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

Rate Adjustment due to Extraordinary or Exceptional Circumstance — **Docket No. R2010-4**

Reply Comments of the American Catalog Mailers Association (ACMA)
(September 2, 2010)

Pursuant to Commission Order No. 485 (July 8, 2010), inviting reply comments by September 2, ACMA is pleased to submit these comments. We view the matters at issue as quite important to our members and to the nation as a whole.

In their initial comments (August 17), two parties, Valpak and MOAA, argue that, if an exigent increase is recommended, a substantial increase for Regular Standard Flats should be considered. Since Valpak's comments are more extensive by far, we focus primarily on them. The issues, however, apply to both Valpak and MOAA. In addition to these comments, we also support the comments of the Users of Flat-Shaped Mail and of the Affordable Mail Alliance, also filed today.

Regarding the Rates for Flats, the Initial Comments of Valpak Are Misleading and Provide Little Help to a Reader Who Wishes to Understand the Situation Being Faced. Also, They Are Oblivious to Other Factors, Such as Fundamental Questions Concerning the Validity of the Reported Costs.

Much of Valpak's 45 pages concerns the gap between the projected costs and revenues for (Regular Standard) Flats in FY 2011, which, as estimated by Postal

Service witness Masse, is $310 million. Valpak uses the terms “loss” or “lose” or “underwater” more than 100 times. The reader is left with the impression that a rate-fix of this imbalance would improve the Postal Service’s net income position by that amount, and thus that Flats bear significant responsibility for the Postal Service’s deficit.

As we explain, Valpak’s assessment does not recognize the context within which any rate realignment would occur. Also, the benefits it sees are dependent on a string of blindly-applied assumptions, the worst of which is that the cost calculations are reliable. In short:

> a) If the costs and elasticities of record are valid, fixing the imbalance would not net the Postal Service more than a small fraction of $310 million.
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> b) Given this, one cannot say that Flats are responsible for a significant part of the deficit. Besides, responsibility for portions of residuals cannot be assigned — the mathematics break down.[1]
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> c) But there is ample reason for believing that the costs and maybe the elasticities are invalid, thus providing no support for a rate realignment. Other problems exist as well.
>
> d) Valpak seems driven by a reaching interpretation of § 3622(c)(2). This interpretation is questionable.

Together, Valpak’s position does not justify a disruptive rate realignment. Rather, it raises questions that need to be addressed. Furthermore, if the losses caused by Nonprofit Flats are not charged to Commercial Flats, and if Congress fixes the

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1 Consider this example: Suppose the net income of General Motors is negative $100 million. Suppose further that estimates show loses on the Chevrolet Cobalt of $700 million. How much of the $100-million is caused by the $700-million? It doesn’t compute. Similarly, losses can exist when net income is positive. Should GM exit the Cobalt business? No, unless GM were able to pull out costs greater than the total revenues associated with building and marketing Chevy Cobalts. Closing down Cobalt production is not the way, in and of itself, to improve GM profitability. Given that large-scale increases to catalog rates is the USPS equivalent of shutting down the Chevy Cobalt business, the circumstances make significant changes to catalog economics ill advised.

health benefit problem[2] (which Valpak supports strongly), the imbalance in Valpak's crosshairs turns into a surplus, and the problem goes away.

Fixing the Imbalance on Which Valpak Focuses Would Not Net $310 Million. Within the framework of a price cap or any average increase, fixing an imbalance in one product involves increasing the price of that product and decreasing the price of at least one other product. Estimating the effects of a candidate adjustment is a complex assignment.

Specifically, estimating the effects of a candidate adjustment would call for valid costs, elasticities, and cross-elasticities, for each product in the fix. The sizes of the volume adjustments, positive and negative, would depend on the interplay of the elasticities. Some costs would increase and some would decrease – probably. We agree that under Valpak's presumption that the costs and elasticities of record are valid, the end result of a realignment might be an increase in net income, but the magnitude of this increase would be no more than a fraction of $310 million. The particular figure would be the sum of the ensuing revenue and cost changes. Valpak provides no analysis of such changes.[3]

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[2] *See* Response of the United States Postal Service to Oral Request at the Hearing on August 12, 2010 (Kiefer), August 19, 2010, pdf p. 23. The Postal Service explains that fixing the healthcare problem, along with the proposed increase of 5.1 percent, would improve the coverage of flats to 98 percent. And, as explained further on in our reply comments, the presence of Nonprofit represents a drag on the cost coverage of Flats of 7 percentage points or more.

