

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES,     )  
2006   )                     Docket No. R2006-1

**COMMENTS OF  
FINANCIAL SERVICES ROUNDTABLE,  
MAJOR MAILERS ASSOCIATION,  
NATIONAL ASSOCIATION OF PRESORT MAILERS  
AND NATIONAL POSTAL POLICY COUNCIL  
(May 4, 2007)**

The Financial Service Roundtable (“Roundtable”), Major Mailers Association (“MMA”), National Association of Presort Mailers (“NAPM”) and National Postal Policy Council (“NPPC”) (collectively “Letter Mailers Group”) respectfully submit these comments pursuant to Order No. 13. For the reasons stated here, the Commission should adhere to the rates it recommended for letter-shaped and flat-shaped mail on February 26.

The undersigned parties are sympathetic to the concerns of flats members about the size of the rate increases for their mail, and have urged the Postal Service to order a brief additional delay in the implementation of the Standard Mail rate changes that are currently scheduled to take effect on May 14. Commission-imposed rate rebalancing, however, would be a zero sum game at the expense of letter mailers. Unless the Postal Service agrees to a reduction in its overall revenue, lower rates for flats will mean offsetting rate increases for letter mailers.

Financing rate relief for Standard Mail in this way would merely restore an unfair and inefficient *status quo ante*. There is no serious dispute that incomplete pass through of shape-related cost differentials has given mailers misleading price signals and discriminated against letter-shaped mail to by forcing it to cover costs that should have been borne by flats mailers themselves.

The notion that avoidance of rate shock somehow justifies a further continuation of this dysfunctional rate structure ignores the 17 years of warnings by the Commission to users of flat-shaped mail that it was underpriced and overdue for catch-up rate increases. Seventeen years exceeds any reasonable transition period several times over; and the repeated warnings given by the Commission over this period preclude any claim of detrimental reliance in a continuation of the existing rate preferences. In any event, the record in this case contains no evidence that the benefits to mailers of flats from holding down flats rates outweigh the adverse impacts on letter-shaped mail and the postal system as a whole. Reducing flats rates on this record would be arbitrary and capricious.

#### **I. THE FINANCING OF RATE REBALANCING WOULD BE A ZERO SUM GAME.**

In Order No. 13, the Commission has invited comment on whether rate relief for Standard Mail flats would be a “zero sum situation.” *Id.* at 13. The answer, given the Postal Service’s posture on the issue, is clearly yes. The Postal Service has been insistent that, “in order to mitigate rates for flats, it would be necessary to make upward adjustments in other rates, namely, the rates for letters.”<sup>1</sup> While this position is

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<sup>1</sup> Initial Statement of the USPS on Reconsideration (Mar. 28, 2007) at 9 (citing Governors’ Decision at 10). The Postal Service’s intransigence on this issue may be related to its projection of a \$5.2 billion net loss in Fiscal Year 2007. See, e.g., H. Glen

regrettable, as a practical matter the Commission can do little to provide relief for flats without offsetting increases in letter rates unless the Postal Service shows some flexibility concerning the revenue requirement. The Governors' power under former 39 U.S.C. § 3625(d) to modify rates recommended by the Commission means that, in a tug of war over a proposed reduction in aggregate After Rates revenues, the Governors will have the last word.<sup>2</sup> Accordingly, absent a change of heart by the Postal Service or a showing that the revenue requirement recommended by the Commission on February 26 is clearly understated, the Commission cannot recommend lower rates for flats without ultimately forcing letter mailers to pay higher rates.

For this reason, the proponents of reducing the rates scheduled to take effect in ten days for flat-shaped mail necessarily must show that the benefits of such action outweigh the harms of an offsetting rate increase for letter-shaped Standard Mail. These harms include the economic injury to letter mailers and their customers from higher rates, plus the deadweight loss to society as a whole from a rate structure that

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Walker, *Financial Update: Board of Governors Open Session* (May 2, 2007). Whether this projection is accurate or not, the Postal Service has adhered to it. Accordingly, any Commission action in this case that reduced the Postal Service's aggregate test year revenue is likely to prompt the Governors to modify the rates under former Section 3625(d)—or file another omnibus rate case under former Section 3622.

