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FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

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JOINT COMMENTS OF THE MAIL ORDER ASSOCIATION OF AMERICA, ADVO, INC., AND VALPAK DIRECT MARKETING SYSTEMS, INC. CONCERNING THE DIFFERENT APPLICATION OF LAWS TO THE UNITED STATES POSTAL SERVICE AND PRIVATE COMPETITORS
(August 6, 2007)

The above-identified parties, individual mailers and trade associations of mailers that use "market-dominant" postal products in their businesses, hereby submit their joint comments in response to the Federal Trade Commission's notice (72 F.R. 23820, May 1, 2007) issued pursuant to section 703 of the Postal Accountability and Enhancement Act (the "PAEA"). That section directs the FTC to submit a report to the President, Congress, and the Postal Regulatory Commission "identifying Federal and State laws that apply differently to the United States Postal Service with respect to the competitive category of mail … and to private companies providing similar products."

We are also authorized to state that the Greeting Card Association, an organization of greeting card publishers which historically has represented the postal interests of the individual citizen mailer, concurs in the substance of these comments.

I. OVERVIEW

The PAEA divides postal products into two separate groupings, "Market-Dominant" and "Competitive." For the market-dominant category, prices will be set by the Postal Service under a CPI-U price cap regime, applied at the mail class level. 39 U.S.C. §3622(d). For competitive products, the Postal Service will set prices subject to

protection against cross-subsidy by market-dominant products, with an "attributable cost" price floor for each product and a requirement that competitive products as a whole contribute an "appropriate share of the institutional costs of the Postal Service" as determined by the Postal Regulatory Commission. 39 U.S.C. §3633(a).

In reality, the Postal Service faces increasing competition for both its "market-dominant" and its "competitive" mail products, not just from hard-copy competitors but particularly from electronic alternatives such as e-mail and the internet. The new law gives no assurance that the Postal Service will be able to succeed in the marketplace in any of its product lines. The PAEA has removed the security of "cost of service" rate regulation, under which the Postal Service was entitled to have rates raised to whatever levels were necessary to recover its full costs of service. Now, without that "breakeven" guarantee, the Postal Service's only means to remain viable are to control its costs and to price its products in a more market-responsive manner.

II. MARKET-DOMINANT MAIL USERS HAVE A VITAL STAKE IN THE SUCCESS OF THE POSTAL SERVICE'S COMPETITIVE PRODUCTS

A. The Parties Concurring In These Comments

The businesses and mail-user interests represented by the parties who endorse these comments cover a wide spectrum of the mailing community, as described below. One interest they all share in common is the long-term viability of the postal system.

ADVO, Inc., a wholly-owned subsidiary of Valassis, Inc., provides bulk mailing services and advertising programs, including shared mail programs, to advertisers and retailers in local markets and throughout the nation, mailed exclusively at Standard Mail rates within the "market-dominant" category of mail.

The Greeting Card Association, which although not a signatory to these comments concurs in their substance, is an organization of greeting card publishers whose products are used by individuals and mailed at First Class postage rates within the "market-dominant" category.

The Mail Order Association of America is a trade association of major companies that sell products through catalogs and the internet. Its members primarily use the mail to distribute catalogs at Standard Mail rates within the "market-dominant" category, although they also have a strong interest in maintaining Parcel Post as a viable competitive delivery alternative.

Valpak Direct Marketing Systems, Inc., a wholly-owned subsidiary of Cox Target Media, Inc., provides advertising services and distribution for local, regional and national businesses through its cooperative "coupons in an envelope" program, mailed at Standard Mail rates within the "market-dominant" category of mail.

B. The Common Interest

All mailers in the market-dominant category have a stake in the success of the Postal Service's competitive products. The competitive products, if successful in the marketplace, will provide a contribution to total institutional costs that will reduce the rate burden on market-dominant products. To the extent the Postal Service is able to earn a profit on its competitive products, that profit will be subject under section 3634 of the PAEA to an imputed income tax which will be transferred from the Competitive Products Fund to the Postal Service Fund – to the benefit of market-dominant products. More importantly, competitive products currently make a significant contribution to the Postal Service's overhead costs (known as "institutional costs" in postal ratemaking

parlance).[1] Express Mail and Priority Mail alone contribute more than $2 billion annually to defraying those overhead costs of the postal system.[2] If the Postal Service is unable to compete and is driven out of the competitive market, it will lose that contribution to overhead costs, which will have to be recovered by the Postal Service either by cutting costs or by raising rates for other mailers. Thus, mailers in the market-dominant category would end up paying for those costs one way or another – either through reduced service and/or increased rates.