[3] On page 43, extending onto page 44, Valpak does present a scenario involving rate increases of zero percent (instead of the USPS proposed 4.8 percent and 4.4 percent, respectively) for both saturation products (1—High Density and Saturation Letters, and 2—High Density and Saturation Flats and Parcels) and 8.9 percent (instead of the USPS proposed 5.1 percent) for Regular Standard Flats (Commercial and Nonprofit). It indicates that the zero percent

But the problems do not end here. The costs used in assessing a price realignment of this kind must reflect true marginal costs. That is, they must quantify how costs do, in fact, behave in the face of volume changes, which is to say that they must be causal. If the marginal cost is $0.20, then a volume change of 100 will cause a cost change of $20.[4] In postal costing, if done right, the unit volume variable cost can be taken to be an estimate of the marginal cost. But if, say, the unit volume variable cost is $0.30 and the true marginal cost is $0.20, then any estimate obtained using the unit volume variable cost will be wrong. That is, the system *does* have a behavior, and the $0.30 *does not* tell us what it is.

As we explain further below, serious questions exist in this case whether the unit volume variable costs[5] of record are valid estimates of marginal costs. If they are not and are instead nothing more than the result of an unjustified

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change would result in an increase of 169 million pieces for the saturation products, *relative to the USPS proposal*. This volume increase comes by subtracting two after-rates volumes from two before-rates volumes, directly from the statement of witness Masse. Masse shows a corresponding loss in contribution of $78 million. Then Valpak says its increase of 8.9 percent for Standard Flats (instead of the USPS proposed 5.1 percent) "would increase net contribution [presumably of Flats *relative to the Postal Service proposal*] by an extra $79 million," presumably making up the loss of $78 million, and "would cause the loss of only **96 million** Standard Flats." No derivation of the 96 million is provided. Masse shows a volume loss of 54.778 million pieces at the USPS proposed rate increase of 5.1 percent. It is possible that Valpak has ratioed up the loss of 54.778 million pieces by 8.9/5.1, and thereby neglected the nonlinearity in constant-elasticity demand relationships. However, the volume increase of 169 million is *relative to the Postal Service proposal,* and the ratioed-up 96 million would be *relative to no increase, not relative to the Postal Service proposal*. Moreover, it appears that the entire scenario is intended to be contribution neutral to the Postal Service. The inconsistencies here are baffling.

4 This example assumes a horizontal marginal cost curve. This assumption is normally made, particularly for small to moderate volume changes.

5 In some cases, both unit volume variable and unit attributable costs are available, and there is sometimes a difference between them. To the extent that the former is an estimate of marginal cost and the latter is not, the latter is irrelevant for analysis purposes. More specifically, it would not help estimate the effects of price and volume changes, and it would not relate to the welfare of the Postal Service, mailers, or citizens.

allocation scheme, then they are not estimates of the appropriate concept and are meaningless for analysis purposes, including for all notions of economic efficiency. Basically, they defy interpretation.

Another problem is that questions have been raised about the applicability of the elasticity estimates. Not only do we not generally have even crude cross-elasticity estimates, but also the own-price elasticities are often for aggregates that include more than the product in question. In addition, more questions than usual are being asked about whether the preferences and associated behaviors of the past can be projected forward, meaning that our elasticities may not be good predictors. Finally, the business model of cataloging is such that 12-18twelve to month elasticities do not appropriately account for expected volume changes that occur in 36+ months following any catalog rate change, and that these elasticities may not work “backward,” as the volume is not likely to come back.[6]

These problems make Valpak’s prescriptions speculative at best, and far from informative at worst. The latter is more likely. Valpak mentions none of these concerns, and does not identify any assumptions made or implied; it just marches on anyhow.

Serious Questions Exist about the Validity of the Costs Available. These Questions Go to the Theoretical Foundations of Costing Measurement. At the time of Postal Reorganization in 1970, it was recognized widely (including in consultants’ reports) that the old Cost Ascertainment System

[6] Initial Comments of ACMA at 16.