<sup>2</sup> See R2000-1 PRC Op. & Rec. Decis. (Nov. 13, 2000) (reducing requested After Rates revenue by approximately \$1 billion, including a \$668 million reduction in the contingency); *id.*, Decision of Governors issued Dec. 5, 2000 (implementing rates under protest and requesting reconsideration of revenue requirement); *id.*, PRC Op. and Further Rec. Decis. (Feb. 9, 2001) (declining to restore most of disputed amount); *id.*, Decision of Governors on Further Recommended Decision (Mar. 5, 2001) (rejecting Further Recommended Decision and requesting further reconsideration); *id.*, PRC Op. & Rec. Decis. on Further Reconsideration (Apr. 10, 2001) (reaffirming previous decision); *id.*, Decision of the Governors on the Recommended Decision on Further Reconsideration (issued May 7, 2001) (modifying Recommended Decision by restoring disputed contingency amounts and an additional \$200 million "to ensure the financial integrity of the Postal Service and the postal system").

violates the Efficient Component Pricing Rule (“ECPR”), plus the transaction costs to mailers and their vendors from back-to-back changes in Standard Mail rate schedules within a very short interval. As we now show, the record in this docket does not begin to support such a comparative showing.

**II. “REBALANCING” STANDARD MAIL RATES WOULD RESTORE A *STATUS QUO ANTE* THAT WAS UNFAIR, INEFFICIENT, AND LONG OVERDUE FOR REFORM.**

The proponents of restoring rate preferences for flat-shaped Standard Mail have not even bothered to dispute the unfairness and inefficiency that would necessarily result from this course. No participant has disputed that flat-shaped mail costs more to process than letters. No one has challenged the accuracy of the data relied on by the Commission to quantify this disparity.

No one has disputed that shape-related rate differentials which fail to cover 100 percent of shape-related cost differences violate ECPR, and are therefore inefficient. 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>

And no one has denied that the pre-existing rate structure has benefited users of flat-shaped Standard Mail at the expense of letter-shaped Standard Mail and, in many rate cells, has forced the latter to subsidize a portion of the costs of the former. *Cf.*

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<sup>3</sup> The inefficiency of price signals that result from the absence of ECPR-compliant rate recognition of shape-related costs means that the mailers as a whole will not achieve lowest combined costs. Accordingly, to describe the outcome as a “zero sum situation” actually understates the problem: in fact, the result of rate rebalancing would be less than zero sum.

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.”).

The silence of the flats mailers and their allies on these points is understandable, for they have been long beyond serious challenge. As long ago as 1980, James Miller, future Chairman of the Board of Governors, characterized as a “problem” the failure of existing postal costing methods to analyze costs in terms of “principal components” such as “speed of delivery, distance, *size*, weight, handling, and so on.”<sup>4</sup> Mr. Miller also offered in the same article a widely quoted formulation of the fairness principle: 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>5</sup>

Likewise, the Mail Order Association of America (“MOAA”) has emphasized, in the analogous context of recognizing distance-related cost differences, that “destination entry discounts which equal only 80 percent of the cost savings” produce a “‘false price signal’ to the market, and would fail to meet the objective of maximizing productive efficiencies.”<sup>6</sup> “Only by a full pass through of cost savings resulting from destination entry will proper price signals be given to mailers and the Postal Service enjoy the full benefits from maximum use of destination entry.”<sup>7</sup>

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<sup>4</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* 67 (1980) (emphasis added)

<sup>5</sup> *Id.* at 63.

<sup>6</sup> Docket No. R97-1, Brief of MOAA (April 1, 1998) at 22 (in section of brief entitled “Destination Entry Discounts Should Reflect 100 Percent Of Cost Savings”).

<sup>7</sup> Docket No. R2000-1, Initial Brief of MOAA (Sept. 13, 2000) at 22.

