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May 21, 1998

Mr. Thomas J. Koerber
Secretary, Board of Governors
United States Postal Service
Room 10300
475 L'Enfant Plaza West, N.W.
Washington, D. C. 20260

Re: Comments of the Saturation Mail Coalition
Concerning the Recommended Decision of the
Postal Rate Commission, Docket R97-1

Dear Mr. Koerber:

The Saturation Mail Coalition hereby submits its comments to the Governors concerning the Postal Rate Commission's recommended decision in Docket R97-1. The Coalition's 36 members include local, regional, and national companies that are involved in the saturation mail advertising business. The Coalition's primary interest is in affordable and competitive postal rates for Standard A Enhanced Carrier Route (ECR) mail, particularly the saturation rate category, although the Coalition also has a broader interest in overall postal rates that enable the Postal Service to be a viable and progressive provider of universal mail services.

The Saturation Mail Coalition supported the rates proposed by the Postal Service in this proceeding. In particular, the Coalition applauds the Governors and the Postal Service for having proposed moderate, below-inflation rate changes and a reduction in the pound rate for Enhanced Carrier Route mail that would have brought rates more in line with costs.

Surprisingly, however, the Commission has ignored the substantial evidence of record that the current pound rate far exceeds weight-related costs, ignored the overwhelming mailer industry support for a lower pound rate, and refused to recommend *any* reduction in the clearly excessive pound rate for ECR mail. For the reasons set forth below, we urge the Governors to challenge the Commission's rejection of the lower pound rate and maintain their resolve to obtain a cost-based rate structure for ECR mail that better reflects the competitive marketplace.



THE IMPORTANCE OF A COST-BASED
ECR POUND RATE AND RATE STRUCTURE.

The saturation mail business is an important segment of the postal mailstream that provides a substantial contribution to postal overhead costs. Moreover, it is one of the few postal products that offers the opportunity, if properly priced, to generate additional volumes and contributions to offset competitive inroads in other postal products. Saturation mail is highly price sensitive due to stiff competition from newspaper and private delivery competitors. The most significant impediment to growth of saturation mail, and the greatest threat to loss of existing volumes, is the severely excessive pound rate charged for ECR mail above the 3.3-ounce breakpoint.

The Coalition, through its witness Harry Buckel, presented extensive evidence demonstrating the irrationality of the current high pound rate, its negative effect on the ability to compete effectively, and the need for a lower rate more in line with costs. Evidence supporting a lower pound rate was also presented by the Mail Order Association of America, Advo, Val-Pak, and the Alliance of Independent Store Owners and Professionals.

The Postal Service's proposed pound rate was unanimously supported by the mailing industry. The supporters include flat and letter mailers, saturation and non-saturation mailers. Even Val-Pak, a saturation letter mailer that in MC95-1 was the only mailer party that opposed the lower pound rate, here endorsed the proposed pound rate as cost-based and "conservative." Val-Pak Br. at 11-13. The core reason for this industrywide support is because the current high pound rate simply doesn't make sense, either in terms of postal costs or marketplace realities. The fact that the only opposition was from competitors -- the Newspaper Association of America (NAA) and the Association of Alternate Postal Systems (AAPS) -- is a clear indication that a more cost-based rate structure is beneficial to the mailing industry and the Postal Service.

The Governors have previously expressed their concern about the need for a lower ECR pound rate more in line with costs. The Commission in the Docket MC95-1 reclassification case rejected the Postal Service's similar ECR pound rate proposal on grounds that it has now apparently abandoned. The Governors criticized the Commission's action and stated their resolve to continue pursuing a more cost-based ECR rate structure:

"[D]espite compelling record evidence that the pound rate for the Enhanced Carrier Route subclass should be substantially less than its historical level, the Commission gave little to that evidence and instead employed a rote formula that produced a pound rate merely as the byproduct of an algebraic exercise. In this competitive area, as the evidence of record makes clear, alternative providers do not use price structures that depend so heavily on a pound charge, and it is

imperative that these facts not be ignored in setting prices for the Postal Service's product." Governors' Decision, Docket MC95-1, at 9.

Unfortunately, the Commission again has declined to respond to the Governors' concerns.