(commonly the CAS) was endemically flawed and did not provide costs that were relevant to the kinds of analyses needed, including attention to notions of economic efficiency and welfare. For good reason, then, the costing people were allowed to begin with a proverbial clean slate.[7]

Over a period of time, supported by theoretical but practical consultation services (and testimony),[8] the Postal Service (with help from the Commission and the crucible of adversary proceedings) built a costing system aimed at developing estimates of *marginal costs*. That it was so aimed was confirmed in 1999 by a comprehensive Data Quality Study,[9] requested by the House Committee on Government Reform, Subcommittee on the Postal Service.

To estimate anything, some general agreement as to what is to be estimated is required. To estimate postal costs in a similar fashion, one must have guidance on what is to be estimated. If there is no guidance, it will be impossible to interpret the costs and they will be meaningless. In regard to the postal costing assignment, all principled and knowledgeable costing practitioners agreed that the process would focus on providing an estimate of marginal costs.

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7 To carry out this assignment, the Postal Service established what was known as the Incremental Cost Task Force. At the time, the term "incremental costs" was usually taken to refer to the effects of reasonably small volume changes.

8 We say "practical" because a key consultant was William Vickrey, one of the few theorists who has been willing to discuss in detail how actual operations align with his prescriptions. Some of these discussions were contained in testimony and extensive cross-examination in the early dockets. For persons interested in appropriate costing, these dockets make some of the more interesting reading in postal history. See various testimony and writing of William Vickrey, subsequently president of the American Economic Association and Nobel Prize winner, and later of William Baumol and John Panzar (who, from a base of unchanged principles, has now testified (or done work) for the Postal Service, the Postal Rate (now Regulatory) Commission, the Office of the Inspector General, and certain interested mailer parties). *See especially* Direct Testimony of John C. Panzar, USPS-T11, Docket No. R97-1.

9 Data Quality Study, Linx, Div. of A. T. Kearney Inc., April 16, 1999, chief investigators Paul R. Kleindorfer, Michael A. Crew, and Donald B. Rubin.

Without prejudice to intentions of the costing process, we would like to back up and discuss the basics, with an example that is central to the methods being used. Although the details are complex, the situations difficult, and the techniques varied, the fundamentals can be discussed rather simply. Suppose there are only two categories of mail: letters and flats. Further suppose that, when done efficiently, it takes twice as long to process a flat as it does a letter. And suppose that the *mix* of mail going through an operation, viewed as a cost pool, is 50 percent letters and 50 percent flats. We can discuss this situation as though time were equal to dollars, because it is.

Let's assume, based on knowledge or analysis, we know that if the volume is increased 10 percent, keeping the same 50 percent mix, the amount of time and dollars in the cost pool will increase 10 percent. In this case, we know that the costs in this pool are 100 percent volume variable, in postal parlance. Under these conditions, the costs in the pool can be allocated to the categories (letters and flats) using IOCS tallies, and the resulting unit costs will be the marginal costs of the letters and the flats. Of course, if the same letters and flats go through other pools as well, the marginal costs of these other pools must be added in.

If 100 IOCS tallies are taken randomly in the pool under these conditions (a 50-percent mix and a flat taking twice as long to process as a letter), one-third of the tallies (except for sampling error) will be for letters and two-thirds will be for flats. The unit volume variable cost of flats is equal to two-thirds of the cost of the pool divided by the volume of flats. A similar calculation is made for letters. In this example, the unit volume variable cost for letters will be one-half that of flats. These costs will be estimates of marginal costs. They are often referred to just as "unit costs."

If one additional flat (increasing the proportion of flats to something just over 50 percent) is processed by the pool, the increase in the cost of the pool will be equal to the unit cost of flats. That is, if the unit cost of flats is 10 cents, and one additional flat is processed by the pool, the cost of the pool will increase by 10 cents. If 10 additional flats are processed by the pool, the cost of the pool will increase by $1. The same would hold true for letters.

