Postal Regulatory Commission
Submitted 2/15/2013 4:16:03 PM
Filing ID: 86513
Accepted 2/15/2013

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Annual Compliance Report, 2012	)))	Docket No. ACR2012

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
REPLY COMMENTS ON THE UNITED STATES POSTAL SERVICE
FY 2012 ANNUAL COMPLIANCE REPORT
(February 15, 2013)

William J. Olson
Jeremiah L. Morgan
John S. Miles
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc.
and Valpak Dealers' Association, Inc.

TABLE OF CONTENTS

REPLY COMMENTS

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") submitted Initial Comments on February 1, 2013, and submit the following Reply Comments with respect to the Initial Comments filed by certain other commenters, as well as to the Postal Service Responses to Chairman's Information Requests filed after the deadline for filing Initial Comments.

I. THE CHRISTENSEN ASSOCIATES MODEL

The Christensen Associates model presented by the Postal Service in USPS-FY12-43 is criticized in the initial comments of Valpak and three other parties — the Public Representative ("PR"), Pitney Bowes Inc. ("PB"), and American Catalog Manufacturers Association ("ACMA"). The PR and PB challenge the assumptions in the Christensen Associates model, finding that it provides no support for the Postal Service strategy of giving deeply underwater Standard Flats small price increases, and giving high-profit products higher price increases. ACMA, in stark contrast, criticizes the Christensen Associates model for failing to incorporate assumptions which ACMA believes would have provided stronger support for continuation of enormous cross-subsidies to underwater Standard Flats.

A. The PR Demonstrates that the Christensen Associates Model Actually Supports Aggressive Price Increases on Flats, Using the Postal Service's Best Available Elasticities.

Analysis of the Christensen Associates models constitutes a significant portion of the PR Initial Comments. At the outset, the PR notes that:

> The purpose of the models is **to prove** that in the long run, after 8 years, the **cumulative contribution** from the Standard Mail class, in general, is **higher** for the scenario with a **moderate**

> price increase for Flats (Scenario 1) than for the scenario with a more **aggressive** price increase for Flats (Scenario 2). In other words, in all prospective models, the models **are claimed to demonstrate** that a relatively moderate Flats' price increase scenario compares favorably (*i.e.*, provides higher cumulative contribution) compared to more aggressive price increase scenarios. [PR Initial Comments, p. 33 (emphasis added).]

While Valpak's Initial Comments (Section III) on the Christensen Associates model accepted the assumptions of the model for purposes of its analysis, the PR took a different approach, challenging the reasonableness of those assumptions. Valpak used the model's own assumptions to demonstrate that greater contribution could be obtained by imposing more aggressive price increases on Standard Flats, and the PR reached the same conclusion by substituting more realistic assumptions in the model, thereby (imploding any belief that lower increases on Standard Flats will result in greater contribution).

The PR replaced the model's own-price elasticities — arbitrarily assumed by Christensen Associates — with the Postal Service's own econometric elasticity results (filed on January 22, 2013) for both Standard Flats and All Other Standard Mail, *i.e.*, the latest and best empirical evidence available. When this change in the model is made, the PR concludes that:

> It is easy to see that under the changed assumptions regarding own price elasticities, while **maintaining all other assumptions** over the 8-year period, the **cumulative contribution** in nominal prices in Scenario 2 [more aggressive price increases on Flats] **is higher** than in Scenario 1.... Also, Scenario 2 shows that **full cost coverage is achievable** in year 7 with the "V2a" model, or almost achievable at 95 percent with the "V2b" model at the end of the 8-year time frame. [*Id.*, p. 36 (emphasis added).]

The PR's discussion of the Christensen Associates model ends with the difficult-to-challenge observation that:

> It does **not** appear to the Public Representative that the Postal Service will be able to bring Standard Flats into compliance in a **reasonable period** of time by continuing with the **minimal annual above-average** price increases. [*Id.*, p. 39 (emphasis added).]

Based on his analysis, the PR renewed his "previously expressed suggestion that 'the Commission must take the next step to move toward 100 percent coverage within a reasonable time period' and bring the rates for Standard Mail Flats in compliance with title 39." *Id.*, p. 38. Specifically, the PR "suggest[ed] that above-cap price increases or 2-3 percent for Standard Mail Flats would speed the movement toward 100 percent cost coverage and prevent further subsidization of Standard Flats by other Standard Mail products" (p. 39).

The PR's critique of the Christensen Associates model takes an approach that differs from, but can be perceived as complementary to, Valpak's critique. Reaching the same conclusion via a different route makes even more robust the view that the Commission must order that Standard Flats prices be given substantial, specific, above-CPI increases each year.

B. Pitney Bowes Finds that, when Using the Latest Price Elasticities, Larger Price Increases on Lower Contribution Products, Offset by Smaller Increases on Higher Contribution Products, Result in Greater Contribution.

