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**BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-001**

Annual Compliance Report, 2011	)))	Docket No. ACR2011

**REPLY COMMENTS OF THE
AMERICAN CATALOG MAILERS ASSOCIATION (ACMA)**

(February 17, 2012)

Pursuant to Commission Order No. 1095 (issued January 3, 2012), ACMA is pleased to sponsor these comments in reply.

In its *Price List* (Notice 123), the Postal Service shows two matrices of rates for flats in the Standard class, one for Commercial and another for Nonprofit (at 15). Each has 11 columns of rates: (a) headed "Carrier Route," 3 categories (Saturation, High Density, and Basic[1]); (b) headed "Automation," 4 presort categories (5-digit, 3-digit, ADC, and Mixed ADC); and (c) headed "Nonautomation," the same 4 presort categories. [2]

ACMA explained in its initial comments that if concern exists over whether mailers of non-Saturation flats are being subsidized, an appropriate grouping for testing

1 The Basic column under the "Carrier Route" heading is the Carrier Route product.

2 Notice 123: http://pe.usps.com/cpim/ftp/manuals/dmm300/Notice123.pdf?PE_DMM300_PDF_5#xml=http://pe.usps.gov/search/jsp/search/xmlread.jsp?k2dockey=http%3A%2F%2Fpe.usps.com%2Fcpim%2Fftp%2Fmanuals%2Fdmm300%2FNotice123.pdf%40PE_DMM300_PDF_5&serverSpec=56.0.145.56:9920&QueryParser=Simple&querytext=%28notice%3Cand%3E123%29

would be the trio of High-Density, Carrier Route Basic, and Standard Flats (which includes the 4 presort categories, Automation and Non), excluding Nonprofit, for which a subsidy is virtually legislated. Focusing just on Standard Flats (which is designated as a product) would be inconsistent with market realities and the logic of subsidies.

Secondly, ACMA explained that if such testing is done, it should be the burden test, not just the incremental cost test, for only the burden test recognizes the role played by the flats in holding down the rates for other mailers.

Finally, ACMA showed that the costs available for the various categories are seriously defective, so much so that they provide no basis for either subsidy tests or conclusions about cost coverage, but that if these costs are used anyhow, the cost coverage for the trio is decidedly over 100 percent.

Although ACMA has pointed to these problems before, several parties have neglected to take them into consideration. Once these problems are recognized, the comments of these parties lose strength and, in most cases, degenerate into arguments for lower rates for mail categories used by their member or members. We review them below.

A. Comments of the Public Representative.

In her initial comments (at 17-19), the Public Representative refers to the cost coverage reported for the Standard Flats product (including Nonprofit but excluding all former-ECR categories; noted above to be an inappropriate category for attention) and: (a) notes that it adds "$651 million to the institutional burden of the Postal Service"[3] and

[3] By definition, the "institutional burden of the Postal Service" is total overall cost minus total overall attributable cost. If the revenue of Standard Flats were increased to the point that

(b) suggests, at least implicitly, larger steps toward increasing the cost coverage than the step taken in Docket No. R2012-3.

However, these observations would lose their moment if she recognized that the costs are deficient or even if she focused on a category more meaningful than Standard Flats. Also, taking larger steps, which means increasing the rates for Standard Flats and decreasing them for at least one other category, might have little or no effect on the net income of the Postal Service, the actual outcome depending on the predictive content of the costs (which ACMA has shown is low), the own-price elasticities (about which we know a little), and the cross-elasticities (about which we know almost nothing). In any case, the effect would be no more than a small fraction of the "loss" cited by the Representative. ACMA has explained this before—*see* our initial comments in Docket No. ACR2010 (at 8-9).

B. Comments of L.L.Bean.

L.L.Bean notes that Standard Flats as a product is "below-cost" (at 1) but focuses mostly on catalogs across products. It believes the matter of losses "should be viewed within the broader context of the catalog industry as a whole" (at 1), suggesting that the Postal Service take a "fresh look" (at 2) at things.

At least implicitly, then, L.L.Bean recognizes that the categories receiving attention are not particularly relevant, but it does not mention the Nonprofit issue or any questions about the validity of the costs. Neither does it discuss how subsidies should

its reported cost coverage was 100%, the institutional burden would not change, sans volume effects. Therefore, a "loss" for Standard Flats cannot add to it. ACMA takes the Representative's observation to mean that the revenue-cost relation for Standard Flats is part of the overall revenue-cost relationship.

be defined or tested. If L.L.Bean were to consider some of these things, it would find it difficult to say that the best path forward is clear. Certainly it has not explained what that path might be. What is clear is that if the costing problems were fixed and an appropriate lens were looked through, all categories of catalogs would be seen to be much more attractive to the Postal Service.

