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

Rate Adjustment Due To Extraordinary Or Exceptional Circumstances : **Docket No. R2010-4**

REPLY COMMENTS OF THE SATURATION MAILERS COALITION AND VALASSIS DIRECT MAIL, INC.

(September 2, 2010)

The Saturation Mailers Coalition and Valassis Direct Mail, Inc. hereby submit their reply comments on the Postal Service's request pursuant to section 3622(d)(1)(E) of the Postal Accountability and Enhancement Act (PAEA) for rate adjustments due to "extraordinary or exceptional circumstances," filed with the Commission on July 6, 2010.

In summarizing the decisional alternatives raised by various parties and available to the Commission, our core position is two-fold. First, we believe the Postal Service's exigency proposal should be denied and that the Commission must advise Congress to make the necessary reforms to remove the number-one cause of the Postal Service's negative financials. This is not the time to be raising rates. Second, in the event the Commission finds that "extraordinary or exceptional circumstances" exist, the proposed rate increases for high-contribution, highly price-sensitive saturation mail should be substantially reduced or eliminated for the reasons set forth in our initial comments.

I. THE COMMISSION SHOULD DENY THE POSTAL SERVICE'S PROPOSAL FOR AN EXIGENT RATE INCREASE AND INSTEAD RECOMMEND TO CONGRESS THAT IT MAKE THE NECESSARY MODIFICATIONS TO SAVE THE POSTAL SERVICE.

The great majority of commenters oppose the exigency rate increase. We concur with the Affordable Mail Alliance and others that the Postal Service has not satisfied the “extraordinary or exceptional circumstances” test. On that ground alone, the Postal Service’s request should be denied.

Although they are neither extraordinary nor exceptional, the conditions facing the Postal Service are very difficult – clearly exacerbated by the current national economic downturn but nevertheless foreseen for many years. The greatest impediment to financial viability, however, is the onerous retiree health prefunding obligation imposed by the PAEA. The exigent increase is simply a short-term bandaid that will not solve that longer-term legislatively-imposed financial problem. Thus, the Commission should deny the exigent increase as neither lawful nor useful. As discussed in our initial comments, the increase is actually harmful as it will scare away more of the mail market and worsen the Postal Service’s financial position.

Instead, the Commission should report this dire situation to Congress and recommend that it take action to correct the longer-term conditions that are hindering postal viability. The most important of those recommendations should involve correction of the estimates for postal retiree obligations, including the CSRS and FERS pension obligations and relief from the excessive retiree health care prefunding payments required by the PAEA.

II. IF THE COMMISSION DETERMINES THAT EXIGENT CIRCUMSTANCES EXIST, IT SHOULD MODIFY THE POSTAL SERVICE’S PROPOSAL BY SUBSTANTIALLY REDUCING OR ELIMINATING THE PROPOSED RATE INCREASES FOR SATURATION MAIL.

If the Commission nevertheless finds that the extraordinary or exceptional circumstances test has been met, the Commission must still determine the extent to which the proposed rate adjustments should be allowed in accordance with the statutory requirement that:

> "such adjustment is *reasonable and equitable and necessary* to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." PAEA §3622(d)(1)(E) (emphasis added).

In making that determination, the Commission clearly has authority to modify the proposed rates either by moderating the overall rate levels or by adjusting rates for specific products.

A. The Commission Should Mitigate The Overall Increase In Whole Or Part Based On (1) The Precarious State Of The Economy And (2) Congressional Action On Pension And/Or Retiree Health Obligations.

Several parties have cited reasons why the overall increase sought by the Postal Service is excessive. Indeed, the very grounds cited by the Postal Service in support of "extraordinary or exceptional circumstances" – namely, the effects of the recession on mail volume – underscore why an exigency increase of the proposed magnitude would be largely self-defeating and harmful to the mailing community and the public.

At the core of this recession, as described in our initial comments, is a severe cutback in consumer spending that has hit hardest in sectors like retail and service providers that are the mainstay of important postal product categories, particularly saturation mail. The grim economic news is not getting better and there is no expectation of improvement anytime soon. Advertisers cannot or will not accept increases in their advertising budgets, and are actively pursuing non-postal alternatives. Saturation mailers must do likewise, either by cutting mailing geography and frequency or by shifting to non-postal alternatives as described in our initial comments.

A rate increase at this critical time would be counterproductive. The Postal Service's volume and net revenue forecasts, based on its historic demand models, do not adequately take into account the severity of current marketplace conditions. The Postal Service has attempted to evade this obvious problem by contending that its proposed increases are similar in magnitude to past "moderate" increases, and that its demand models should therefore be considered reliable. Tr. 3/469-70 (Kiefer). That is a *non sequitur*. While a 5-percent rate increase in economic boom-times may be manageable, that same magnitude of increase in the current depressed and fragile marketplace can be a disaster for mailers and cause a far greater reduction in mail volumes.

Indeed, in the current economic environment, the Postal Service would likely generate nearly the same net contribution with increases only half the magnitude it seeks, or with no increase at all, by focusing its efforts on retaining existing mail volumes and market share. This would avoid the graver danger of the proposed increases where much of the volume loss would come from permanent shifts to non-postal alternatives – ones that will harm the Postal Service's longer-term efforts to remain viable.

Another factor that will affect the amount of revenues needed is Congressional action on proposals to mitigate the Postal Service's required payment to the Treasury for retiree health obligations, currently due on September 30th. Congress is well aware of the funding issues and is actively considering legislative remedies. The Commission will likely know the extent of any Congressional action prior to the time that it must issue its decision in this proceeding. Any such relief should be factored into the Commission's determination of whether and to what extent the exigency increase is "necessary" under the provisions of the statute.