PB's comments on the Christensen Associates model take an approach similar to the PR. PB also challenges the Christensen model and demonstrates that, by incorporating the latest and best evidence on own-price elasticities, Christensen Associates's risk assessment of lower contribution does not support the Postal Service's conclusion when using reasonable assumptions. The PB initial comments conclude:

> The new models are … flawed and the **results are assumption-driven.** Use of more accurate assumptions flips the results, showing that **smaller price increases on the higher-**

> **contribution products** — offset by larger increases on lower-contribution products — **improves the Postal Service finances.**
>
> For example, the retrospective model uses a price elasticity of -0.2 for Standard Mail Letters … despite the fact that the Postal Service's most recent demand equation for the former Standard Regular subclass (which consisted primarily of Standard Mail Letters) is -0.437.… Increasing the price elasticity assumption for Standard Mail Letters to -0.437 results in **a finding that larger increases for Standard Mail Flats** (the low-contribution product) … **would have increased FY 2009 to FY 2012 USPS contribution by $120 million**.… [PB Initial Comments, pp. 3-4 (emphasis added).]

In other words, PB agrees with the PR that even the Christensen Associates model itself, when utilized more properly, does not support Postal Service pricing, but demonstrates that the real risk to the Postal Service bottom line results from small price increases on negative-contribution Standard Flats.

C. ACMA Faults the Christensen Model on Several Counts.

The Christensen Associates model was helpfully designed to allow parties to try different assumptions with respect to prices, elasticities, etc. — exactly as was done by the PR, PB, and Valpak. ACMA, however, does not report to the Commission any results from testing different assumptions, but rather criticizes the Christensen Associates model as flawed for not incorporating assumptions which it asserts would have better supported continued subsidy. For example, ACMA claims that in the Christensen Associates model (1) price elasticity for flats is understated, (2) catalogs' multiplier effect is ignored, and (3) ACMA's speculative assertions about excess capacity are excluded.

1. Elasticity. With respect to understating the elasticity of Standard Flats, ACMA states:

> Although the price-elasticities of demand in the Christensen spreadsheets can be adjusted by the user, the scenarios shown assume that Standard Flats has an elasticity of -0.6. **We believe the elasticity for many catalogers is much higher** than this (in absolute value). Some of our members make mailing decisions using business planning and circulation models that have elasticities in the neighborhood of **1.35**. These models are not unique to one or two catalogers. They recognize market behaviors that we believe are common to many catalogers. Also, the elasticities estimated for the Commercial categories have always been higher than those for the Nonprofit categories. [*Id.*, p. 19 (underscore original) (emphasis added).]

This "belief" of ACMA about the elasticity of "many catalogers" is no more than a naked, self-serving, assertion — anecdotal at best, then speculatively extrapolated — submitted without any attempt at proof. Within memory, an elasticity of 1.35 has not been reported by the Postal Service for any product. Of course, even if true, the elasticity of certain companies does not control the product. It is in order to avoid such baseless speculation that the Commission requires the Postal Service to update and publish annually its econometric demand studies, and ACMA's "belief" is in not way supported by any of the data submitted by the Postal Service on January 22, 2013.

From the standpoint of business economics, if ACMA's "belief" about elasticity of Flats being "in the neighborhood of 1.35" were really true, it would have an important consequence. Namely, ACMA is telling the Postal Service that it could never expect to break even or obtain any kind of meaningful contribution from Standard Flats, because catalogers will desert the Standard Flats product in droves if the Postal Service ever tries to raise meaningfully the price of Flats to eliminate its subsidy. ACMA essentially puts the Postal Service on notice that its oft-repeated strategy — to nurture the product back to health with subsidies from other mailers[1] — is doomed to fail, and the Commission (and the Postal Service) should take note.

2. Multiplier Effect. With respect to the multiplier effect, ACMA states as follows:

> The Christensen Study does not discuss the possibility of a **multiplier**. But an increase in catalog volume would be expected to cause an increase in **parcels** and **First-Class letters**. We believe such a multiplier is a reality for catalogs and that it has financial effects on the Postal Service that **should not be neglected**. Further, considering a multiplier effect, although difficult to quantify precisely, would be consistent with the Burden Test for cross-subsidy, which is accepted as the most advanced (and only thorough) assessment of the value to an organization of a product. [*Id.*, p. 20 (emphasis added).]

ACMA's discussion of multiplier effect overlooks a number of important considerations. The most important is that it was expressly rejected by the Commission two years ago:

> Valpak argues that all products create a **multiplier effect** and that using the contribution from other products to assess Periodicals' cost coverage would be double counting. The Commission agrees. **Each product must be evaluated using its own revenues and attributable cost**. [FY 2010 ACD, p. 93 (emphasis added).]

