



## National Association of Presort Mailers

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April 16, 2007

The Honorable Steven W. Williams, Secretary  
Postal Regulatory Commission  
901 New York Avenue, N.W., Suite 200  
Washington DC 20268-0001

Re: Docket No. R2006-1, *Postal Rate and Fee Changes, 2006*

Dear Mr. Williams:

The National Association of Presort Mailers (“NAPM”), which is an intervenor and full participant in this case, respectfully submits these initial comments on the third issue submitted by the Governors of the Postal Service to the Commission for reconsideration: whether the rates recommended by the Commission for flat-shaped Standard Mail should be reduced. Order No. 8 (issued March 29, 2007) at 4-6. We respond, in particular, to the suggestion of the Governors that “some rebalancing between Standard Mail letter and flats rates”—i.e., a reduction in flats rates funded by an offsetting increase in letters rates—“might be appropriate.” *Id.* at 4 (quoting March 19 Decision of the Governors of the USPS at 8-10).

The NAPM is concerned about the proposal because its members produce and/or process Standard Mail letters for customers who could be severely and adversely impacted by any rebalancing of the rates for Standard Mail flats and letters.

The NAPM is not unsympathetic to the predicament in which catalog mailers find themselves. The costing principles established by the Postal Reorganization Act and their interpretation by this Commission dictate the outcome of the rates recommended for flats-shaped mail. Nonetheless, this has resulted in “rate shock,” with prices greatly higher than many in that category apparently anticipated.<sup>1</sup> The result claimed is a potentially severe impact in some cases on budgets, earnings and business plans – effects no mailer would wish to face. So, mitigating that rate shock would be an unobjectionable outcome so long as, and only if, there is no impact on rates for letter-shaped mail directly or indirectly from such mitigation. Thus, NAPM would not object to a short-term tempering of rates for flat-shaped Standard Mail if the downward adjustment did not entail any offsetting rate increases (or any reductions in destination entry discounts) for letter-shaped mail. Indeed, we are gratified that many catalog mailers themselves recognize the unfairness of such offsetting increases. *See, e.g.*, Comments of DMA to Governors of the USPS (March 8, 2007) at 5 (“we would like to emphasize that such a reduction in the rates for flat-shaped Standard Mail need not, and should not, result in any increase in the rates for any other mail class or category, including letter-shaped Standard Mail”).

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<sup>1</sup> However, what we may have here is a failure to listen to that members of that community have been told for some time. See discussion about the history of realigning costs for letters and flats, *infra*, pp. 3-4.

We strongly oppose, however, any form of rate “rebalancing” that would finance rate relief for flat-shaped Standard mail by increasing rates (or reducing dropship discounts) for letter-shaped Standard Mail (or any other class of mail). The Commission’s February 26 decision to recommend rates aimed at eliminating the cross-subsidy of flat-shaped mail by letter-shaped mail was long overdue. The Commission should stick to its guns on reconsideration.

The favorable postal rates that mailers of flats have enjoyed for many years exist only because letter mailers have been compelled to offset the resulting revenue shortfalls through higher rates on their own mail. The result is that letter-shaped mail pays significantly higher markups than flat-shaped mail, in both percentage and absolute terms. In many of the lighter weight cells, flat-shaped mail at current rates does not even cover its attributable costs. In short, averaging of rates by shape amounts to an elaborate tax and redistribution program; and both economic price discrimination and cross-subsidy result.

Fairness and equity offer no conceivable justification for these distortions. First, postage is a cost of doing business for all business mailers. Mailers of flats have no more equitable claim to a subsidy from letter mailers than *vice versa*. Each mailer should be expected to pay for the costs it imposes on the Postal Service as a result of the decisions made by the mailer about the shape of its mail. As Chairman Miller also noted, fairness dictates that “none should be favored and none benefited. Each party pays the cost of service it consumes, not less, and does not bear the cost of others’ consumption.”<sup>2</sup> *Accord*, R2006-1 PRC Op. & Rec. Decis. ¶ 4032 (“it seems to be fundamentally fair that mailers pay the costs they impose upon the Postal Service plus the same contribution per piece that all the mailers make within the same subclass.”).

