

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

Annual Compliance Report

Docket No. ACR2009

**Reply Comments
of the
American Catalog Mailers Association**

The American Catalog Mailers Association (ACMA) hereby submits Reply Comments to Docket No. ACR2009, the US Postal Service (USPS) Fiscal Year 2009 Annual Compliance Report:

1. ACMA notes that some interests continue to call for further, dramatic increases to catalog postage rates¹ on the grounds that the attributable cost coverage to Standard Mail flats is low. As the US Postal Service writes in the FY2009 Annual Compliance Report, it is critical to “move with discretion when attempting to shore up the Flats coverage” and “consider the health of the industry and pursue a long run approach” (at 36). As written in our Initial Comments and elsewhere, the catalog industry continues to suffer economic harm from the lingering effects of a rapid increase to postage following R2006-1 and has not been able to adjust fully to the material change to mailer economics following this major postage rate increase.

2. The current attributable cost coverage is largely a result of sharp reductions in catalog volumes since 2007 and the necessity of spreading a high fixed cost base over fewer units.² As recent experience has demonstrated, further increases to catalog-dominated rate bands in the name of improved cost

¹ See, for example, Docket ACR2009, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2009 Annual Compliance Report, at 19.

² The Initial Comments of Time Warner Inc. in Docket 2009ACR provides an in depth discussion of these issues at 11-19.

coverage is likely to have the opposite effect as more catalogers reduce circulation, adopt alternative media or go out of business when they cannot react in time to wholesale changes to a very large cost center.

3. The ultimate issue to be addressed is the high cost to process flats. In its Initial Comments, Time Warner identifies and documents³ a variety of these for Periodicals that largely also apply to catalogs, while suggesting a roadmap to improve these costs. Admittedly late to the game, ACMA is also now working with the USPS to identify and promulgate cost savings initiatives that may help reduce processing costs. Viewed through the lens of comparative cost reductions for non-flat mail over the past decades compared to that actually achieved in flats, one might conclude that there are significant opportunities to improve the cost effectiveness for flats processing, a goal the USPS seems clearly focused on realizing.

4. The ultimate cost reduction initiative is the Flats Sequencing System (FSS) that is only beginning to be deployed. The impact on flats processing cost of this automation has not been felt in FY2009 yet falling volumes threaten to undermine this progress in FY2010 and beyond. With nearly a billion dollars of capital committed, precipitous action placing this investment at risk should be avoided. Further large increases to catalog rates would only exacerbate the situation and make it harder to achieve a return on investment.

5. While we acknowledge that the concepts of “attributable costs” and “institutional cost” coverage have become well established in postal circles, we also point out that this approach is unique to postal policy. Businesses use only “variable” and “fixed costs.” There are allocated fixed costs in the attributable cost calculations that may mask sound business decision-making. As recent history has shown, the fixed costs of operating the nation’s postal system do not respond well to large volume declines. While a margin over total costs is to be desired, there are times when pricing over allocated costs can yield bad

³ Docket ACR2009, Initial Comments of Time Warner Inc., at 11-19.

decisions. In a high fixed cost system hungry for volume, activities that provide a margin over variable costs can be of value in business terms provided every product or service is not justified on contribution over variable cost. The fixed costs remain regardless of whether the volume materializes. Getting some margin over variable cost provides economic value in circumstances where market place dynamics do not allow a higher price.

Allocation of fixed costs is a useful exercise to determine what organizational resources are supporting various activities, but the business manager must look at both contribution over variable costs and contribution over allocated fixed costs when making business and pricing decisions. Oftentimes, such as when operating a high fixed cost system with ample unused capacity, it makes “business sense” to attract volume at a margin over variable, especially—as in the case in USPS operations—when it is not possible to shed fixed costs. This is especially true when the business activity brings additional benefits or the customer represents a strategic benefit. In the case of catalogs that bring desired content to the mail recipient building excitement and interest that further the Mail Moment while generating a host of other social benefits for America, one might justify a pricing regime that fails to cover allocated fixed costs. This is particularly true when the elasticity of demand indicates this volume would not materialize at a different, and higher, price.

Solely making pricing decisions on attributable and institutional cost coverage neglects to account for current reality of the marketplace. Not by choice but by necessity, catalogs continue to migrate out of mail. Technology has done what Congress has not: broken the postal monopoly as it relates to catalogs. The proliferation of mail substitutes and the high cost of mail has created a downward spiral of volume out of the system that has implications well beyond the catalog industry alone. This is not healthy for the USPS or the mailing community who lose the incremental contribution and the beneficial impact of content highly desired by mail recipients.

6. ACMA thinks what is needed is to find that rate structure that retains and grows catalogs, helping return this segment of the mailing industry to health, including continued investment in, and business model dependence on, mail. The USPS Summer Sale is a good example of pricing innovation. While we had several changes we would like to have seen in the program, we also realize that practical considerations require one not pursue a perfect solution at the expense of progress. We applaud continued work by the USPS to find the levers that incent mailing behavior to drive volume.