Although more complex to discuss, these results apply for all mixes, 60 percent flats, 80 percent flats, or some other. Thus, if a pool in one facility processes 30 percent flats and a corresponding pool in another facility processes 55 percent flats, or if the proportions change from month to month or year to year, *ceteris paribus*, the same unit cost for flats is obtained. Also, these results apply if some flats take more time to process than others, and if near-identical pieces in a pool are part of two different products. Because some flats in a product may be different from others, it is common to refer to these unit costs as "average" unit costs, meaning that we have averaged across the varied flats in the product, not that we have averaged over time or over volume.

The important fundamental here is that this procedure will yield estimates of marginal costs only if it is true that the costs in the pool are 100 percent variable with volume. The truth of this may be difficult to know. Various techniques may be used to learn or to test the volume variability of the pool. And note that adjustments can be made if it is learned that the pool is less than 100 percent volume variable.[10] For example, if it is learned through econometrics or in some other way that a 10 percent volume increase (mix unchanged) tends to cause an 8 percent increase in the cost of the pool, it would be said that the costs of the pool are 80 percent volume variable. In this case, 80 percent of the cost of the pool would be allocated with IOCS tallies,[11] and the resulting unit costs would remain valid and proper estimates of marginal costs. That the pool is 80-percent variable is a behavioral characteristic of the pool. It relates to the way it functions. It is not out of order to think of the productive operation behind the costs in the pool as being a mechanism with a behavior.

We go into these costing matters in some detail because they have become critical in the instant docket. If the costs in a pool are not 100 percent volume variable, or if they do not have some other level of volume variability that is recognized in the analysis, such as distributing 80 percent of the costs in the pool as in the above example, then the costing results obtained by proceeding anyhow with a rote allocation process are not estimates of marginal costs and are meaningless for nearly all purposes. Particularly, they are meaningless for all

[10] In order to be complete, we note that the costs in a pool can be more than 100 percent volume variable, as would be the case if a 10 percent volume increase (mix unchanged) tends to cause, say, a 12 percent increase in the cost of the pool. A situation like this is generally referred to as involving *diseconomies* of scale. It could also involve the use of overtime. It is generally considered to be uncommon.

[11] Fixed costs are residual. If 80 percent of the costs are volume variable, then it could be said that 20 percent of the costs are fixed. But such statements can be misleading, because it is not necessarily possible to point to some component of the costs in the pool and explain that it is fixed. Rather, what is important is that the *behavior* of the costs in the pool is such that the costs are 80 percent volume variable. On this point, it is interesting to think about a situation where the costs are – say 110 percent variable with volume. The fixed costs would be negative. Looking for a component of costs that is negative is mind boggling.

financial analyses, because they cannot be used to provide estimates of cost changes *caused by* volume changes.

Note the relation of this matter to the issue of excess capacity. When excess capacity exists, it generally means not only that the costs are too high, but also that the volume variability of the costs may be very low – perhaps zero. If a pool of costs has excess capacity, wherein workers may not be fully employed or are working slowly, it is generally the case that if there is an increase in volume, the additional volume will be handled with no increase in costs. As a result, the volume variability would be zero, not 100 percent. A variability of zero means a marginal cost of zero. Throughout the instant docket, numerous parties, including the Postal Service, have presented discussions to the effect that excess capacity exists. This raises the serious issue that the costs resulting from the existing costing systems are not marginal and are not at an appropriate level.

A response from the Postal Service itself should suffice to indicate the problems. In response to POIR No. 5, Question 8, August 25, 2010, pdf p. 12-16, Kiefer sets out to provide an explanation for recent large increases in the unit delivery costs of flats. He focuses primarily on the in-office work of city carriers, the costs of which are a pool allocated according to the proportions of IOCS tallies, very much in line with the discussion of basic costing theory we provide above. Kiefer says that two factors help to account for the large cost increase.

a) Kiefer says that casing time has increased because "cased volume is falling faster than workhours" (pdf p. 12).

Because these costs are presumed in the costing systems to be 100 percent volume variable, the direct implication of this statement is that the assumption needed for the costing systems to provide meaningful results is not met. That is, the costs obtained from the systems are not marginal, in addition to being incurred efficiently. This makes them useless for rate purposes.

b) Kiefer says: "This implies a fall in casing productivity" (*Id*.).

In other words, the mailer is being told: We are sorry about your rates; our carriers have slowed down. This should not be a basis for a disruptive rate adjustment.

