

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

Rate Adjustment due to Extraordinary or)
Exceptional Circumstances)

Docket No. R2010-4

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
SUGGESTED QUESTIONS TO BE ASKED OF THE POSTAL SERVICE
WITNESS KIEFER DURING PUBLIC HEARING
(August 5, 2010)

Pursuant to Order No. 485 (July 8, 2010), Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") submit the following suggested questions to be asked of Postal Service witness James M. Kiefer during the public hearing on August 12, 2010.

BACKGROUND

The purpose of Mr. Kiefer's testimony was "to sponsor the Postal Service's prices in this docket and to explain the policy reasons for the is the pricing witness for the Postal Service." P. 3, ll. 11-12. The Postal Service's pricing was within a narrow band (except for certain badly underwater products), and fairly could be described as a near across-the-board increase. Price increases for the Postal Service's highly profitable products such as High Density and Saturation Letters received virtually the same as price increases as were given to some badly underwater products such as Standard Flats, and mailers of those highly profitable products, along with other mailers, are asked to pay extremely high cost coverages to help defray and subsidize losses on such underwater products, raising questions as to whether the prices proposed are reasonable or equitable.

QUESTIONS

1. Your testimony states that this “exigent price request is not structured as an across-the-board increase similar to the increased proposed in Docket No. R2005-1.” P. 8, ll. 10-11. The overall increase for market dominant products is 5.6 percent. P. 10, ll. 6-7.
 - a. Would you agree that products receiving an above-average price increase (*e.g.*, Non Flat-Machinables/Parcels at 23.3 percent, Periodicals Outside County at 8.0, Periodicals Within County 8.0 percent, Bound Printed Matter Parcels at 7.0 percent, and Media Mail at 7.0 percent) were given such an increase due to the requirement that each product make a contribution to institutional costs?
 - b. Except for products discussed in preceding part a, would you agree that price increases exist within a narrow band around the 5.6 percent average — generally from 4.4 percent (a -1.2 percent deviation) to 6.1 percent (only a +0.5 percent deviation)? For all these products, would it be fair to describe the Postal Service’s proposal as a near-across-the-board increase?
2. The price increase for Standard Flats is below the 5.6 percent average — 5.1 percent, to be exact. Your testimony states that the Standard Flats product has been “particularly hard hit,” and has “experienced volume declines exceeding 20 percent, driven by reductions in catalog mailings.” P. 28, ll. 21-23.
 - a. In view of the fact that the cost coverage of Standard Flats was less than 100 percent during the years when volume declined by 20 percent, can you please explain whether the Postal Service’s bottom line — *i.e.*, net profit (loss) — has been improved or made worse by the 20 percent decline in volume of this

money-losing product? That is, if the volume of Standard Flats had not declined so much, please explain whether the Postal Service would not have incurred even greater losses.

- b. According to Attachments 9, 10, 11, and 12 to the testimony of Stephen J. Masse, the Postal Service has lost, and is expected to continue losing, hundreds of millions of dollars annually on Standard Flats. For how many more years does the Postal Service propose to continue incurring substantial losses on this product?
 - c. Please discuss the extent to which Postal Service pricing personnel are focused on retention of volume, regardless of profitability, versus focusing on net revenues from a product and the effect of each product on the Postal Service's "bottom line."
 - d. Please explain (1) whether your pricing policy is designed to retain, and perhaps even help increase, the volume of a sizeable money-losing product — such as Standard Flats; (2) whether your pricing is tantamount to a plan for at least one more year to help the Postal Service continue losing still more money on Standard Flats, and (3) why you believe that knowingly and deliberately incurring continued substantial losses is considered reasonable and equitable for the Postal Service, particularly when other mailers are required to pay higher coverages to offset these losses.
3. Your testimony states that the catalog industry, which depends heavily on Standard Mail Flats, is in a "delicate" financial position. P. 29, ll. 16-18. Please refer to the

testimony of Mr. Joseph Corbett and Mr. Stephan J. Masse in this docket and compare the “delicacy” of the catalog industry’s financial position with that of the Postal Service. In particular, discuss whether the Postal Service’s current financial condition is considered to be more delicate, less delicate, or equally delicate than that of the catalog industry.

