 at 59, ¶ 3022. The sentence would have been equally valid in discussing rate increases for any class of mail.

Further, NAA’s position that the volume dominance of First-Class Mail was the driving force in pricing is belied by the rates recommended by the Commission in those decisions. Notwithstanding the allegedly controlling significance of First-Class Mail volume dominance, the Commission in R87-1 and R90-1 recommended substantially larger rate increases for Standard Mail than for First-Class Mail. In R87-1, the First-Class Mail rate increase was barely half of the Standard Mail increase : 13.6 percent compared to 24.9 percent. Op. and Rec. Dec. R87-1 at i. The fallacy of the NAA position is most glaringly revealed by the fact that in R90-1 the Commission decreased by one cent the First-Class rate proposed by the Service, resulting in rate increases of 15 percent for First-Class Mail and 25 percent for Standard Mail.<sup>2</sup> Op. and Rec. Dec. R90-1 at i. So much for the delusional volume dominance theory of pricing now advanced by NAA. Only in the R2001-1 proceeding, at a time when First-Class Mail’s volume problems were clearly in evidence, were the rate increases for First and Standard Mail about equal: First 7.7 percent, Standard 7.1 percent. Op. and Rec. Dec. R2001-1 at ii.

## **B. Starting With A False Premise NAA Arrives At A False Conclusion**

It is evident that there is no support for NAA’s assertion that volume dominance has been a driving force in Commission rate decisions. NAA, however, places extraordinary

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<sup>2</sup> In both R87-1 and R90-1 Standard Mail was classified as Third Class Bulk Regular.

importance upon current relative volumes in making its pricing arguments. NAA states that “the Postal Service and Commission can no longer rely upon the traditional ground of First-Class Mail’s leading size for assigning it the lion’s share of institutional costs.” NAA Initial Brief at 28. The extent to which NAA on brief relies upon its false premise of the importance of the relative volumes of First-Class and Standard Mail is made even more explicit by the following statement:

The historic replacement of First-Class Mail by Standard Mail as the largest class of mail and the decline of First-Class Mail in absolute volume create a legal obligation for the Postal Service and Commission to reevaluate the relative institutional cost burdens borne by the largest classes of mail.

*Id.* at 30.

Similarly, NAA claims that the need to “reevaluate”, based upon its false premise, is required by “policy considerations”, and is necessary to “address the future fiscal stability of the Postal Service.” *Id.* at 30. NAA concludes:

NAA respectfully submits that legal duty and compelling policy considerations require that the Commission reevaluate traditional institutional cost assignments in light of these changed circumstances. More revenues for the Postal Service’s overhead costs inevitably will have to come from other classes of mail.

*Id.* at 31.

Contrary to NAA’s contention, the “leading size” of First-Class Mail has not been the “traditional ground” of the pricing decisions of the Commission. Indeed, the “leading size” of First-Class Mail has never been used by the Commission in making its pricing

decisions for either First-Class Mail or Standard Mail. NAA's entire premise has been invented and has no relationship to reality. The contention that there is a "legal obligation for the Postal Service and Commission" to shift the rate burden from First to Standard is mere hyperbole. The "legal obligation" of the Service and the Commission is to set rates in accordance with the pricing factors of the Act, factors wholly unrelated to relative volumes.

**C. The Commission Has Not Had The Goal Of Shifting The Institutional Burden From First To Standard Mail**

In reliance upon a demonstrably false premise, that the Commission's past rate decisions for First-Class Mail and Standard Mail were heavily influenced, if not effectively determined, by the respective volumes of those two classes of mail, NAA argues that the Commission should now "fulfill its longstanding goal of shifting a greater share of institutional costs to Standard ECR and Regular Mail." *Id.* at 35. The only support offered for the contention is selective quotations from Dockets No. R90-1, R94-1 and R97-1. Initial Brief at 36, n. 27.

Initially, it is notable that the first two of those decisions predated the creation of the Standard Mail ECR subclass. Therefore, neither can be used to support the proposition that it has been a goal of the Commission to shift the rate burden from First-Class Mail to all of Standard Mail.