The question of costs being too high (inefficiently incurred due to low casing productivity) can be separated from whether they are 100 percent volume variable. If a 10 percent increase in volume does cause a 10 percent increase in cost, all at a low productivity, then the costs can be marginal but too high. However, in cases like these, the usual situation is that a 10 percent increase in volume would be absorbed without *any* increase in cost – by carriers working faster – so that the marginal cost is actually zero. Again, the costs that result from proceeding with an allocation scheme anyhow are useless for rate purposes.

c) Kiefer says that “a mail mix change has occurred” so that “carriers are spending a larger percentage of their time casing flats.”

He says “[t]his also increases the unit casing costs for … flats” (pdf p. 13). However, as we explained above, if the operation is functioning properly and the costing is done correctly, an increase in the proportion of flats will not cause an increase in the marginal cost of flats. If the conditions necessary for the costing results to be valid are met, such an increase in the unit costs of flats will not occur. The implication is that the costs are inappropriate. They should not be used.

These issues go to the foundations of measurement in costing. They are strongly related to issues of excess capacity and to questions of automation refuges (as raised by Time Warner throughout the past decade). In response to a question to Kiefer from the bench, the Postal Service said: “Going forward, as excess capacity is squeezed out, there should be some offsetting reductions in unit costs.” Response to Oral Request at Hearing on August 12, filed August 19, 2010, pdf p. 14. These issues are not addressed by Valpak. The costs of record do not provide a basis for disruptive rate adjustments.[12]

It is reasonable to ask what should be done. In their August 17 comments, the Users of Flat-Shaped Mail indicate that the Postal Service is completing “a Lean Six Sigma value stream map for Periodicals” (p. 17). A similar process might be helpful for Regular Flats. Another possibility, not instead of any Six-

[12] We might point out that an increase of five or more times the rate of inflation in a major cost center would be considered disruptive by most businesses.

Sigma program, would be to build "should cost" models of flats processing. Such models would identify the steps needed for flats and sum up the costs that each step should have. Where actual costs differ, an inquiry could be undertaken to try to get a handle on the reason for the difference. We do not know all of the answers. It does seem clear, however, that it would be better to ride things out and hope that operations tighten than to forge forward with disruptive rate changes. This is particularly true when the USPS is in the midst of the largest flats automation initiative ever undertaken. Whatever one's opinions of the eventual success of this undertaking are, it must be clear to all that continued erosion of flats volumes will successively worsen the payback.

The Valpak Analysis Does Not Deal with Whether Section 3622(c)(2) Should Be Read To Require a Focus on Whatever Categories the Postal Service Might Designate as Products. Title 39, as amended by the PAEA, refers to "products" a very large number of times — we counted more than 100. Yet in the oft-cited section used by "underwater watchdogs," § 3622(c)(2), which refers to bearing "direct and indirect postal costs," it does not refer to products. Instead, it refers to "each class or type of mail service." One has to ask what this choice of words means. Valpak takes it to refer to products. ACMA does not see this as clear. It could mean services grouped together "like a class." It could mean mail with similar characteristics, such as urgency, sensitivity or shape. It could mean mail from a collection of customers of similar type. Before using this section as a basis for imposing substantial burdens on any mailers that might be involved, further thought should be given.

One possibility is that Congress's reference to "or type of mail service" was meant to deal with the fact that the Postal Service has a long list of things normally called "Special Services," and that these services might not fall neatly into classes. Another would be that Congress meant to indicate "or similar unit." Both of these would be consistent with giving the Postal Service and the Regulator a degree of flexibility to deal with the realities of the business, and with avoiding rigid constraints that might limit the utility of the new law and cause difficulties of implementation[13].