4. Your testimony states that “Over the long run, the Postal Service sees the catalog industry as a growth segment in its business.” P. 29, ll. 21-23.
 - a. Please define the term “long run” as it is used here.
 - b. Explain whether the catalog industry is considered to be what economists describe as an “infant industry” (*i.e.*, just starting up the learning curve — as opposed to a somewhat mature, sophisticated industry).
 - c. If the catalog industry is considered to be a mature, sophisticated industry — as opposed to an infant industry that perhaps deserves to be nurtured during its early development — then explain why continued subsidization of their postage costs by other mailers is required in order for catalogs to grow into a healthy, robust and, hopefully, profitable customer of the Postal Service.
 - d. Discuss whether previous subsidization of Standard Flats by other mailers has developed in portions of the catalog industry an unhealthy dependency on such subsidy from other mailers and, possibly, a feeling of entitlement.
 - e. Discuss whether continued subsidization of Standard Flats (and catalogs) at the expense of other mailers is likely to promote a dependency and, possibly, a

feeling of entitlement, and explain why a pricing policy that lends itself to such results is reasonable and equitable.

- f. To the extent that prices are designed to send proper signals to the market to promote the efficient use of resources such as the decision to send a letter-shaped or flat-shaped catalog, do you consider the prices you have proposed for Standard Flats to send accurate signals?
5. Your testimony states that “The Postal Service may have to adjust Standard Mail Flats prices at above average rates at some point, but *now is not the time.*” P. 30, ll. 15-17 (emphasis original).
 - a. If now is not the time, explain how the Postal Service thinks it will know when that time comes. That is, what facts or milestones — in terms of volume of catalogs mailed, postage paid, profitability of Standard Flats, profitability of catalog mailers, insolvency of the Postal Service, or whatever — will indicate when the time has arrived to give Standard Flats a rate increase that (1) is above the average, and (2) even more importantly, is above attributable cost?
 - b. What kind of information does the Postal Service plan to gather in order to ascertain when is the time for Standard Flats to receive a price adjustment that is above average?
 6. a. In setting rates, was it your understanding that PAEA (*e.g.*, 39 U.S.C. section 101(d) which states “Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis”) required

prices for each product to cover not only its costs, but also make a fair and equitable contribution to institutional costs?

- b. If not, do you believe PAEA allows the Postal Service to offer underwater products? Do you believe that other parts of PAEA encourage the Postal Service to offer underwater products?
- c. How do the rates you have proposed for Standard Flats measure up to your understanding of this statutory mandate?

7. According to CRA Reports:

- in **FY 2008** the Postal Service **lost \$237 million** on Standard Flats, and
- in **FY 2009** the Postal Service **lost \$622 million** on Standard Flats.

Witness Masse estimates that the Postal Service:

- **will lose another \$418 million** on Standard Flats in **FY 2010** (Masse Testimony, Attachment 9); and
- **will lose another \$312 million** on Standard Flats in **FY 2011** (Massey Testimony, Attachment 10) (based on January 2 implementation of the rates you propose).

Therefore, over those four years FY 2008-11, **the cumulative loss to the Postal Service from Standard Flats is almost \$1.6 billion** (\$1.589 billion, to be exact).

- a. Do you consider \$1.6 billion to be a very large amount of money?
- b. Of the private sector businesses with which you are familiar, how many are willing to lose \$1.6 billion on one product over a four year period in order to nurture other businesses which purchase that product?
- c. Please explain what plan the Postal Service has for recouping these prior \$1.6 billion of losses from Standard Flats. In other words, does the Postal Service

plan to impose (or foresee) particularly high-coverage rates on Standard Flats in the future to recoup the losses incurred by this product in the past.

- d. With respect to this \$1.6 billion loss on Standard Flats, would you agree that:
 - i. It represents a cross-subsidy from other products that pay more than their attributable costs? and
 - ii. Without this loss, the price charged for one or more of those other profitable products might have been reduced?
- e. If the Postal Service has no plan for recouping either prior or continuing losses on Standard Flats, please indicate whether some or all other mailers will need to have paid disproportionate high rates to offset losses on this product, and explain why it is equitable and reasonable for those other mailers to pay for losses incurred on Standard Flats.
- f. After the cost coverage on Standard Flats exceeds 100 percent, please (1) estimate the number of years that will be required in order to recoup the \$1.6 billion of prior losses from Standard Flats, and (2) discuss the reasonableness of such recoupment period.
- g. Does the Postal Service have \$1.6 billion to spare right now? Stated alternately, if the Postal Service had reduced or eliminated some of that \$1.6 billion of losses on Standard Flats, would its financial position not be improved right now?

sector of the economy engaged in the delivery of mail matter other than letters....”) as

the only reason for low increases for Standard Flats, stating that:

Although Standard Flats ... failed to covers its costs, the Postal Service believes that the catalog industry ... is in an especially vulnerable time right now.... **For this reason**, Flats were given an average increase in this price adjustment. (Factor 3). [Page 61 (emphasis added).]