In Docket No. R90-1, the Commission stated that "we shall continue to develop third-class rates designed to provide a contribution to institutional costs near, or slightly

below, the system-wide average.” Op. and Rec. Dec. R90-1 at IV-35, ¶ 4110. The basis of the Commission’s decision in that case was best expressed by the following statement:

Thus, we conclude that there is no good basis for departing from our previous decision that third class bulk regular should provide a contribution to institutional costs near the system-wide average, although slightly below that of First-Class letters.

*Id.* at IV-37, ¶ 4118.

Under the Postal Service proposed rates in this proceeding, the Standard Mail cost coverage would be 185 percent, above the system average of 163 percent. The cost coverage for ECR would be 214 percent only slightly below the First-Class cost coverage of 226 percent.

The Commission’s decision about rate relationships in R94-1 was driven in large part by the then anticipated mail reclassification case. Op. and Rec. Dec. R94-1 at IV-20, ¶ 4059. The R97-1 decision was in large part the result of the whole cent integer restraint. Op. and Rec. Dec. R94-1 at 275, ¶ 5046.

As the Commission has recognized, there is no single basis for determining the rate increases that should be imposed upon the various classes of mail. Any given factor is “only one factor to be examined in a very complex process.” Op. and Rec. Dec. R2000-1 at 235. In this case the Postal Service has proposed rate increases for Standard Mail which exceed those for First-Class Mail. The proposed increases for both Regular, 9.6

percent, and ECR, 8.9 percent, are above not only the proposed 7.1 percent First-Class increase, but also above the system-wide average of 8.5 percent. Mailers are affected by price increases; not abstract concepts such as price indices. Despite all claims to the contrary, there can be no valid argument that the increases proposed in this case for First-Class Mail are excessive.

**D. The Proposed Standard Mail Rates Are Well Within, Or Above, Commission Precedents**

The proposed Standard Mail rates are within past Commission precedents. In the R90-1 decision, the Commission presented an index of institutional burdens between First-Class and Third-Class: 1.24 for First-Class letters and 0.93 for Standard Mail. In commenting upon that index the Commission found that the “rates more nearly accord with the pricing policies of the Act than those proposed by the Service.” Op. Rec. Dec. No. R90-1 at ii. This is particularly notable when compared with the cost coverage indices found in Table 1 at page 26 of the Initial Brief of NAA. That table shows that currently, and as projected for the Test Year, First-Class Mail has a more favorable relative institutional cost burden, 1.21, and Standard Mail, 0.98, a less favorable relative institutional cost burden, than was found to be in accordance with policies of the Act in the R90-1 proceeding. And, of course, the institutional cost burden of ECR, 1.14, is well above the 0.93 found by the Commission to accord with the pricing policies of the Act.

Further, the “real price” of First-Class Mail has remained relatively unchanged during the course of the last 20 years. As stated by witness Bernstein, “for the past 20 years, First-Class Mail rates have been essentially unchanged in real terms, rising following a

postal rate case and then declining by an approximate equal amount as inflation reduces the real price of the newly established rate.” USPS T-8 at 7. This destroys NAA’s claim that First-Class Mail rates have been set at excessively high levels. Witness Bernstein’s testimony also shows that the loss of First-Class volumes is a result of diversions to electronic alternatives unrelated to Postal Service prices. As concluded by witness Bernstein, the “most plausible explanation for the recent drop in First-Class Mail volume is electronic diversion.” *Id.* at 62.

**E. The Decline Of First-Class Mail Volumes Should Not Result In Excessive Standard Mail Rates**

It is, of course, inevitable that a continuing decline in the percentage of mail accounted for by First-Class will result in a relative shift in the institutional cost burdens of the Postal Service. As a simple matter of math, if current volume trends continue, Standard Mail will bear an increasing share of the overall institutional costs of the Postal Service.