Our concern is that competitors of the Postal Service will attempt to use the FTC's findings in this proceeding as the basis for imposing a non-cost-based surcharge on USPS competitive products as a "remedy" for alleged "unfair competitive advantages." United Parcel Service (UPS), for example, has argued in comments to the Postal Regulatory Commission that the PAEA "essentially redefines subsidy" to require an allocation to competitive products of an additional third-tier of "imputed costs" – above and beyond attributable and institutional costs that the Postal Service actually incurs – in order to offset the Postal Service's "unfair competitive advantages."[3] UPS

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[1] In postal ratemaking, total postal costs are divided into two components. "Attributable costs" are those costs that are "caused by" a particular mail subclass or product, including both volume-variable costs and incremental costs (i.e., those non-volume-variable costs that would be saved if a product were eliminated). They are charged to the product that causes them. "Institutional costs" consist of all other postal costs that must be recovered from all mail products collectively. They are allocated among products judgmentally based on statutory pricing factors.

[2] *See* Recommended Decision of the Postal Regulatory Commission, Docket R2006-1, Appendix G, Schedule 1.

[3] Comments Of United Parcel Service In Response To Second Advance Notice Of Proposed Rulemaking On Regulations Establishing A System Of Ratemaking, June 18, 2007, PRC Docket RM2007-1, at 9.

specifically cited this FTC proceeding as a source for quantifying such a surcharge. It is not for the FTC to decide whether UPS's novel three-tier cost allocation interpretation of the statute is correct; that is a job for the Postal Regulatory Commission. However, the FTC should bear in mind that postal competitors, particularly UPS, will hope to use the FTC's findings for just such purpose.

The notion that the Postal Service, by virtue of its status as a federal entity and a creature of Congress, enjoys a substantial net "unfair advantage" over private competitors is difficult to reconcile with the realties of the marketplace. If that were the case, one would expect the Postal Service to be the dominant competitor. The indisputable fact, however, is that UPS and FedEx are far and away the dominant competitors in both the Express Mail and Parcel Post markets. The Postal Service is, at best, a distant third, especially in the area of commercial bulk services.[4] And its survival in these markets is by no means assured – particularly if federal agencies like the FTC and PRC were to burden it further with phantom costs ostensibly designed to "level the playing field," costs that would instead more likely tilt the field to the point that these postal products slide off into oblivion. That outcome would no doubt be good for the parochial interests of the competitors, eliminating potential competition, but it would be

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[4] According to the Postal Service, a Colography Group analysis shows that its revenue market share for domestic competitive products was only 11 percent in 2006. Initial Comments of the United States Postal Service on the Second Advance Notice of Proposed Rulemaking, PRC Docket RM2007-1, June 18, 2007, at 25.

harmful to everyone else, including not just current users of those competitive postal products but all mail users and the American public. [5]

In considering any allegations that the Postal Service has unfair competitive advantages, the FTC cannot ignore the status of that competition in the real world marketplace. This is why it is imperative that the FTC critically assess allegations of competitive advantage. Particularly given the Postal Service's comparatively weak position in these competitive products, the burden of proof should be on those private companies claiming that they are at an unfair disadvantage.

III. THE POSTAL SERVICE, AS A REGULATED GOVERNMENT ENTITY SUBJECT TO NUMEROUS FEDERAL LAWS THAT HINDER ITS ABILITY TO MANAGE AND COMPETE, IS AT A NET COMPETITIVE DISADVANTAGE TO ITS PRIVATE-COMPANY COMPETITORS

Our comments will focus on areas where the Postal Service is hampered in its ability to compete by virtue of its status as a governmental entity subject to a variety of federal laws and political pressures that do not apply to private competitors. Those competitors undoubtedly will recite various state and federal laws, such as taxes and parking tickets, that have a quantifiable cost on their businesses (although determining an "imputed" cost to the Postal Service will not be so simple). The constraints on the Postal Service, in contrast, are for the most part less easy to quantify because they are endemic to its entire operations, yet are far more debilitating because they impair the

[5] We recognize, of course, that it is possible for a business to enjoy unfair competitive advantages yet still be unable to compete, perhaps due to inefficient management. In the case of the Postal Service, however, its ability to manage its workforce and operations and services is hampered by federal laws and political constraints that increase its costs and impair its competitiveness relative to private-sector competitors.