C. Comments of the National Postal Policy Council (NPPC).

NPPC refers to Standard Flats as a product that is receiving a subsidy (at 1, 10, and 13), but does not discuss any questions about how a subsidy should be defined or measured. ACMA believes these questions are important. The thinking of NPPC is clearly that if the rates for Standard Flats are increased, the rates for Standard Letters, which its members send, would be decreased. It wants to move in a "measured way" (at 13) in that direction.[4]

Although ACMA has raised these issues in prior proceedings, NPPC does not address the Nonprofit matter, the subsidy questions, the matter of which categories should receive attention, or the validity of the costs. If it considered these matters, it would find that a prescription is not an easy thing to write.

D. Comments of Valpak.

At a total of 123 pages, the initial comments of Valpak qualify as a primer, not in all cases elementary, to the Postal Service on how it should manage a pretty wide

[4] If the rates for Standard Letters are reduced, it would seem that some of NPPC's members who send First-Class letters might shift to sending Standard Letters. This might help NPPC in two ways and be a double whammy for the Postal Service. ACMA has not analyzed this matter.

range of matters, though with concentration on matters of rates. One of its concerns is that the rates it pays are too high and another is that rates of Standard Flats are too low.

Although the issues addressed by ACMA in the instant docket have been addressed in prior dockets, sometimes in less aggregate form and sometimes in response to prior comments of Valpak, Valpak neglects all of them. This is the regulatory equivalent of “damn the torpedoes, full speed ahead.” But present conditions do not justify taking risks, certainly not when a series of mines have been identified.

Valpak discusses subsidies, but does not discuss any issues surrounding how they should be defined or measured. Valpak focuses on Standard Flats as a product, without asking whether the product has been defined in a meaningful way. Valpak does not address the Nonprofit question, although it has come up on several occasions before.

Finally, Valpak does not address the validity of the costs—it just sails on anyhow.[5] Admiral Farragut would be proud. But the costing questions ACMA has raised are serious. Here is a snippet that connects to Valpak’s mail. In FY 2011, before burdening and piggybacking, the unit city carrier street cost of Saturation letters was

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5 As a point of embarkation, Valpak notes that Standard Flats were “deeply underwater” at the time of Docket No. R2006-1. (at 54, fn. 55) For this conclusion, it cites to pages 160 and 196 of testimony it submitted in that docket (VP-T-1). But page 160 contains no cost coverage for Standard Flats and page 196 contains nothing but percentage increases proposed by Valpak for rate cells. Page 161 contains a cost coverage of 152.2%, but this appears to be an implicit coverage at the Mixed ADC level at VP-proposed rates. So it is not clear how Valpak reaches a conclusion that Standard Flats were “deeply underwater.”

This matter has come up before. In its FY 2008 Determination, the Commission referred to Standard Flats being profitable in years “previous” to 2008 (at 5). Also, ACMA indicated in a Statement (May 24, 2011) in Docket No. ACR2010 that “By our estimate, Standard Flats had a cost coverage of 104.5 percent in FY 2005, including the Nonprofits” (at 3). See this same coverage with sources relating to its development in ACMA’s workbook submitted in the instant docket, ACMA_Graphs_2011ACR.xlsx, tab Std Flats.

1.99 cents; for Standard Letters, it was 2.58 cents.[6] For letters delivery point sequenced or cased, the carrier on the street cannot tell if he is handling a saturation piece. For letters carried as extra bundles, which would require extra motion, it would seem that the street costs should be higher. So shouldn't the city street costs of Saturation letters, some of which might be extra bundles, be at least as high the street costs of Standard Letters? If Valpak looked into these matters, it might find itself wondering why the costs for its mail are so low and the costs of Standard Flats are so high. And if the costs for its mail were increasing by leaps and bounds, as we have showed they are for Standard Flats, Valpak would be speaking loudly.[7]

To be sure, Valpak does ask some questions about the costs. It devotes 5.3 pages and 4 tables to a question about certain cost elements for High-Density and Saturation letters. In its Table VII-1 (at 95), it shows the unit mail processing costs for each, and points out that they are dropship adjusted. It does not point out, however, that the proportions DPSed of High-Density and Saturation might be different. This omission is troublesome because differences in these proportions would contribute to the cost differences Valpak displays. Then, assuming the unit DPS costs are the same

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6 Costs are segment 7.1 street delivery costs per CCCS piece. See UDCmodel11.xls in USPS-FY11-19. Tab 11.SummaryBY, column H shows the costs. Tab 9.DeliveryVols, column G, shows the volumes.

The costs in the text are for Saturation and Standard Letters. Costs could also be examined for Saturation and Standard Flats. It turns out that the relationships in each are about the same.