Second, the existing rate design is a haven for inefficiency. Rates that fail to recognize the full cost effects of shape give mailers signals that encourage use of flat-shaped mail whose costs exceed its benefits, and suppress volumes of letter-shaped mail whose benefits would have exceeded its costs. Better price signals would encourage mailers to enter letter mail, and flat-shaped, whenever doing so is cost effective, and discourage mailers from using these shapes when using them is not cost effective. The Governors should establish rate designs that maximize the overall benefit of the mails for consumers as a whole, not just for a handful of interest groups. A rate design that artificially subsidizes the costs of catalogs and other flat-shaped mail received by consumers, while correspondingly inflating the costs of letter-shaped mail received by consumers, does not achieve this outcome. *See* R2006-1 PRC Op. & Rec. Decis. ¶¶ 4001-4020 (explaining why postal rate relationships should satisfy the Efficient Component Pricing Rule); *id.* at ¶¶ 4023-4038 (explaining why ECPR requires that rates reflect cost differences caused by shape).<sup>3</sup>

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<sup>2</sup> James C. Miller III and Roger Sherman, “Has the 1970 Act Been Fair to Mailers?” in Roger Sherman, ed., *Perspectives on Postal Service Issues* 63 (1980).

<sup>3</sup> The Governors’ observation that “the ability to convert from flat-shaped to letter-shaped is not shared by all mailers of Standard flats equally” (Decision of Governors at 10) is baffling. While the statement is undoubtedly true, the same is almost certainly true of *any* form of worksharing

Third, shape-based rate relationships that violate ECPR are also a needless drag on the Postal Service's *overall* earnings. Unnecessary costs and inefficiencies increase the total combined costs of Standard Mail, and the costs of complementary goods and services produced by mailers and third party vendors, and thus siphon away the combined potential benefits to the Postal Service and its customers (i.e., combined producer and consumer surplus) from Standard Mail. Unlocking the potential benefits would allow the Postal Service to achieve greater unit contribution, or greater mail volume, or both. "Just as ECPR should produce the least cost mail by incentivizing a mailer or third party to workshare if it can perform mail processing or transportation more cheaply than the Postal Service, so too it should provide appropriate incentives to minimize costs in the case of shape and other mail characteristics." R2006-1 PRC Op. & Rec. Decis. ¶ 4024.

Fourth, further subsidies of catalog mail by letter mail cannot be justified on the theory that the rate adjustments recommended by the Commission are too sudden or too "steep." *Cf.* Decision of the Governors at 9. To the contrary, the Commission's action is long overdue. Mailers have been on notice for decades that postal rates needed realignment to reflect the cost differential between letters and flats.<sup>4</sup> The Postal Service announced its intention to begin such a realignment in the early 1990s. Even the flat mailers acknowledge this fact.<sup>5</sup> Today, 15 years later, the existing rate structure still recognizes only a fraction of recognized shape-related cost differences. If the movement toward the recognition of shape-related costs had proceeded with reasonable dispatch, full cost recognition would have occurred years ago.

In Docket No. R2005-1, the Commission, while recommending the across-the-board rate increase proposed by the Postal Service in that docket, put mailers on notice that the deviations from cost-based pricing in the existing rate structure were likely targets for correction in the next omnibus rate case, and that above-average rate increases were likely to result:

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or bypass. No one seriously contends that presorting or dropshipping is equally practical or cost-effective for all mailers. To the contrary, the costs and effectiveness of these options almost certainly vary widely among mailers. This is the very reason why the mailer demand for these alternatives is downward sloping, changes in discounts affect mailer behavior, and ECPR-compliant price differentials are therefore good for society. If full cost passthroughs were appropriate only when all mailers were equally able to respond to the rate differentials by changing their behavior, the Efficient Component Pricing Rule could never be applied to *any* form of worksharing, including presorting and destination entry.

<sup>4</sup> See Miller and Sherman, *supra*, at 67 (emphasis added) (noting as a "problem" the failure of 1979-vintage postal costing methods to analyze costs in terms of "principal components" such as "speed of delivery, distance, size weight, handling, and so on.").

<sup>5</sup> See "DMA Calls on Members to Protest Exorbitant, Unexpected Postage Rate Recommendations; Fax Postal Governors By Mar. 8," available on <http://www.the-dma.org/cgi/dispanouncements?article=688> (downloaded March 5, 2007).