Let's consider an unrelated but clear-cut illustration that may illuminate Congress's expectations. If Congress were imposing a constraint on states, it might refer to states or similar units. A question might then be asked whether the constraint applied to territories and protectorates. But it seems unlikely that Congress would intend for the constraint to be applied to all villages in the states. Similarly, a reference to "bee hives or other bee home" would not be taken to apply to bee types, and a reference to "schools or types of educational institutions" would not be taken to apply to classrooms. One would think that if Congress meant to apply its constraint to a full range of subordinate units or

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[13] In fact, Congress was clear PAEA was intended to provide more <u>flexibility</u> in pricing than in the past. Clearly, it is critical to get the costs correct, especially when they are changing so dramatically and are expected to change further once successful automation is brought on line. Now, however, cost is but one factor to consider. The behaviors of elasticity, markets, total customer value and lifetime customer value can also be now considered. It also can be expected to take years, if not decades, to properly develop and deploy a more sophisticated pricing strategy grounded not only in accurate costs but an acute understanding of customers, markets, and alternatives that optimizes the price and volume generated in a high fixed cost system. Despite this clear Congressional imperative, the mailing community frequently defaults back to a cost based system as the sole justification for changes it seeks. Old habits die hard.

members, units that could be defined and redefined, sometimes based on nothing more than the current focus of a marketer or whether data are available, Congress would be reasonably expected to have given some hint that it intended this. It did not.

A theme of the PAEA is that the Postal Service is to be provided flexibility, limited by a rate cap. Clearly, the cap is to be applied at the level of a class. To go further and say that section (c)(2) must be applied rigidly at the level of products, however products are defined, would be to take a giant step to limit the flexibility further. Also, it might create incentives to define products that are not effective. In fact, if Congress meant the ubiquitous term product to apply here, one might reasonably expect it would have left out the word "class" altogether.

Another theme of the PAEA is that rates are to be predictable. Suppose a class has two products, alpha and beta. The cost coverage of alpha is relatively high and of beta is just over 100 percent. Now suppose the Postal Service, with the approval of the Commission, makes an "improvement" in costing method, and both cost coverages decline, pushing beta below 100 percent. An unthinking application of (c)(2) to the two products would require a decrease in the rates of alpha and an increase in the rates of beta. This is at odds with any thought that the rates of the two products might increase with the cap. Alpha is being told: Your costs *increased*, so we must *decrease* your rate. The result is at odds also with predictability, as well as rationality.

Since it is often awkward to take rules applicable at an aggregate level and apply them at a disaggregate level, like attempting to apply macroeconomic principles to individual firms, it is ACMA's position that the purported benefits of Valpak's prescription should be examined selectively but certainly not applied in a way that will cause disruption.

The Valpak Analysis Does Not Deal with the Nonprofit Question. As we noted in our initial comments, the PAEA does not say how to define products, it just refers to them.[14] Without guidance on this point, the Postal Service specified a Regular-Standard-Flats product that includes both Commercial and Nonprofit mail, even though these would be expected to be sold in different markets and probably to have different costs[15]. It is true that Congress specified certain dimensions of the relationship between Commercial and Nonprofit rates, and left other dimensions to be decided in rate setting. However, there is no reason why this specification of Congress implies that Commercial and Nonprofit must be two parts of the same product. In fact, if the Nonprofit rates were to be pegged to a Commercial product, it would seem to be most sensible that the Commercial rate be set on independent bases. Only then could it be a meaningful reference.

In its FY 2009 Annual Compliance Determination (p. 85), the Commission noted that the cost coverage for the Nonprofit category is considerably below the cost coverage for the Commercial category, 53 percent and 89 percent,

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[14] Section 102(6) says that a reference to a "'product'" is meant to be a reference to "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied." There is little or no end, then, to the number of disaggregate categories that could be called products and to which the law could comfortably be taken to refer.

[15] There are also a variety of mail piece types and industries using "regular flats."

respectively. The cost coverage for the Commercial category is, at least as reported, 7 percentage points above the average for the Flats product. We say "as reported" because the costs for the Nonprofit category are based not on any direct measurement process, but rather on a range of assumptions (discussed in USPS-FY-09-27), meaning that the actual spread could easily be larger. All this is consistent with the logical thought that the coverage of a similar item priced 40% less will have a much lower revenue-to-cost ratio.

For a considerable period after Reorganization in 1970, Congress provided an appropriation to fund the lower rates for the several Nonprofit categories. Its position was that it was in the national interest for nonprofit organizations to have lower postal rates, and that the provision of such is appropriately funded by the nation through taxes. Later, in a series of steps, Congress stopped separate funding and mandated that the funding be covered by other mailers. Using Regular Flats as an example, the setup now appears to be that the lower rates for Regular Nonprofit Flats will be funded by higher rates for Regular Commercial Flats.