B. The Commission Should Modify The Increases For Specific Products Based On Market Circumstances, Particularly For The High-Margin, Highly-Price-Sensitive Saturation Mail Product.

A number of parties, ourselves included, have urged the Commission to modify the proposed exigency rates for specific products. In the past, we have generally urged the Commission to give deference to the Postal Service's pricing determinations, based on the statutory policy in the PAEA of affording pricing flexibility. Thus, in the context of rate-cap price adjustments where the Postal Service has affirmatively exercised its pricing discretion, the Commission should (and generally has) given the Postal Service's choices deference.

Here, however, the Postal Service has not exercised its pricing discretion in a manner consistent with the policies of the statute nor consistent with maximizing financial contribution. USPS witness Corbett, for example, stated that a core element of the Postal Service's long-term pricing strategy is to give greater weight to demand factors in setting prices. Tr. 1/73. This is entirely appropriate, given the Postal Service's poor financial condition. Yet astonishingly, Corbett conceded that it *has not done so* in this exigency filing. Instead, it has proposed essentially an across-the-board increase for all products regardless of demand factors,[1] as revealed in his responses to questions from Chairman Goldway (Tr. 1/74-75).

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1 The principal exceptions were for products that currently do not cover their attributable costs.

> CHAIRMAN GOLDWAY: Okay, so could you explain how this exigency proposal, the exigency rate proposal that you've submitted, which is close to an across the board rate increase for most products, how that elevates the role of demand factors in pricing?
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> THE WITNESS: The exigent price increase in and of itself does not go to where we'd like to be in terms of being able to use demand. As you said it's more uniform and less focused except for those products which were under the cost coverages which we attempted to bring up to or above cost coverage in every case where we could. But other than that in terms of a demand based pricing it's not apparent in the exigent price increase.

In essence, the Postal Service appears to have based its pricing on a factor not in the statute – namely, the political desire not to unduly upset any groups of mailers by treating them alike, despite the clear demand and market differences between products. Consequently, the Commission should in this instance scrutinize the Postal Service's proposed rates more critically to ensure conformance with the policies of the statute and improvement in the Postal Service's longer-term financial condition.

In our initial comments, we explained why the proposed rate increases for saturation mail should be substantially reduced or eliminated because of its high price-sensitivity that is particularly acute in the current precarious economy.[2] Valpak concurs,

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[2] While every high-contribution product can argue that the Postal Service is hurt if it switches to other media, the loss of saturation program mailers from the system is particularly harmful. When a saturation program mailer leaves to up its own private delivery network, it not only takes margin from the Postal Service but also begins to compete with the Postal Service for distribution of hard copy. The mailer statements in the appendix to our Initial Comments highlight this risk. Many saturation mailers already use private delivery for portions of their distribution, and others are taking active steps to explore and set up or expand private delivery networks. Thus, the Postal Service faces the double danger that its excessively high rates will result in lost contribution and the impetus to create new, lower-cost private carriers that will compete with the Postal Service for the delivery of saturation advertising mail.

and proposes that the Commission make offsetting rate adjustments among products.[3] The Commission, of course, has authority to make either type of adjustment. We do not take a position as to the type of adjustments that should be made, so long as the rate increases for saturation mail are reduced or eliminated.

III. MITIGATION OF THE GENERAL RATES FOR SATURATION AND HIGH DENSITY MAIL IS A MORE PRODUCTIVE MEANS TO RETAIN AND GROW VOLUME THAN THE NARROW PROPOSED INCENTIVE PROGRAM.

In general, we support Postal Service initiatives to generate new volumes through incentive programs.[4] However, as explained in our initial comments, the proposed "Saturation and High Density Incentive Program" – with a 5.5% baseline growth threshold – will not be meaningful in the current uncertain economy, particularly if accompanied by an exigency rate increase.

Valpak argues that the better approach would be to "moderate rates for all High Density and Saturation products." Valpak Initial Comments at 38. While we disagree with some of Valpak's rationale and do not oppose the incentive proposal, in the current economic climate we concur with Valpak that the saturation mail industry – and the Postal Service – would be better served by a reduction in the general rates than by this

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[3] Valpak Initial Comments at 39-44. In its discussion at page 28, Valpak cited a colloquy between Chairman Goldway and witness Corbett (Tr. 77-78):

CHAIRMAN GOLDWAY: You are concerned with any loss of volume.

THE WITNESS: Any loss of volume.

CHAIRMAN GOLDWAY: Regardless of whether it's profitable or unprofitable?

THE WITNESS: …I thought the question you asked was, which once [sic] concerns you more? And given the situation we're in today, from a financial perspective loss of profitable volume concerns us more than loss of nonprofitable volume.

CHAIRMAN GOLDWAY: But the pricing you submitted doesn't really address that.

THE WITNESS: Right.

[4] See, for example, our joint comments in Docket RM2010-9 (July 16, 2010) concerning the Postal Service's need for flexibility in designing and implementing pricing incentive programs and negotiated service agreements.

too-narrowly-crafted incentive program. At a minimum, holding saturation rates at current levels or even reducing them will far more effectively incentivize mailers to maintain and grow their mail volumes in these extremely difficult economic times. Compared to other products, retention and growth of saturation mail is particularly beneficial because saturation program mailers commit themselves to long-term high-frequency mailings that provide a relatively-permanent high contribution to the Postal Service, yet which have viable non-postal alternatives if the price is not right.

Respectfully submitted,

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