THE COMMISSION'S REFUSAL TO RECOMMEND A LOWER ECR POUND RATE IS CONTRARY TO RECORD EVIDENCE AND MUST BE REMEDIED.

Under the current ECR pound rate and rate structure (recommended by the Commission in Docket MC95-1), the postage rate for saturation mail weighing above the breakpoint doubles as weight doubles. Postal costs, however, are clearly not 100% weight-related, but include significant piece-related handling costs. It doesn't require cost analyses or expert testimony to know that this counter-intuitive rate structure is non-cost-based and overcharges weight in relation to costs.

The Postal Service proposed to moderate this irrational rate structure by reducing the pound rate from 66.3¢ to 53¢ per pound and adding a 3.2¢ piece charge for saturation mail over the breakpoint, reflecting the indisputable fact that handling costs are not purely weight-related. The comparison of the rates for a 3.5 and 7 ounce saturation mail piece under the current, USPS proposed, and PRC recommended rates are shown in the following table:

	<u>ECR Saturation Postage Rates</u>		
	<u>3.5 Ounces</u>	<u>7 Ounces</u>	<u>Percentage Increase</u>
Current Rates (PRC MC95-1)	14.5¢	29.0¢	+100%
USPS Proposal	14.8¢	26.4¢	+78%
PRC Recommended Rates	14.8¢	29.3¢	+98%

Compared to the current rate structure where the rate doubles as weight doubles (a 100% rate increase), the Postal Service's proposal would have produced a 78% rate increase as weight doubles. Its proposed weight-rate relationship was quite high (particularly compared to the low weight-cost relationship shown on this record), but it clearly would have been a significant, albeit modest, improvement in the rate structure.

The Commission's recommended rates, by contrast, still result in a virtual doubling of the rate as weight doubles. There is nothing in the record, or in common sense, that supports such an absurd weight-rate relationship.

The Commission's refusal to reduce the ECR pound rate is contrary to the compelling evidence that the current 66.3¢ pound rate greatly exceeds weight-related postal costs. The record evidence demonstrated that weight-related ECR costs were only a fraction of the Postal Service's proposed 53¢ pound rate. Yet the Commission not only rejected the USPS proposed pound rate but declined to recommend *any*

reduction from the current rate. To compound matters, the Commission, without any real explanation, also increased the letter-nonletter rate differential for ECR high density and saturation mail, resulting in a rate structure that is even less cost-based than the existing one.

The Commission gave two reasons for refusing to reduce the pound rate: concerns about the reliability of cost data, and concerns about impact on competitors. Neither withstands scrutiny.

A. The Cost Studies On The Record Fully Support A Lower Pound Rate.

The Commission claimed that the Postal Service's cost data were "not sufficiently reliable to support a substantial reduction in the pound rate." PRC Op. at 399, ¶5418. Its purported concerns about reliability of the data are exaggerated and more importantly, disregard the clear, consistent, and uncontroverted evidence that costs above the breakpoint are nowhere near 100% weight-related.

The Commission analysis of the cost study data narrowly focused on unit cost "variation from [ounce] increment to increment." In doing so, the Commission ignored the far more important *overall pattern* of costs that clearly showed only moderately increasing costs with increased weight above the 3.3 ounce breakpoint. This pattern is evident from the Commission's own table of unit costs (Table 5-10, Op. at 400). Between the 3-4 ounce increment and the 15-16 ounce increment, unit costs increase from 7.1¢ to 18.1¢, an increase of only 11¢ over a 12-ounce range. This increase of less than a penny per ounce is equivalent to a cost of less than 15¢ per pound, a small fraction of the recommended 66.3¢ pound rate. Similarly, the 18.1¢ unit cost in the 16th ounce increment in the Commission's table is only a fraction of the current and PRC-recommended rates for a 16-ounce piece. Even allowing for a large margin of error in the cost study data, there is no question that the pound rate greatly exceeds weight-related costs, and that a reduction in the pound rate is fully justified.