The adoption of the policy urged upon the Commission by the NAA, however, could not be more disastrous. The decline of First-Class Mail is due to diversions to the internet which has costs with which the Postal Service cannot possibly hope to compete on the basis of rates. Attempting to cope with the Postal Service’s long term dilemma by drastically increasing the institutional cost burdens of Standard Mail would be entirely counterproductive. Only by pricing Standard Mail at levels to promote volume growth can the Postal Service achieve the total revenues that will be necessary to continue to maintain current levels of service.

### **III. THE RELATIVE PRICE ELASTICITIES OF STANDARD AND FIRST-CLASS MAIL SHOULD BE A SIGNIFICANT FACTOR IN SETTING RATES.**

In this proceeding, NAA has invited the Commission to ignore the different elasticities of First-Class Mail and Standard Mail. This has been done primarily by testimony discussing the fact that at various confidence intervals the true elasticity of ECR mail may be above or below the elasticity that has been calculated by the Postal Service. There has also been an attempt to show that the Postal Service elasticities, as calculated for First-Class Mail, are not sufficiently reliable to be used for pricing purposes. The latter position has been premised entirely upon the testimony of Greeting Card Association witness Clifton, testimony which has been shown to be so riddled with poor specifications and faulty theories that it is not usable in this case. USPS witness Thress, USPS-RT-2.

Even NAA witness Ingraham has agreed that the elasticities that have been calculated by witness Thress are the best that are available and are therefore appropriately used by the Commission for the purpose of determining the volume response to particular price increases. Tr.35/11870. The calculation of volumes is as critical a function as is the pricing of postal products in terms of the overall ability of the Postal Service to meet its revenue needs. Therefore, there is no logical or commonsense basis for using the elasticity estimates for the purpose of volume projections while rejecting the use of those elasticities for the purpose of assessing the “value of service” factor of the Act.

One of the purposes for the enactment of the Postal Reorganization Act was to permit the Postal Service to function in a more businesslike manner. A business offering a wide range of products subject to considerable differences in relative demand would be loath to increase prices for a product line with a relatively greater elasticity by an amount that is the same or similar to price increases for products with lesser levels of elasticity. For a product which is price elastic, such as ECR, that reluctance would become even more pronounced. A business approach to pricing would be to attempt to impose price increases, as necessary to meet the costs of the enterprise, plus a profit, by raising prices in a manner which would result in the smallest loss of business.

We recognize that the Postal Reorganization Act and in particular the factors of § 3622 do not permit a straight forward approach to pricing postal products in accordance with good business practice. At the same time, particularly under the current circumstances, it would be not only bad economic practice, but also bad public policy for postal prices not to reflect the realities of the marketplace as measured by relative elasticities. NAA's position that the Commission should ignore price sensitivity in setting Standard Mail rates is an invitation to disaster.

NAA also essentially ignores the fact that Standard Mail consists of two subclasses while simultaneously ignoring the fact that there are no subclasses within First-Class Mail. NAA makes rate comparisons to single piece and presort First-Class Mail as though they were subclasses. In MC95-1, however, the Commission refused to recommend subclasses within First-Class Mail because of its conclusion that to do so

would lead to higher single piece rates. Op. and Rec. Dec. MC95-1 at V-15, 16, ¶ 5033. Thus, the only proper rate comparisons of the Standard Mail subclasses is to First-Class Mail as a whole.

NAA would have the Commission ignore the volume history of Standard Mail ECR, and its price elastic status. NAA's interest is limited to ECR because it is the subclass with which its members compete. Both ECR and Regular should be priced so as not to inhibit volume growth, and the price elasticity of ECR and the relative elasticity of Regular should be an important consideration in setting Standard Mail prices. To ignore marketplace realities for either subclass would be a mistake.

It is vital for the future of the Postal Service, characterized by a high percentage of institutional costs, that price sensitive mail not be driven out of the system. The Commission should resist the notion that First-Class Mail rates should be held far below economic levels and Standard Mail rates raised far above economic levels. The net result inevitably would be to harm the very mailers who are ostensibly to be protected by such actions *i.e.* First-Class mailers who, through preference or necessity, continue to use the mails, including *e.g.* mailers making use of the Postal Service for the purpose of sending greeting cards.