After careful consideration, the Commission agrees that under these unique circumstances, small equal increases now, to be followed by a proceeding to “true-up” rates after a thorough examination of postal costs, is consistent with sound public policy. The Commission’s preference is to develop rates that accurately reward mailers’ worksharing. It is concerned that *the delay in recognizing the impact of recent innovations and improvements in postal operations, coupled with the passage of time, will probably result in unusually disproportionate increases and decreases in different rates in the next case. The Postal Service and mailers seem prepared for that possibility as they too recognize that proper cost-based rates foster efficiency and promote a healthy postal system.*

R2005-1 PRC Op. & Rec. Decis. (Nov. 1, 2005) at ii (emphasis added). The Commission also warned mailers that, while they were free to offer “rate shock arguments,” the Commission would seek in the next case to develop “economically efficient cost-based rates”:

Rate shock arguments are often raised in rate proceedings. They are likely to be raised in the next proceeding as well, in which case the Commission will assess their merits based on the record developed in that proceeding. *Parties should be aware that the Commission will seek to obtain economically efficient cost-based rates and appropriate allocation of institutional cost burdens.*

*Id.*, ¶ 5032 (emphasis added). Rate shock in the next rate case, the Commission added, is “a risk that settling parties run, one presumably considered and deemed acceptable,” by agreeing to an across-the-board rate increase in R2005-1. *Id.* ¶ 5030.

The case for continued subsidies of flat-shaped mail also gains nothing from the catalog mailers’ claim that the rate increases for flat-shaped Standard Mail will reduce its volume. *Cf.* Decision of the Governors at 9-10. The same is true of letter-shaped Standard Mail: we all live in a world of downward sloping demand curves. Absent some credible econometric evidence that the demand for flat-shaped Standard Mail is significantly more elastic than the demand for letter-shaped mail, anecdotal and self-serving claims that rate increases for flat-shaped mail will suppress volume provide no justification for rate increases on letter-shaped mail.

Likewise, flat-shaped mail is hardly unique in having a “multiplier” or “ripple” effect of generating additional mail. *Cf.* Decision of Governors at 9. Letter-shaped solicitation mail has the same effect. *See* Docket No. RM2005-3, *Rate and Service Changes to Implement Baseline Negotiated Service Agreement With Bookspan*, PRC Op. & Rec. Decis. (May 10, 2006) at ¶¶ 3003-3004 (describing multiplier effect of letter-shaped Standard Mail sent by Bookspan book clubs). Similarly, letter-shaped solicitation mail produced or processed by NAPM members also generates a long tail of monthly account statements and other correspondence sent as First-Class Mail that, in the Governors’ words, “contributes to the institutional costs of the Postal Service.” Decisions of the Governors at 9. Moreover, letter-shaped solicitation mail, like catalogs, has a multiplier effect that spreads into the larger economy. To paraphrase the Governors, “the benefits of a robust [letter mail] sector spill over not only into other types of

mail . . . but also into those portions of the economy that produce, distribute and service the goods [and services]” offered by banks and other financial institutions. *Id.* at 9.

The “rate rebalancing” suggested by the Governors, stripped of its euphemistic rationalizations, amounts to confiscating money from letter mailers to subsidize part of the cost of flat-shaped mail. If this is the alternative, the Commission should adhere to its original rate recommendations. They are the result of a careful weighing of the statutory ratemaking criteria by the expert body charged by Congress with enforcing the law. They are fair to all mailers, and serve the best interests of the Postal Service. They should be allowed to remain in effect.

If the decision is to rob Peter to pay Paul, however, then any tempering of the maximum rate increases for Standard Mail flats be funded first from within flat-shaped Standard Mail itself. It is important to recognize that the rate increases for flats are not uniform, and do not result from the new letter/flat rate differentials alone. The letter/flat differentials are only one of several new dimensions of cost deaveraging recommended by the Commission: others are deeper presort passthroughs, deeper dropship passthroughs, and a greater recognition of the primacy of pieces rather than weight in driving costs. The Standard Mail pieces that receive the biggest percentage rate increases from the Standard Mail rates recommended by the Commission are not only flat-shaped, but also less presorted, less drop-shipped, and lighter in weight—in other words, more costly to process per pound of content. Thus, for example, while a Mixed ADC nonautomation flat weighing less than four ounces and entered at the origin SCF faces a rate increase of 50.9 percent, pieces that are more finely presorted, destination entered or heavier faces increases that are much smaller. Indeed, heavy weight flats presorted to 5 digits and entered at the destination SCF will actually receive rate *decreases*. See Library Reference PRC-LR-15, *Standard Regular and Nonprofit Rate Design*, “Flats” worksheet, columns U through AB.

If (contrary to fact) the threat of rate shock for flats in fact justified significant departures from the Efficient Component Pricing Rule, the first place to look for relief would be elsewhere within flat-shaped mail itself. Increasing the 5-digit rate for flats and using the revenue to temper the 3-digit rate, reducing dropship discounts for flats, and increasing the pound rate for flats would greatly reduce the maximum increases facing flat-shaped Standard Mail—*without any additional subsidy from letter-shaped mail*. Before flats mailers start collecting handouts from other mailers, shouldn’t the charity begin at home?

Respectfully Submitted,



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