This is not merely a housekeeping matter — it has practical implications. First, to the extent that the cost coverage of the joint category receives attention, it means that the cost coverage of the Commercial category will be higher than that of the joint category. Second, it means that when the proportion of Nonprofit volume increases, as it did from FY 2008 to FY 2009, the price of products used only by a select group must be raised to cover the shortfall. That is, the Postal Service must say to these specific Commercial mailers, "We are sorry, but the

Nonprofit mailers in with you are sending more mail volume, so we must increase your rates." Third, it means that if the Commercial rates are to be fair, competitive, and cost-based, then one cannot be guided by the cost coverage of the joint category.

There are other implications. Many mailers use both the Carrier Route rates and the Regular Flats rates, and the difference between these two rates is an important signal. It is important to co-mailing decisions, for example, an efficient mailer activity that requires considerable investment. However, the Flats rates are required to carry about twice as much Nonprofit mail as the Carrier Route rates, making it difficult to establish a coherent, meaningful relation between them. And the relation between Regular flats and Carrier Route flats will become more important as FSS-scheme rates are considered. This issue is even more acute when high-density flats are considered, as it bears virtually no Nonprofit volume. So, under this approach, mailers with a high proportion of 3-digit and 5-digit sortation have to subsidize more Nonprofit volume than Carrier Route or High Density flat mailers. While it is clear Nonprofit discounts effectively became an unfunded mandate paid by Commercial mailers, it is not clear this burden was to be disproportionately applied to some mailers but not others, based solely on the amount of Nonprofit mail being sent in each category.

In times like these, with increased competitive pressures on mailers and the Postal Service, it is ACMA's position that it is not reasonable for the rates for specific Commercial categories to be elevated in order to fund lower rates for Nonprofit organizations, particularly when, as a practical matter, most of these organizations compete with the Commercial organizations. Another way to look at this is to say that Congress has the authority to sanction below-cost rates and cost coverages below 100 percent, to help provide low rates for the Nonprofits, but that it is awkward to elevate the corresponding Commercial rates to achieve it. Also, tying Commercial rates to Nonprofit rates means that, coverage held constant, an increase in Nonprofit volume causes not only an increase in the Commercial rates, but also an increase in the Nonprofit rates. This says to the Nonprofits, “Your volume has increased, so we must increase your rates.” In the extreme, if the Commercial volume became negligible and the cost coverage were to continue, the Nonprofits would have to pay 100-percent-coverage rates, not the 53-percent-coverage rates they appear to pay now.

In order to survive, commercial organizations need to be presented with rates that are cost-based and competitive. It is these kinds of rates that are presented to them by other firms from which they purchase, and it should be so for the Postal Service.

Going a step further, it is ACMA’s position that if the Nonprofit rates must be funded by other mailers, they should be funded by the overall Postal Service, not necessarily by mailers that happen to be in a host category.

Conclusion.

ACMA does not feel the costing procedures have not been followed. Rather, ACMA is concerned that the assumptions necessary for the procedures to yield valid results are not being met. Circumstances have changed. The well-established concept of “marginal costs” is still valid, but meaningful results are not being obtained.

The costs available are deficient in fundamental ways. They cannot be taken to be estimates of marginal costs or of any other cost that is meaningful for rate purposes. They do not provide a basis for disruptive rate adjustments. But even if they were taken as correct and used as a basis for assessing the effects of an increase in Flats rates, the estimated gain in the net income of the Postal Service, under a rate cap or any average increase, would be smaller by an order of magnitude than the imbalance in FY 2011 on which Valpak and MOAA focus. The gain from fixing a shortfall is the gain from fixing it, not the size of it.

Questions need to be asked whether § 3622(c)(2) should be taken to point narrowly at products. We discuss this matter in some detail.

Questions also need to be asked about how reduced rates for Nonprofit categories should be funded. If the Commercial rates are set on a basis that applies to them, rather than to a joint category, and if the health care issues are fixed, the cost coverage on Commercial Flats, even based on the invalid costs reported, is over 100 percent.

Respectfully submitted,
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