#### **IV. ELECTRONIC DIVERSIONS ALSO THREATEN STANDARD MAIL**

The pricing of Standard Mail must take into account the reality of electronic diversions. As stated in the Report of the President's Commission on the Postal Service "Internet use is likely to divert increasingly larger portions of the mail stream to the electronic

format.” Report at iii. The Commission found that “processing a digital payment over the internet costs between one-third and one-half less than a check sent through the mail.” Ft. nt. omitted. *Id.* at 7. “The Postal Service could lose a major fraction of financial transactions, correspondence and heavy advertising pieces.” *Id.* at 8.

As also found by the Commission, the Postal Service must be able to “adjust to increasingly dynamic markets and to pursue new strategies to bring revenues and expenditures into balance without sacrificing quality of service and the ability to meet the nation’s evolving postal needs.” *Id.* at viii.

Electronic diversion is now a much greater threat to First-Class Mail volume, but the threat to both Standard Mail subclasses is real and growing through such alternatives as “virtual” catalogs fully accessible on the internet and other alternatives such as Google. It would be counterproductive for the rates of the Standard Mail subclasses to be set without taking that reality into account. The worst possible reaction to the decline of First-Class Mail volumes would be to attempt to replace the lost revenue by the imposition of large and uneconomic Standard Mail rate increases.

#### **V. THE INITIAL BRIEF OF THE ASSOCIATION OF ALTERNATE POSTAL SYSTEMS (AAPS) IS NOT SUPPORTED BY EVIDENCE**

The Initial Brief of the Association of Alternate Postal Systems (AAPS) consists of little more than a contention that the Postal Service has failed to take into account that portion of § 3622 (4) of the Act that requires the Commission to make its recommendations in accordance with the policies of the Act and a number of factors

including “the effect of rate increases upon ... enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters.”

Pursuant to §3624 (a) of the Act, the Commission is to make its recommended decision only after it has provided an “opportunity for a hearing on the record ....” AAPS has chosen not to provide any evidence in the hearing to support the claim in its brief that the proposed rate increases will have adverse effects upon its members. Instead, AAPS’s brief relies solely upon contentions that the Postal Service has failed properly to take into account the effect upon competitors of the rates that have been proposed.

The Postal Service, however, has made it clear in its testimony that it did consider the effects upon enterprises in the private sector, as is made abundantly evident by the very citations to the record contained in the AAPS Brief. Counsel for AAPS may be disappointed that the conclusions of the Postal Service do not conform to his conclusions, but counsel's disappointment does not support the proposition that the issue was not fully considered by the Postal Service in making its rate recommendations.

In any event, the burden of showing that the Service’s conclusions were wrong rests with those parties disputing those conclusions. Despite being offered a hearing, AAPS has provided no evidence of the effect that the proposed rate increases would have upon its members. Counsel has instead asked the Commission to consider the “obvious impact” of the proposed rates upon competition. AAPS Initial Brief at 6. There

is, of course, nothing “obvious” about the “impact” and the Commission should give no credence to AAPS’s wholly unsupported position.

Under the “adverse inference” rule, the fact that AAPS has not introduced any evidence that the rates that have been proposed by the Postal Service will have an adverse effect upon competitors should lead this Commission to conclude that it need not take into account any such potential effect, other than to the extent that it has already been taken into account by the Postal Service. The adverse inference rule provides that “when a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him.” *International Union (UAW) v. NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972). As the court explained, “the rule is disappointingly free of mystery and mumbo-jumbo. Indeed, it is more a product of commonsense than of the common law.” *Id.* at 1335.

AAPS’s complaints about the pound rate are equally lacking in substance and record support. As found by the Commission in R2000-1:

The Commission finds no persuasive evidence on this record that a reduction in the pound rate, at the Commission’s recommended level, will unduly interfere with competition.

Op. & Rec. Dec. R2000-1 at 389.

In this case there is not only “no persuasive evidence” that a reduction in the pound rate “will unduly interfere with competition”, there is no evidence.

## VI. CONCLUSION

For the above reasons, the positions of NAA and AAPS should be rejected by the Commission.

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