Similarly, one of the attorneys for the Coalition of Catalog Mailers (“CCM”) has emphasized the importance of full recognition of cost differences in the analogous context of setting inter postal charges for international mail:

Bulk mailings . . . are invariably commercial in nature and should pay the proper associated costs. Indeed, any discrepancy between postage rates and postal costs will either artificially encourage the bulk mailer to print his material out of the Member State or represent a subsidy from other mailers to his business. Neither result is desirable.

James I. Campbell, Jr., *The Rise of Global Delivery Services: A Case Study in International Regulatory Reform* (2001) at 447 ¶ 300.

The unfairness and inefficiency that would result from restoring, in whole or in part, the cross-subsidy of flats by letters would be compounded by the additional transaction costs needed to achieve this result. Pursuant to Resolution No. 07-3 of the Board of Governors (March 19, 2007), the rates recommended by the Commission on February 26 for Standard Mail are scheduled to take effect at 12:01 am on May 14, 2007—only ten days from now. It is too late for the Commission to recommend a different set of rates in time for the Postal Service and its customers to implement by then. Accordingly, rate “rebalancing” would entail back-to-back rate changes for Standard Mail. Rates for flat-shaped Standard Mail would go up and then down; rates for letter-shaped Standard Mail would go up and then up further. The substantial transaction costs involved in such an effort—publication of new rate schedules in the Postal Bulletin and Domestic Mail Manual, reprogramming of postage-related hardware and rewriting of software, and reeducation of customers would all need to be done anew. These costs would be a dead weight loss to mailers and the Postal Service, rather than a transfer of resources from one postal stakeholder to another.

### **III. CLAIMS OF “RATE SHOCK” CANNOT JUSTIFY ANY FURTHER DELAY IN FULL RECOGNITION OF SHAPE-RELATED COSTS.**

Rather than defend the pre-existing rate structure on its economic merits, the users of flat-shaped mail argue instead that the existing rate preference for flats must be preserved for some indefinite further period to avoid rate shock. The record, however, does not support these claims.

“Rate shock” is a short-hand term for the notion that otherwise-appropriate rate changes should be phased in over a short transition period when immediate implementation of the rate changes would strand investment sunk by ratepayers (including through long-term contracts) in reasonable reliance on the continued existence of the prior rate structure. The rate shock argument fails here for two reasons. First, users of flat-shaped mail have been repeatedly warned since 1980 that flats rates were too low and would be raised. Seventeen years is a far-more-than ample transition period. Second, the record provides no evidence that the benefits to flats mailers from rescinding or moderating the rate increases scheduled to take effect on May 14 would outweigh the adverse financial impact on letter mailers and the postal system from the offsetting additional increases needed to fund the rate relief for flats.

#### **A. Mailers Of Flats Were On Notice For Many Years That Their Mail Was Overdue For Large Rate Increases.**

Mailers have been on notice for years that postal rates needed realignment to reflect the cost differential between letters and flats.<sup>8</sup> If the movement toward the

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<sup>8</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.”).

recognition of shape-related costs had proceeded with reasonable dispatch, full cost recognition would have occurred years ago.

The Postal Service announced its intention to begin such a realignment in the early 1990s, as the flats mailers acknowledge.<sup>9</sup> The Commission began deaveraging third-class mail for shape in Docket No. R90-1. R90-1 PRC Op. & Rec. Decis. (Jan. 4, 1991) at ¶¶ 5930-5944. The Postal Service, defending the importance of shape-based deaveraging in the Court of Appeals, reiterated “the need to begin to recognize cost-driving factors in the rate structure to a meaningful degree.” *Mail Order Ass’n of America v. USPS*, 2 F.3d 408, 433 (D.C. Cir. 1993) (quoting R90-1 PRC Op. & Rec. Decis. at ¶ 5943). Further deepening of letter-flat rate differentials in the following omnibus cases was slow, however, and a large degree of shape-related averaging persisted in the rate structure at the outset of Docket No. R2005-1. See R94-1 PRC Op. & Rec. Decis. ¶ 5235; R2000-1 PRC Op. & Rec. Decis. ¶ 5407 & n. 92; R2001-1 PRC Op. & Rec. Decis. ¶ 3133.