Postal Service's ability to manage its workforce and its operations, and result in excessive costs and inefficiencies that undermine its ability to compete.

A. Postal Employee Wages And Benefits

Postal workers are federal employees, and as such, enjoy the benefits of many laws applicable to government workers. Unlike other government employees, however, postal workers can engage in collective bargaining with binding arbitration. As the President's Commission on the United States Postal Service found in its 2003 Report to the President, this unique status places the Postal Service at a significant disadvantage compared to private businesses.

- The Postal Service is required by law to pay retirement benefits pursuant to the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS). Unlike its private competitors, those benefits are beyond the Postal Service's control, dictated by law and not subject to collective bargaining.

- The Postal Service is required under the Federal Employee Retirement System (FERS) to give credit for military service in computing pension benefits. None its competitors are so required, and none do.[6]

- Unlike its private competitors, the Postal Service is required to participate in the federal employee health benefits programs (FEHBP). Moreover, these mandated benefits programs must cover not only current workers but also postal retirees.

- No private company is required by law to provide health benefits for retirees; any such benefits they grant are either voluntary or subject to collective bargaining.

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[6] Although PAEA eliminated the military credit under the CSRS retirement program, that credit still applies under the FERS program.

The President's Commission noted that, at the time of its report, postal clerks and city letter carriers had an average annual wage of more than $42,000, and moreover,

> "Postal workers also enjoy the job security and ample benefits packages that make Federal employment attractive. According to the Postal Service, average annual *total* compensation, including both wages and benefits, for postal clerks and for city letter carriers is nearly $60,000." [7]

As evidence of the attractiveness of this "best of both worlds" compensation package, the President's Commission cited the high backlog of job applicants and low turnover among postal bargaining unit employees:

> "Given this 'best of both worlds' package, it is entirely understandable why so many would be attracted to Postal Service employment. As of July 2001, the Postal Service had a backlog of some 400,000 job applicants and virtually no turnover. In 2002, less than 1.5% of bargaining unit employees resigned before they retired, a 'quit rate' that is lower than the rate for most private firms in America." *Id*.

Significantly, the President's Commission found that "[u]nlike [the Postal Service's] private-sector counterparts, however, total compensation costs are largely outside management's control."

> "Costs for retiree health care and pension plans are skyrocketing for all employers, and the Postal Service has unfunded obligations for retiree health benefits of approximately $48 billion. Yet retiree health care and pension benefits are effectively 'off the table' of collective bargaining." *Id*. at 110.

The Commission elaborated about the high cost of these benefits and the limitations on the Postal Service's ability to control them:

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[7] Report of the President's Commission on the United States Postal Service, July 31, 2003, at 109 (footnotes omitted, emphasis in original).

> "In the arena of benefits, the contrast is even more pronounced. While health care benefits are part of the collective bargaining process, employees have access to the full range of generous plans available to Federal employees. They also contribute only slightly more than half (16.5% of the total premium) of what private-sector workers contribute (about 31.5% of the total premium) and of what other Federal workers pay (about 28% of the total premium) for health care coverage. Retirement benefits are even more generous, rising with inflation (a rare provision among private plans). The Postal Service, like the Federal government overall, permits employees to retire as early as age 55 (under the Civil Service Retirement System, CSRS) and as early as age 57 (under the Federal Employee Retirement System, FERS) with a full pension. And, while fewer private companies today offer retiree health care benefits (and many more are shifting a greater percentage of the costs to recipients), these benefits remain a mainstay at the Postal Service.
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> "In sum, these benefits accounted for just under $20 billion of the $51.5 billion the Postal Service spent on its employees in Fiscal Year 2002—almost $1 out of every $3 the Postal Service spent in that fiscal year." *Id*. at 118 (footnotes omitted).