The Commission's concern about the "thinness" of IOCS mail processing tallies in the upper weight increments beyond 8 ounces is misplaced, and was fully addressed on the record. Advo witness Crowder's refinements to the USPS cost study substantially eliminated the "erratic" ounce-by-ounce variations cited by the Commission, and showed a cost curve that increases only very moderately with increasing weight beyond the breakpoint. Tr. 34/18310-14. Crowder also demonstrated that this pattern of costs is consistent with every other prior cost study presented over the last 15 years. Tr. 34/18314-15. In dismissing this consistency with past studies on the ground that those studies may also have had data "thinness" problems, the Commission misses the point. The glaring fallacy in the Commission's logic was pointed out in the Coalition's initial brief, responding to NAA's identical "thinness" argument:

"If all of these various studies -- including the ones on this record -- were, indeed, unreliable because of data thinness, then one would expect that their resulting cost curves would vary wildly from one to another in some random, haphazard manner. Instead, the same general cost pattern emerges from each one. The notion that these supposedly random, 'unreliable' unit costs would, by sheer chance, align in the same cost pattern in test after test after test is truly unfathomable, and would defy all notions of statistical probability. The only reasonable conclusion from this consistency is that these repeated cost patterns do, indeed, reliably demonstrate true cost behavior." Coalition Initial Brief at 34.

The Commission is also in error in claiming that additional studies are needed in order to assess whether the current pound rate is too high. While new studies and better data are always, in the abstract, desirable, they are not necessary in order to make a determination on the basis of the Docket R97-1 record that the current pound rate is, by any measure, too high.

The Commission's preoccupation with the details of studies approaches the surreal, ignoring the most obvious fallacy of its recommended rate structure: for its rate structure to be cost based, one would have to assume that virtually all postal costs for pieces weighing over 3.3 ounces were entirely weight-related, with virtually no piece-related cost elements. That assumption is demonstrably false.

A case in point is the Commission's apparent concern about the effect of weight on delivery costs, focusing particularly on city delivery carrier elemental load costs. PRC Op. at 402, ¶5421-22. What the Commission ignores is that a substantial chunk of total ECR delivery costs is unequivocally piece-related. Rural carrier costs, for example, which constitute 36.4% of the Commission's estimated total delivery costs for ECR mail, are purely piece-related.¹ Similarly, single subclass stop access costs are purely piece-related. Even if a portion of the remaining delivery costs were weight-related, the overall cost pattern for delivery costs would be far from 100% weight-related as implied by the current and PRC-proposed rate structures.

The Commission's criticisms of the Postal Service's weight cost study and its call for new studies are also perplexing because the current study was a refinement of a similar study presented as a library reference in the Docket MC95-1 reclassification case in support of a lower ECR pound rate in that case. There, however, the Commission did not address the cost study or suggest that additional studies were needed. Instead, it rejected the lower pound rate on the ground that its recommended 66.3¢ pound rate was the mathematical result of its other "cost-based"

¹ Tr. 34/18330 and PRC Op. at 393-94, ¶5396. Rural carrier costs constitute \$263 million of the total \$723 million attributable ECR delivery costs estimated by the Commission. PRC Op. Appendix J at 6 and 9 (Cost Segments 7 and 10 combined).

rate design determinations -- a rationale that it has abandoned in this proceeding. The Postal Service and the parties could understandably feel sandbagged by the Commission's failure to raise any concerns about the cost study in Docket MC95-1.

The Commission's criticism of the Postal Service for ostensibly not responding to its earlier "requests" in Dockets R87-1 and R90-1 for additional studies is even more perplexing and unwarranted. A review of those decisions reveals that the Postal Service has, indeed, responded to those requests.

In the portion of its Docket R87-1 decision it cites here, the Commission requested two additional studies. PRC Op. R87-1 at Appendix K, ¶001. First, it requested that the Postal Service collect Form 3602 data on volume by ounce increment, which the Postal Service has since consistently collected and provided to the Commission. Second, it directed the Office of Consumer Advocate to conduct a study of "the relative costs" of third-class BRR mail "at various weight levels," with the further instruction that:

"We expect that the FY 1986 IOCS tallies provided in this proceeding will be a useful starting point." *Id.*, Appendix K at 3, ¶003.