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 surviving deviations from cost-based pricing in the existing rate structure were targets for correction in the next omnibus rate case, and that above-average rate increases for the previously underpriced rate cells were likely:

After careful consideration, the Commission agrees that under these unique circumstances, small equal increases now, to be followed by a

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<sup>9</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).

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 Commission was entirely justified in carrying out this promise in the present docket. The 17-year slog toward full recognition of shape-based cost differences since 1990 has already exceeded any reasonable transition period several times over. Moreover, the years of notice to mailers that the rate preference for flats was living on borrowed time—and the Commission’s stark warning in Docket No. R2005-1 that all such rate anomalies faced outright elimination in the next omnibus case—preclude any claim that further reliance on the old rate design was reasonable. “Exclamations of ‘rate

shock' are . . . undermined when the period since first notice has itself become a protracted delay." *National Association Of Regulatory Utility Commissioners v. FCC*, 737 F.2d 1095, 1146 (D.C. Cir. 1984) (no claim of rate shock for rate changes taking effect four years after FCC first stated that it intended to remedy the discrimination in the traditional rate structure); see also *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 531-32 (D.C. Cir. 1996) ("the circumstances that may have justified the Commission's action [to mitigate rate shock] in 1992 do not justify its continued inaction in 1994, much less in 1996"); *City of Nephi, Utah v. FERC*, 147 F.3d 929, 932 (D.C. Cir. 1998) ("four-year mitigation requirement" after change of FERC ratemaking policy was sufficient to avoid claim of "rate shock"); *Washington Water Power Co. v. FERC*, 201 F.3d 497, 503 (D.C. Cir. 2000) (ratepayer that entered into a supply contract with a gas pipeline after the FERC had already announced that it would reconsider the ratemaking methodology for the pipeline in the next rate case "cannot show detrimental reliance" on the existing rate design).

**B. The Record In This Proceeding Provides No Evidence That The Benefits To Mailers Of Flats Of Rate Relief Would Outweigh The Rate Impact On Other Mailers.**

Beyond the ample advance warning given to flats mailers, the rate shock argument fails on a second and independent ground: the absence of record evidence showing that the benefits to flats mailers from restoring all or part of the rate preference for flats would outweigh the harm to letter mailers and the postal system from the offsetting rate increases on letter-shaped mail. The only testimony cited by the proponents of rate rebalancing on the issue of rate shock is the rebuttal testimony of USPS witness James M. Kiefer (USPS-RT-11). See MOAA Answer to Motion of CCM

to Reopen (Apr. 19, 2007) at 3-4; Response of USPS to CCM Motion to Reopen (Apr. 19, 2007) at 2 & n. 1. Mr. Kiefer's testimony does not begin to make the requisite showing.

The testimony derides the testimony of Valpak witness Robert Mitchell in support of full pass through of shape-related costs as "dogmatic," "doctrinaire," "mechanistic," "radical," "excessively narrow," lacking in "balance," and insufficiently attentive to the "impacts" and "repercussions of his proposals" for mailers. USPS-RT-11 at 20-26. Beyond these bromides, however, this portion of Mr. Kiefer's testimony offers little substance.

Mr. Kiefer notes, for example, that Mr. Mitchell's proposed rate design would cause rate increases "exceeding 40 percent and 50 percent" for some cells. USPS-RT-11 at 21. Mr. Kiefer's testimony ignores that these increases result from the *combined* effect of shape recognition with greater recognition of presort and destination entry cost differences, as well as increased emphasis on weight rather than piece count as a rate determinant. For flat-shaped mail that is heavier, more thoroughly presorted or entered closer to destination, the increases are smaller. For flat-shaped mail with all of these characteristics, the rate changes are very small or even negative.<sup>10</sup> Mr. Kiefer's testimony unsurprisingly does not consider the alternative of tempering the highest increases by reducing the other dimensions of cost recognition within flat-shaped Standard Mail itself. *Cf.* Order No. 13 at 13 (question 2).