The President's Commission concluded that the "lack of negotiating authority with respect to these costs would be intolerable to most private-sector companies. They should be brought within the collective bargaining process at the business-oriented Postal Service, as well." *Id*. Congress, however, at the insistence of postal unions, declined to make any meaningful change in the laws relating to postal labor.[8]

B. Accelerated Prefunding of Retiree Health Benefits

As a result of the PAEA, the Postal Service now is required by law to pre-fund its federally-mandated retiree health benefits. Moreover, the pre-funding payment

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[8] Of the President's Commission's many labor-related recommendations, the sole change adopted in the PAEA was to implement a three-day waiting period before eligibility for benefits under workers' compensation. PAEA §901.

amounts are not only fixed by law but also must be paid on an accelerated schedule, with payments in excess of $5 billion each year through the year 2015. PAEA §803.

This schedule of payments is itself an example of the role of politics. As a precondition to acceptance of the PAEA, the administration and budget committees required that the legislation be "revenue neutral" in its impact on the federal budget. Thus, the statutorily-imposed payment amounts and schedule were not based on "business" considerations, but were instead dictated by federal budget considerations.

By contrast, no private company is required by law to provide, much less to pre-fund, retiree health benefits. Indeed, as the President's Commission noted, the recent trend with private companies has been a scaling back of such benefits and a shifting of a greater percentage of the cost to recipients. The Postal Service, by federal law, is barred from making or even negotiating such cost saving changes in retiree health benefits, but instead must pre-fund those benefit costs.

C. The Universal Service Obligation

The Postal Service is mandated by law to provide universal service to every household in the nation six days a week. Private companies can choose the areas they serve and the level of service they provide.

D. Rate Regulation

Although the PAEA gives the Postal Service some latitude to set prices for competitive products, that process is still subject to regulatory oversight by the PRC, a process that is open to competitors like UPS who in the past have been aggressive participants. Moreover, those competitors may be allowed to lodge complaints with the PRC in order to overturn Postal Service rates. Competitors, by contrast, can establish rates that they determine to be in their business interests without any regulatory

constraints. Moreover, they are free to enter into negotiated contract rates with selected customers, without disclosing their terms and rates or even the identities of their contract customers.

There are, of course, public policy rationales for regulatory oversight of Postal Service rates. That, however, does not lessen the fact that the Postal Service, unlike its competitors, must operate in a regulatory "fishbowl" where its competitors can gain insight into what the Postal Service is doing in the marketplace and can use the regulatory process to advocate higher rates either through PRC costing proceedings, annual compliance reviews, or complaint proceedings.[9]

E. Political Constraints on Management of the Workforce and Operations

Perhaps the greatest constraint on the Postal Service is that, as a federal entity, it is a creature of Congress and the political process, pursuant to the authority bestowed on Congress by the Constitution (Article I, Section 8). As a consequence, the entirety of its operations is subject to oversight by Congress, constantly under the political microscope of Washington, an arena in which its workers and competitors take keen interest and have great influence. UPS, FedEx, and the postal unions are among the most organized and powerful interest groups in town, whereas the Postal Service itself is barred by federal law from lobbying on its own behalf. 18 U.S.C. §1913.

A recent example of this political impingement on the Postal Service's operating flexibility is a bill introduced in Congress at the behest of postal unions: S. 1457, the so-

[9] The Postal Service is subject to other constraints that hinder its ability to compete. It is barred from raising capital by issuing stock, the cheapest form of capital generation. And, it is restricted in the compensation it can pay to attract executive talent, capped at a fraction of the compensation and benefits offered to executives by its private-sector competitors. *See* 39 U.S.C. §3686(b)(1), capping USPS compensation at no greater than that of the Vice President of the United States (currently $215,700).

called ‘Mail Delivery Protection Act of 2007,’ which would amend 39 U.S.C. section 5212 to prohibit the Postal Service from contracting out delivery service on any postal route with one or more families per mile – a proscription that encompasses more than 99 percent of all postal routes in the nation. Postal competitors like UPS, by contrast, are free of this kind of legislative involvement in their operational initiatives and relations with their employees.