- a. For a product that is underwater — *i.e.*, whose revenue does not cover attributable cost — please explain why Factor 3, the effect of rate increases on mailers, by itself, constitutes a sufficient and reasonable justification for a rate increase of only 5.1 percent, significantly below the average 5.6 percent increase for all Market Dominant products.
- b. Please discuss all consideration that was given to Factor 2 (39 U.S.C. section 3622(c)(2)), which is the one factor in PAEA that is stated in the law as a **requirement**, but which is not even explicitly mentioned in the justification provided in your testimony, and explain why you believe your rates can be considered reasonable and equitable without any discussion of Factor 2.
- c. Please explain fully all reasons why Factor 2 does not indicate a rate increase for Standard Flats that, at minimum, is substantially above the average for all market dominant products?
- d. Please discuss all reasons why Factor 2 seemingly is totally trumped by Factor 3.
- e. When proposing a price adjustment for Standard Flats that is well below unit attributable cost, please explain all consideration given to Objective number 5,

((39 U.S.C., Section 3622 (b)(5) “to assure adequate revenues, including retained earnings, to maintain financial stability [of the Postal Service]”).

- f. Discuss all reasons why Factor 3 seemingly has trumped Objective Number 5, and explain why it is reasonable and equitable to omit discussion of Objective 5.
 - g. For an underwater product such as Standard Flats, please discuss whether it would be reasonable to expect that Objective Number 5, considered alone, would indicate a rate adjustment that is substantially above the average for all market dominant products.
 - h. In your opinion, is the financial health of the catalog industry is more important than financial health of the Postal Service?
10. On July 26, the Affordable Mail Alliance filed with the Commission a Motion to dismiss the Postal Service’ pending request for an exigent rate adjustment. In that motion, the Affordable Mail Alliance argues vigorously that the Postal Service has been much too lax and un-aggressive in taking actions within its purview to reduce its losses and restore profitability.
- a. Please explain whether you believe the Postal Service should have been — and should now be — more aggressive in cutting losses on money-losing products (such as Standard Flats) by raising rates and trying to restore profitability. If not, why under existing circumstances is that a reasonable policy?
 - b. Please explain all reasons why losses on Standard Flats should not be eliminated more rapidly to help the Postal Service return to profitability as rapidly as possible.

11. The Postal Service's treatment of the IMb discount is discussed in your response to Question No. 3 of POIR No. 2. What has not been discussed, either there or in any of the references cited in that question, is whether mailer participation in the IMb program, either at the levels attained in March or at projected levels, will provide the PRC, the Postal Service, and mailers with a sample of adequate size and diversity to provide a **reliable** database from which meaningful conclusions can be drawn with respect to performance. The purpose of the following questions is to develop on the record information pertinent to ascertaining whether the existing discount is reasonably likely to achieve the goal of a **reliable** performance database — *i.e.*, viewed in that light, is the existing discount reasonable?
- a. Please confirm that one purpose of the IMb discount is to encourage mailer use of the IMb sufficient to provide a database of size and diversity that is statistically **reliable**, and thereby avoid the necessity and cost of developing an alternate performance measurement system to satisfy the requirement in PAEA for performance measurement. If not confirmed, please explain the purpose of the IMb discount.
 - b. Based on the number of mailers and the volume of mail using IMb in March, and assuming that usage continues at that level (*i.e.*, without further growth), please discuss whether the resulting data base will be sufficient to provide statistically **reliable** estimates of performance for each reportable item specified in Commission Order No. 465.

- c. To the extent that the number of mailers and usage of IMb achieved last March will not be sufficient to provide statistically **reliable** estimates of performance for each reportable item specified in Commission Order No. 465, please discuss the extent to which the number of mailers and volume of mail using IMb will need to be increased in order to reach that goal, how long a time is envisioned, and whether the existing discount is likely to provide adequate incentive to reach that goal.
12. When establishing rates, were you given a specific increase in revenue to achieve?

Respectfully submitted,

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