Although the multiplier effect was rejected within the context of the Commission's discussion of Periodicals, there is no reason why it should be different for Standard Flats. As to parcels, despite the recent increase in the Postal Service's parcel volume, the vast majority of parcels are still delivered by FedEx and UPS. Thus, underwater Standard Flats, to the extent they generate package fulfilment by catalogers, can be viewed as a loss-leader paid for by the Postal Service, primarily for the benefit of highly-profitable FedEx and UPS. As to

---

[1] *See, e.g.*, FY 2012 ACR, p. 17.

First-Class Mail, now most consumer purchases from catalogs are paid at the time of purchase, which almost invariably is done via some form of electronic transaction (*e.g.*, credit card or PayPal) and usually does not involve any First-Class letters (other than, for some, a credit card statement covering multiple transactions — and even that statement is increasingly delivered and paid electronically).

3. Excess Capacity. ACMA criticizes the Christensen Associates study as follows:

> Finally, the Christensen Study contains an internal inconsistency that causes it to **lowball the profitability of the flats** it analyzes. Specifically, it assumes the **excess capacity** is of a kind that can be modeled with a below 1.0 volume-elasticity of cost but fails to see that the presence of this excess capacity implies that **the costs it uses are too high**. Automatically reducing the cost to recognize the **excess capacity** would make the scenarios more complex, but also more realistic, and it would increase the negative effects on the Postal Service of above-cap rate increases for Standard Flats, that is, the effects would be more highly negative. [*Id.*, p. 21, (emphasis added).]

ACMA's assertions about excess capacity, arguing for the use of lower costs, ignores the fact that the Commission determined that "short-run marginal costs is not an appropriate basis for evaluating the adequacy of revenues." FY 2010 ACD, p. 93. ACMA's claims concerning excess capacity are discussed more fully in Section II, *infra*.

II. AMERICAN CATALOG MAILERS ASSOCIATION

A. Standard Flats Again Requires a Finding of Noncompliance.

ACMA believes the setting for this annual compliance review of Standard Flats can be found in one sentence of the Commission's Order on Remand in Docket No. ACR2010: "The Commission responded to the remand in Order No. 1427 (August 9, 2012), saying that to decide if the situation is 'extreme,' the 'totality of circumstances presented' must be considered (at 4)." ACMA Initial Comments, p. 3. If a loss of $532 million on Standard Flats in FY 2012, with $2.6 billion lost over five years, is not sufficiently serious to meet that standard, one would hope the Postal Service never has to confront what ACMA considers a serious problem.

ACMA questions why the Standard Mail "groupings" are the way they are, because if "a category is to receive scrutiny, including under § 101(d), its meaningfulness should be established." *Id.*, p. 4. Valpak believes that sufficient justification for evaluating the cost coverage of Standard Flats is found in the Commission's ruling that: "Each product must be evaluated using its own revenues and attributable costs." FY 2010 ACD, p. 93.

ACMA believes Standard Flats should not be evaluated as a product:

> We have explained that Standard Flats is a non-homogeneous grouping that does not relate well to mailings or markets. Therefore, it being axiomatic that **the mere availability of a cost coverage figure is not a good reason for attaching importance to it, some justification is needed** for any attention accorded its cost coverage.... The lack of desirable attributes in the constitution of the Standard Flats category makes shaky ground for evaluating the level of its cost coverage. [ACMA Initial Comments, p. 24 (emphasis added).]

ACMA's argument — that the Commission should ignore the reported cost coverage of the Standard Flats product because ACMA disagrees with the makeup of the Standard Mail products — is not new. Last year, ACMA argued that the product designations do not provide an appropriate way to measure cross-subsidy within the Standard Mail class. *See* FY 2011 ACD, p. 117. The Commission rejected that argument then, stating that "measuring cost coverage is a reasonable way to test for intra-class cross-subsidies." *Id.*, p. 118.

ACMA correctly noted that, "[a]s a practical matter, the law allows considerable leeway in product designation," citing 39 U.S.C. section 102(6). ACMA added, "it is clear that the law countenances almost any product breakdown."[2] However, this point alone undermines the rest of ACMA's argument against the Standard Flats product designation. Since the Commission has such broad discretion to determine what a product is, there is an extremely high burden to show that the products are wrong or illegal.

ACMA poses numerous questions about the Standard Flats product, but makes no attempt to answer the questions it poses. These questions can be answered, but in a way that presumably will not satisfy ACMA.

> *1. In terms of its homogeneity, its use by mailers, its relation to markets, its scope, the ease of interpreting results on it, its alignment with mail processing and delivery operations, or some other characteristics, what is it about the Standard Flats grouping that makes its cost coverage particularly meaningful?* [ACMA Initial Comments, p. 4.]