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<sup>10</sup> See Library Reference PRC-LR-15, *Standard Regular and Nonprofit Rate Design*, "Flats" worksheet, columns U through AB.

Mr. Kiefer also suggests that “market information” on differences in demand elasticities between letter-shaped and flat-shaped mail should be considered in “developing appropriate rates.” USPS-RT-11 at 23. He offers no evidence, however, that the demand for flat-shaped mail is in fact more price-elastic than the demand for letter-shaped mail.

Mr. Kiefer’s testimony does not even mention, let alone support, the welter of after-the-fact theories asserted by flats mailers in support of rate relief since the February 26 recommended decision. For example, his testimony does *not* claim that:

- “Small entrepreneurs offering niche products and services” represent a higher percentage of flats mailers than letter mailers.
- Businesses that rely on flat-shaped Standard Mail for marketing “have greater dependency” than do letter mailers “on a continuous stream of mailings to generate future sales volume.”
- Businesses that rely on flat-shaped Standard Mail for marketing “use extensive sample testing to drive mailing decisions” to a greater degree than do mailers that rely on letter-shaped Standard Mail for marketing.
- Businesses that rely heavily on flat-shaped Standard Mail for marketing have a more “elongated planning cycle” than do businesses that rely heavily on letter-shaped Standard Mail for marketing.
- Mail “is a key component of” the “business plans . . . and drives revenue” to a greater extent for flats mailers than for letter mailers.
- Postage “constitutes a [more] substantial portion of” operating costs for users of flat-shaped Standard Mail than for users of letter-shaped Standard Mail.
- Flats mailers are more likely than letter mailers to have “[d]ifficulty in quickly changing cost structure (due to, e.g., restraints imposed by existing contractual commitments with vendors).”
- Letter mailers can convert to a less expensive format for solicitations more readily than can flats mailers.

- Flats mailers have greater difficulty than do letter mailers “in quickly adjusting mailings to decrease postage costs.”
- Flats mailers, to a greater extent than letter mailers, face “limitations on passing through an increase in costs to customers.”
- A decline in the volume of flat-shaped Standard Mail solicitations will have a larger adverse multiplier effect on other classes of mail than would a decline in the volume of letter-shaped Standard Mail solicitations.

*Cf.* CCM Motion to Reopen Record at 7-8.

Beyond the lack of record support for the rate shock rationale, the relief sought by the flats mailers founders on the Commission’s explicit findings about the unfairness and inefficiency of incomplete pass through of shape-related cost differences. See, e.g., R2006-1 PRC Op. & Rec. Decis. ¶ 5470. The Postal Service’s contention that the Commission retains unfettered discretion to reverse course ignores (among other things) the reality that the issue is no longer one of first impression. *Cf.* Response of the USPS (April 19, 2007) at 2-3 n. 1. To deviate from the Commission’s February 26 findings in the absence of any new evidence that the societal benefits of ECPR pricing should receive less weight, or the flats mailers’ rate shock claims should receive any weight at all, would be arbitrary and capricious. *Association of Oil Pipe Lines v. FERC*, 281 F.3d 239, 245-48 (D.C. Cir. 2002) (agency reversal of prior findings without adequate explanation is arbitrary and capricious).

Finally, restoring the rate preference for flat-shaped Standard Mail would send an unfortunate signal to the Commission’s stakeholders that politics trumps economics. As MOAA stated in Docket No. R97-1,

“it is inappropriate to look solely at the apparent ‘winners’ and ‘losers’ within the mail stream in setting prices. These considerations, which are essentially political, should not lead the PRC to ignore economic

efficiency. *The very existence of the PRC is premised in large part upon ensuring that rates are established on the basis of sound economics; not politics.*

Docket No. R97-1, Brief of MOAA (April 1, 1998) at 19 (emphasis added).

## CONCLUSION

For the foregoing reasons, the Commission should adhere to the rates it recommended for letter-shaped and flat-shaped mail on February 26, 2007.

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