Even the threat of legislation can have a chilling effect on the Postal Service’s efforts to improve the efficiency of its operations, and has been used by parties in the past to coerce it into modifying or abandoning planned changes. The Mail Delivery Protection Act, cited above, is a good example. At the time S. 1457 was introduced, the Postal Service was negotiating its latest labor contract with its letter carriers’ union, the National Association of Letter Carriers (NALC). As part of the final labor agreement announced on July 12th, the Postal Service agreed to a five-year moratorium on contracting out. This concession, according to the testimony of NALC’s president before a Senate committee, was the direct result of the pending legislation. As reported by Business Mailers Review (July 30, 2007):

> “Young conceded to [Sen.] Carper that it was the threat of legislation mandating an end to contracting out of mail deliveries that prompted the service to accept the ban in the NALC contract. ‘When they perceived that the legislation was viable, we believe things changed in a New York – let me put it – in a Delaware – second,’ the NALC executive told Carper.”

This example illustrates that, unlike its private-sector competitors, even the Postal Service’s collective bargaining with its employees is subject to political influence.

The cost of these political impediments to the Postal Service, although undoubtedly great, is not easily measurable. Indeed, the full impact likely goes beyond

the instances that become public, inhibiting the Postal Service from even pursuing some proposals knowing that its competitors and employee unions have powerful voices on Capitol Hill.

Another area where the political process impedes the Postal Service is that of operational changes. Whenever the Postal Service proposes to eliminate or consolidate operating facilities or even to transfer functions from one to another in the interest of improving its efficiency, the one certainty is that politicians will get involved in the process to curb the potential loss of jobs in their jurisdictions. This political interference was highlighted by the President's Commission on the United States Postal Service:

> "Unfortunately, while the Postal Service has many of the same opportunities as leading corporations to find new efficiencies, it also faces unique political and statutory hurdles. In reality, the Postal Service does not have the latitude to manage its infrastructure based on the needs of the postal network. Instead, the network remains largely unchanged and increasingly inefficient *due to the inertia that results from restrictive statutory requirements as well as political resistance to closing or consolidating postal facilities*." [10]

The Commission concluded that "[t]he Postal Service must be freed from these debilitating political restraints that ill serve all who rely on the institution." *Id*.

To lessen the influence of politics, the President's Commission recommended establishment of a "Postal Network Optimization Commission," modeled after the military Base Realignment and Closure Commission. Although such a commission was proposed in the original Senate version of the Postal Accountability and Enhancement

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[10] Report of the President's Commission at 77-78 (emphasis added).

Act, it was not included in the final law.[11] Thus, the Postal Service remains constrained by political considerations in its efforts to modernize and rationalize its network.

CONCLUSION

Management flexibility is a key to efficiency, and in turn, competitiveness of any company. There is no question that private competitors like UPS and FedEx -- unburdened with many of the federal laws and rules and oversight that constrain the Postal Service's management of its employees and its contracts and its operations – enjoy a huge competitive advantage as a result. Although the Postal Service's disadvantages may not be as easily quantified (in part because they are so pervasive and embedded in the structure of the postal system created by Congress), they impose a far greater impediment on the Postal Service's competitiveness than mere taxes and parking tickets.

As the FTC appears to recognize in its Federal Register notice, the task assigned by Congress requires consideration of both sides of the competitive equation, including not just the Postal Service's advantages but also its disadvantages in competing due to its status as a federal entity. The danger is that the areas of possible advantage, such as parking tickets, may be susceptible to some form of quantification and could lead to the temptation to "impute" them as a non-cost surcharge on competitive postal products; whereas the Postal Service's disadvantages are less quantifiable yet more pervasive and intractable, impairing its ability to control costs and improve efficiency. On the labor

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[11] *See* S. 1285, §§302-306, 108th Cong., 1st Sess., June 18, 2003, at 43-60. The very fact that the proposed military-base-style commission itself involved cumbersome procedures (entailing eighteen pages of legislative language) may have contributed to its being dropped from the final bill.

side, given the recent experiences both in the legislative process that led to enactment of the PAEA and the pending legislation to bar contracting out, it is clear that legislative remedies for the Postal Service's competitive disadvantages are, at best, unlikely.

The worst outcome, and one we submit would be contrary to the public interest, would be to recommend "remedies" to offset the Postal Service's advantages while leaving it shackled with its existing disadvantages.

Respectfully submitted,

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