The OCA did conduct the requested study. As Advo witness Crowder showed here, the results of that OCA study were fully consistent with the weight-cost relationship shown in the Postal Service's weight cost study presented in this proceeding. Tr. 34/18314-15. Moreover, the Commission's specific endorsement in Docket R87-1 of the use of IOCS tallies for assessing the effect of weight on costs belies its conclusion here that IOCS costs are not appropriate for such an analysis.

The Commission's reference to its Docket R90-1 decision is likewise misplaced. There, the Commission stated:

"However, the relationship of weight to costs remains largely unexplored. For example, no cost study underlies the pound rate, a fundamental component of rate design. We think it important for the Service to conduct a study to obtain this information." PRC Op. R90-1, Appendix K at 1-2, ¶104.

The Postal Service in Docket MC95-1 provided just such a study in support of a lower ECR pound rate, which the Commission did not critique. Nor did the Commission call for new or different studies of the effect of weight on costs.

In the current proceeding, the Postal Service substantially expanded and refined its MC95-1 cost study, going beyond its earlier analysis of IOCS costs to include all postal cost segments. The Commission, however, mischaracterizes the study, claiming at ¶5423 that:

"The Service has submitted the same basic cost study to the Commission since 1982, despite Commission requests for a more comprehensive analysis. Tr. 34/18315."

The Commission's transcript citation, to Advo witness Crowder's rebuttal testimony, contradicts the Commission's characterization. Crowder did not in any manner suggest that the Postal Service's R97-1 study was the "same basic cost study" as the earlier studies, but rather that the "same cost pattern" appears in *all* of the studies -- further reinforcing the reliability of the results shown in the R97-1 study. Tr. 34/18314-15.

Finally, apart from the cost studies, the current and PRC-recommended pound rates -- which implicitly assume that ECR costs above the breakpoint are almost entirely weight-related -- defy common sense and known cost behavior. There are unquestionably significant piece-related handling costs for all ECR mail, both below and above the breakpoint. Neither the Commission nor the competitors dispute this fact.²

B. The Commission's Conclusions About Impact On Competition Are Not Supported By The Record.

The Commission, citing criterion (b)(4) of the Act, said that competitive considerations about impact on private delivery companies "militate against a substantial reduction in the pound rate." The Commission's only discussion of impact was the vague statement that:

"While it is unknown how a substantial decrease in the pound rate will affect the 'bottom line' of these [private delivery] businesses (i.e., their ability to survive), the record indicates that the impact may be severe. See, e.g., Tr. 23/11982."

The "record" indicates no such thing. The only record support cited by the Commission on the impact issue was to a page from AAPS witness Bradstreet's testimony. However, all that Bradstreet offered was the unsupported assertion that "the USPS proposal would significantly harm these [private delivery] businesses, especially in competing for those items weighing 4 ounces and above." Tr. 23/11982. That kind of bare assertion does not constitute substantial evidence supporting a conclusion of severe impact.

² The irrationality of the Commission's refusal to recommend a lower pound rate for Commercial ECR mail is further illustrated by its opposite approach for Nonprofit ECR mail. There, the Commission recommended a 36% reduction in Nonprofit ECR pound rate, from 45.1¢ down to 29¢ per pound, substantially lower than even the Postal Service proposed. PRC Op. at 399. The recommended Nonprofit pound rate is less than half the 66.3¢ recommended Commercial pound rate. After drop ship discounts, the disparity is even greater: a 16.4¢ pound rate for Nonprofit ECR mail compared to a 53.7¢ pound rate for Commercial ECR mail drop shipped to the destination delivery office.

The Commission's conclusion about impact on competitors is particularly appalling because the AAPS witnesses refused to provide information about their businesses that would have permitted an assessment of impact. Tr. 23/12037-38. Nevertheless, AAPS's own witness Green conceded that weight is a relatively insignificant factor in private delivery costs ("we haven't been concerned with weight for so long since we're in the hand delivery," Tr. 23/11973). He also conceded that the current high pound rate "would make it prohibitive" to mail his privately-delivered publication. Tr. 23/11970. This record evidence from the AAPS witnesses undermines the Commission's conclusion about impact.