7 Questions surrounding the street costs for Saturation mail do exist. The notion of a rate-induced volume change focuses on the extra pieces that would result from a rate reduction. But extra pieces do not occur for Saturation mail. If the rate is reduced, an entire additional full-coverage mailing might be made, which would be an identifiable burden to the system and would add a noticeable lump to costs. On a unit basis, the additional cost could easily be larger than the marginal costs of ordinary categories, which are found by taking a first derivative of a cost function. Also, an additional lump of Saturation could cause repercussions elsewhere.

for each, it neglects the city-rural split and sets out to explain the differences by referring to the in-office and street activities of city carriers. This is troublesome as well because mail processing costs do not relate to what carriers do (except that if a piece is DPSed, a carrier does not have to case it). Thus, the discussion involves nothing but non sequiturs.[8] Its Table VII-2 shows unit delivery costs for the same two categories, city and rural combined, and attempts to explain them by discussing street activities. But this is a non sequitur as well, because the costs cover in-office activity too. Finally, its Table VII-4 shows cost pools through which High-Density and Saturation pass, sometimes unexpectedly. It is surprised, for example, at an AFSM100 cost for Saturation letters of 15 thousandths of one cent.[9] [10] Valpak is way short of coming to grips with anything going on in the costing area.

Part of the concern of Valpak seems to be a belief that the losses on underwater products have been part of the deficit-reason for the Postal Service's pursuit of service

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[8] On the basis of its analysis (or not), Valpak is willing to call these costs "anomalous" (at 95-96). That is, on the basis of the mail processing unit costs of High-Density letters being 0.2 cents higher that the corresponding cost for Saturation letters, the results become anomalous. One would think then, that Valpak would be invigorated by ACMA's showing that some of the costs for Standard Flats are several cents and maybe over a dime more than can be explained. But such does not seem to be the case.

[9] Questions about pieces showing up in pools unexpectedly have been around for some time. In its spreadsheets, the Postal Service even shades these cells in a different color (aqua) and labels them "Unexpected". *See*, for example, USPS-FY11-10 FCM_LTRS.xls, tab CRA-BULK METERED LETTERS in USPS-FY11-10 in the instant docket.

[10] Another cost receiving Valpak's attention is the unit delivery cost for Carrier Route letters (at 100-101), a small component of the Carrier Route product. Valpak is concerned that this cost increased 88 percent from FY 2010 and suggests greater investment in its estimation. In addition to being small, which Valpak notes, Carrier Route letters is a strange category at this point, being generally nonmachinable and maybe difficult to handle, and its cost has misbehaved for some years. But, except that its cost is a component, perhaps not an exogenous one, of the cost of the Carrier Route product, the level of its cost is of no consequence—it is not used in ratemaking. ACMA would think that there are more important candidates for Postal Service investment.

reductions (especially at 41-42). But since making adjustments to alleviate these losses would, at best, increase net income by only a small fraction of the reported losses, this concern is small reason to make significant changes. As indicated above, ACMA has discussed this issue before. We note as well that the virtual absence of any information on cross-elasticities makes estimating the effect on net income difficult if not impossible.

If Valpak would look carefully at the nature of the situation being faced, including the cost situation, as ACMA has laid out on several occasions, culminating in its comments in this docket, it would see that a prescription is not so clear and that important questions need to be addressed.

E. Comments of John C. Panzar.

Professor Panzar develops recommendations on the role that the notion of Efficient Component Pricing (ECP) should play in postal ratemaking. ACMA presumes that the attractiveness of ECP is increased by the virtual absence of information on cross-elasticities, which is needed for certain other approaches. Also, there may be weaknesses in the own-price elasticity information.[11] He goes so far as to recommend that the cost avoidances as now estimated (which are really cost *differences*, and sometimes differences at a margin instead of over the increment) should be both a floor and a ceiling to associated rate differences.

ACMA takes no position on Panzar's analysis. We do, however, have two concerns relating to his recommendation.

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[11] It could also be asked whether the cost difference and cost avoidance information is higher in quality than any absolute cost information that might be needed for other approaches. ACMA doubts that it is.

First, if the costs are unreliable, and increase inexplicably, sometimes by quite large amounts, as ACMA has shown in its comments, then locking in the differences in these costs as a ceiling and a floor would cause destabilizing rate changes, based, it appears, on costs that are not up to the job. This should be avoided.

Second, ACMA has reservations about the advocacy of tying ratesetting to a series of costing results, be they cost avoidances, cost differences on average, or cost differences at a margin. Mainly, our concern is that such an approach has the potential to relegate ratesetting, in lock-step fashion, to a simple equation involving a series of deltas, where the deltas are the cost differences or avoidances. Such an approach appears to leave little room for policy, recognition of demand, concern over issue-specific signal matters, considerations that are longer-term in nature, or mailer investment in complying with regulations. Some flexibility is needed.

Respectfully submitted,

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