The operating precedence and general mailing industry belief seems to hold that if something is done for one, it should be done for all. We disagree with this approach. We urge segmenting the broad and diverse mailing industry into progressively smaller customer groupings, so that the value-added by the mail can be understood at a tangible and discrete level. When these levers are understood well, it is possible to better design discrete pricing regimes that drive and retain each discrete customer segment's volume. Development of sophisticated pricing models take businesses years. We hope observers and policy makers realize that progress is hard won and resist taking actions that reduce the Postal Service's freedom of action on pricing innovation.

Part of the strategic marketing segmentation we expose also concerns picking the optimal mailing industry segments to focus on. Catalogs represent a good strategic choice for the USPS. They are a group that has favorable demographics and can be managed for growth. Catalogers want to grow mail volume as it represents business growth. Catalogs are also highly elastic. The only way out of the dilemma catalogs face today, unless the USPS wants to exit this segment, is to price to attract volume, automate handling and reduce processing costs, while driving increasing value to the mailer. The vision must be, that some years hence, we have many more catalogs in the USPS system, handled at significantly less cost, so the totality of contribution to overhead and profit is much larger than today. To attempt to raise prices to optimize the per piece contribution only serves to drive additional unit volume out of the system

making both automation and increased contribution from the catalog segment unattainable.

7. Some consider that the USPS loses money with each catalog it processes. Catalogs, some say, are “underwater” so rates, specifically Standard Mail flats rates must be sharply increased. It is not true that “catalogs are underwater.” One must consider the total impact from catalogers as postal customers. For instance, since catalogs mail in nearly equal proportions in both SM flats and SM Carrier Route, the combined contribution when considered together is not “underwater,” even at the significantly diminished unit contribution resulting from the recent, sharp volume declines. Taken together, these flat shaped catalogs make money for the USPS. More, to understand the total economic impact of cataloging for the USPS, one must add the tremendous volumes in other types of mail originating from catalogs. Catalogers mail large volumes of FTC-required notices, invoices and solicitations via First Class. Catalogers also make use of SM letters and postcards and send a significant quantity of outbound parcels.

Parcels are particularly interesting because the USPS has a comparatively small market share in catalog parcels yet catalogers spend nearly as much on outbound freight as they do to mail catalogs. Thus, the USPS can grow parcel volume well in excess of industry growth rates simply by taking share from other competitors. USPS has pursued a number of important innovations in Parcel Services that now make it very possible to grow market share. Products such as priority mail and merchandise return services have significant applicability to catalogers. The IMb for parcels solves a longstanding barrier to catalog adoption of USPS Parcel Services by providing improved track and trace functionality.

When considered across all the USPS activity generated, the total economic impact of cataloging is clearly positive and catalogs represent a needed source of future volume growth. One cannot effectively remove an entire service category fundamental to a customer segment’s use of the mail by pricing it out of the market, then expect related volumes won’t disappear with these.

8. In a world of increasing communication choices, attention must be given to managing the content value of mail to keep it welcome and relevant. The pressures of the past few years have allowed too little consideration of what drives the ultimate effectiveness of mail: consumer attention. Too little is also understood about the significant role of the mail on the social and economic health of the nation, including the importance individual customer segments have in driving system health and mail's impact. Consumers clearly enjoy receiving catalogs. Catalogs are part of the value of mail that drives the Mail Moment for mail recipients. Catalogs provide a wide variety of social benefits beyond their financial contribution to postal system overhead.

9. A number of commenters have noted that recent developments in the accuracy of actuarial assumptions for the Postal Service Retiree Health Benefit Fund and overcharges to the Civil Service Retirement System pension fund each significantly cloud the financial health of the postal system. In fact, were either of these two enormous cost loads on USPS finances resolved, they would materially change postal economics, including perceptions on profitability of every postal product. Given these circumstances, wholesale changes affecting entire industries dependent on the mail, especially those that will create widespread dislocation and irreversible damage, should be deferred until greater clarity is achieved. It could well be that the Postal Service's finances are not "dire" at all. Under these circumstances, a wait-and-see approach is not only prudent, it is clearly called for.

CONCLUSION

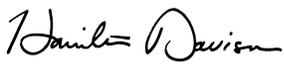
This is a time of great opportunity and risk in the postal landscape, with enormous financial pressures made worse by the general economic climate. This calls for accelerating innovation led by the USPS and enabled by both Congress and the postal regulator, as well as heightened participation by postal customers in the improvement process. What seems clear to most is that we must continue to extricate ourselves from the inefficient past to move forward focused on the

root cause issues of customer satisfaction, operational improvement and making the correct long-term strategic choices given market and technological change. With so much in play and so much at stake, caution and prudence to resist wholesale changes with far-reaching impact is an appropriate course, along with the continued support and encouragement of an environment of communication, collaboration and advancement.

In a postal system that needs long-term, committed customers providing both volume and profit, making short-term decisions that eliminate this potential brings with it a huge opportunity cost and unintended consequences that are difficult to recover from. As the USPS moves toward a sustainable and market driven posture, we respectfully urge the Commission to continue to provide a regulatory environment that seeks to stimulate innovation and accelerate improvement without making wholesale changes to a system on which so many depend.

Respectfully submitted,

American Catalog Mailers Assn., Inc.

By: 
Hamilton Davison
Executive Director
PO Box 11173
Hauppauge, NY 11788-0941
800-509-9514

Dated: February 24, 2010