Moreover, the Commission overlooked the evidence provided by Saturation Mail Coalition witness Buckel who, unlike the AAPS witnesses, directly addressed the question of the effect of the pound rate on competition. In his direct testimony, Buckel testified:

"Unlike preprint insert rates of our non-postal competitors that increase only moderately as preprint weight increases, rates for mailed inserts must increase steeply with weight to cover the high linear pound rate postage cost. The Postal Service's proposed pound rate will moderate, but not eliminate, this disparity. For traditional retail preprints, such as a 2-or-more-ounce circular typical of the major retail preprints carried in newspapers, even the lower pound rate would still leave us priced out of the market." Tr. 23/12091-92 (emphasis added).

On rebuttal, Buckel presented further evidence that proves the obvious -- that newspaper and alternate delivery pricing is far less sensitive to weight, and that this competitive disadvantage for mail is due to the unreasonably high pound rate:

"In general in the alternate delivery industry rates tend to be weight-insensitive or have very little relationship to weight relative to the postal rates." Tr. 17274.

"I am competing with a newspaper hand delivery program that has virtually zero incremental costs if they had that sheet, and it cost me to add that sheet, roughly \$5 or \$6 in postage, plus inserting, plus sales commission, handling costs, et cetera." Tr. 17260.

In response to questions from Commissioner LeBlanc, Buckel gave a specific "real-world example" illustrating this pricing disadvantage due to the pound rate. Tr. 17270-71. Because of the high pound rate relative to newspapers' pricing structure, Buckel's publication lost a one-ounce piece from a large customer to a newspaper that offered a rate lower than his postage cost. "I couldn't have been competitive at that rate, because that didn't even cover postage." *Id.*

Significantly, neither NAA nor AAPS cross-examined Buckel on these points, and neither party presented rebuttal testimony. In light of Buckel's uncontested testimony, and the dearth of evidence from AAPS and NAA, the Commission's conclusion that a lower pound rate would have a severe impact on competitors is unsubstantiated on the record.

More fundamentally, the Commission's treatment of the competition issue is troubling because it represents a departure from the past application of Criterion (b)(4) of the Act. First, that criterion speaks not only of impact on competitors but also on mail users, a balancing that appears to have been one-sided. Second, as the courts have held:

"In evaluating competition-related arguments under subsection (b)(4), it must be remembered that the PRC's task is to protect *competition*, not particular competitors." (emphasis in original).

Direct Marketing Association, Inc. v. USPS, 778 F.2d 96, 106 (2nd Cir. 1985). The Commission's assessment of the competition issue here sounds strikingly like the arguments presented to the court by NAA's and AAPS's predecessors, urging an expansive, protective interpretation of subsection (b)(4) -- arguments that the court in *DMA v. USPS* specifically rejected.

Indeed, the best way to ensure that postal rates are neither harmful to mail users or competitors, nor undermine competition, is to establish rates that are cost based. Maintaining an artificially high pound rate that is out of line with any realistic assessment of cost behavior, solely for the purpose of protecting competitors from competition, is the antithesis of the proper consideration of the (b)(4) criterion.

C. The Commission's Decision To Increase The Letter-Nonletter Rate Differential Is Inconsistent With Its Refusal To Reduce The Pound Rate, Is Contrary To The Record, And Produces An Even Less Cost-Based Rate Structure.

The Commission, with almost no discussion, also recommended a substantial increase in the letter-nonletter rate differential for ECR saturation and high density mail, well beyond that proposed by the Postal Service. Its decisions to *both* retain the current excessive ECR pound rate *and* increase the letter/nonletter rate differential are internally inconsistent, contrary to the record, and result in an even higher rate disparity for nonletters above the breakpoint -- producing a rate structure that is even less cost based than the existing structure.

The flaw in the Commission's decision is its failure to recognize the inherent interrelationship between the letter-nonletter rate differential and the pound rate. The only legitimate purpose of a rate differential between letters and nonletters is to reflect *shape-related* cost differences -- independent of *weight-related* cost differences that should be recovered through the pound rate. The cost data upon which the

letter-nonletter rate differentials are based, however, include the cost effects of both mail shape *and* weight. Nonletters weigh more, on average, than letters. The higher average cost of nonletters compared to letters therefore reflects the combined effect of both shape-related *and* weight-related cost differences. The true shape-related cost differences are therefore *less than* the full letter-nonletter cost differences. Tr. 7/3139-40 (USPS witness Moeller).

The Commission nevertheless recommended increasing the Postal Service's proposed passthroughs of the letter-nonletter cost differentials from 60% to 65% for high density mail and from 80% to 95% for saturation mail. The Commission's only explanation for these higher passthroughs was to "reflect greater recognition of shape-based cost differences." PRC Op. at 450, ¶5560. This, however, ignores the difference between "shape-based" cost differences and the "letter-nonletter" cost differences, erroneously treating them as being identical. By passing through an even greater percentage of the letter-nonletter cost difference that includes the cost effects of weight, the Commission's rate structure further overcharges flats for the effects of weight that are already overcharged through the excessive pound rate.

This interrelationship between the letter-nonletter rate differential and the pound rate was further demonstrated by Val-Pak witness Haldi. As he explained, the Postal Service's proposed lower pound rate is "conservative" because of this interrelationship between shape- and weight-related costs. Tr. 15162. He observed that the higher the assumed weight-related cost effect, the lower the shape-related cost effect. Tr. 15057-58. Even at his "moderately high" assumed weight-related cost, the remaining non-weight-related (i.e., shape-related) unit cost for saturation nonletters would be *lower* than that for saturation letters. Tr. 15172. Noting that "this result is already hard to swallow" because it would imply a negative shape-related letter/nonletter cost differential, Haldi concluded:

"Using even higher pound rates, such as those last approved by the Commission, would cause a further reduction in the unit cost of nonletters below the corresponding cost of letters. In light of these considerations, I consider [USPS] witness Moeller's recommended pound rate to be conservative." *Id.*

Haldi's analysis showed that the USPS-proposed pound rate alone would more than cover the entire letter/flat cost differential, even without a separate shape-based letter/flat rate differential. His analysis is thus consistent with Advo witness Crowder's conclusion that the Postal Service's proposed pound rate is still high in relation to true weight-related costs, and that it would substantially over-recover weight-related costs. No party disputed these unassailable conclusions on the record. The Commission in its decision simply ignored them, and then greatly compounded its error by recommending a higher letter-nonletter rate differential that further (and inconsistently) overcharges nonletter mail in relation to both weight- and shape-related costs.

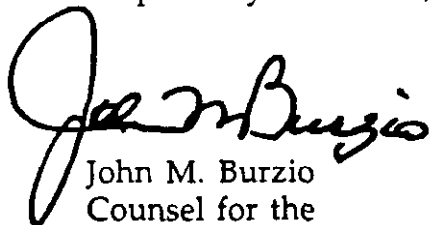
Conclusion

The Commission's refusal to recommend a lower pound rate is unsupported on this record. Its various rationales mischaracterize the evidence of record, ignore crucial facts and analyses that refute its conclusions, and are internally inconsistent. The Commission's apparent preoccupation with "reliability" of data and additional studies, in the face of compelling evidence on this record that the pound rate is excessive under any measure, raises concerns that future studies may face a similar fate.

The Governors at this point have three options to pursue this issue. First, the Governors can allow the recommended decision to go into effect under protest and remand the decision to the Commission for further consideration of the pound rate issue. Second, the Governors can allow under protest and seek judicial review of this aspect of the Commission's decision. Third, the Governors can accept the Commission's recommended decision but emphasize their disagreement, as they did in their decision in the MC95-1 proceeding, with the Commission's arbitrary and unsupported refusal to recommend a lower pound rate, and express their continuing resolve to pursue this issue in future proceedings.

Whatever option the Governors choose should be made with the clear and unchallenged knowledge that continuing the current excessive pound rate, as recommended by the Commission, will preclude the Postal Service from legitimate, cost-based competition for advertising circulars -- a market in which the Postal Service has been a valuable service provider for decades and one of the few markets where the Postal Service has the potential for generating additional volumes and contributions to offset its declining market share in other products.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "John M. Burzio". The signature is stylized with a large, looping initial "J" and a cursive script for the rest of the name.

John M. Burzio
Counsel for the
Saturation Mail Coalition

cc: All parties in Docket R97-1