The Postal Service and Commission adopted the current products based on a variety of factors, such as shape, demand factors, mailer preparation requirements, and processing methods. The product definitions were not created to discriminate against any category of mailer, but are a fair way to measure profitability. All product designations are meaningful, and the billions of dollars of losses on Standard Flats makes that product "particularly meaningful." Rather than just raise questions, ACMA could petition for changes in products, but has not done so.

---

[2] Indeed, the Commission has indicated that "the term 'product' in section 102(6) is so general that almost any category of mail nominated would qualify" (Order No. 536 at 22, September 14, 2010, Docket No. RM2009-3). ACMA Initial Comments, p. 2 and n.4.

> *2. Why is the Standard Flats grouping of categories more deserving of attention than other candidate categories or groupings of categories?* [*Id.*]

All products are examined in an annual compliance review. Although ACMA seems to believe that the fact Standard Flats lost $2.6 billion over the last five years does not make it "more deserving of attention," but the Commission cannot avert its eyes from that serious problem.

> *3. Since, in effect, the Nonprofit grouping is designated by Congress to have below-cost rates, why are the Nonprofit categories included in the Standard Flats category that receives attention?* [*Id.*]

The basic assumption of this question is incorrect as a matter of law. 39 U.S.C. section 3626(a)(6) specifies a reduced level of revenue per piece for nonprofit mail, but for any profitable product, this does not equate to "below-cost rates." For most of the profitable products, even the nonprofit elements have unit revenues that cover the product's unit costs. *Compare* FY 2012 CRA, USPS-FY12-1, *with* FY 2012 Standard Mail Billing Determinants, USPS-FY12-4.

> *4. If conclusions are to be reached concerning the level of the rates paid by catalog mailings, why shouldn't a grouping be selected that houses the categories used by catalog mailers?* [ACMA Initial Comments, p. 4.]

ACMA gives no deference to the Commission's establishment of the current products, or its ruling, cited above, that each product stands on its own. But even ACMA's approach helps it little. Changing the product definitions to cater to catalog mailers, for example, by combining Carrier Route and Standard Flats would result in a combined product that would be barely profitable. *See* Docket No. ACR2011, Valpak Reply Comments, pp. 17-19. The Postal Service cannot function if both Standard Flats and Carrier Route combined make no meaningful contribution. The combined catalog product would then need a large price increase in order to bring it to a level of cost coverage that makes the Postal Service self-sustaining. Someone must pay the Postal Service's institutional costs.

> *5. Why shouldn't the selection of rate elements used by catalogers, or by Commercial flats mailers generally, be a matter of Postal Service selection, according to ratesetting principles and market realities, instead of a matter of the fairness of the average level of rates of a category that houses part of this mail plus a string of Nonprofit categories?* [ACMA Initial Comments, p. 4.]

We have no idea what this means, but a compliance review is retrospective, required to determine "whether any rates or fees in effect during such [prior] year … were not in compliance with applicable provisions…." 39 U.S.C. § 3653(b)(1). This docket must consider the products as they are configured and existed during FY 2012.

Although ACMA disregards current products when it suits, it is not above arguing the case from the other side of the coin when that seems to help, stating: "The increase in FY 2012 of the reported cost coverage for Standard Flats should also be recognized…." *Id.*, p. 25. Likewise, "ACMA is deeply concerned about the rising costs of Carrier Route [one of the products that catalogers use] and its declining cost coverage." *Id.*

The ACMA Initial Comments are a collection of inconsistent, random questions and thoughts, throwing everything against the wall and hoping something will stick. ACMA has made no new points, and certainly no points worth reconsidering.

Based on substantially the same situation in FY 2010 and FY 2011, the Commission made findings of unlawful prices for Standard Flats, and were upheld by the U.S. Court of Appeals, and there is no reason to do anything else in this docket.

B. Contrary to ACMA's Contentions, Consensus Exists that the Postal Service Costing System Produces Costs Fully Adequate for Pricing Purposes.

ACMA, in another desperate effort to preserve the continuing cross-subsidy to Standard Flats, again challenges virtually the entire Postal Service costing arguing from a series of cost indices. ACMA Initial Comments, pp. 6-14. These indices illustrate the indisputable fact that, in recent years, the attributable unit cost of flat-shaped mail (as reported in the CRA) has increased faster than the cost of letters, factor prices, or the CPI. The indices also indicate that Postal Service productivity with respect to processing of flat-shaped mail may have retrogressed. Regrettably, ACMA expends little effort to investigate possible underlying causes for divergence between its indices for factor prices and unit costs. *See* section E, *infra*, for further discussion.

As the Commission described in its FY 2011 ACD, the system now used to develop attributable costs for all products in all classes of mail has been under development and refinement by the Postal Service, the Commission, and innumerable experts assisting Intervenors, for over 40 years (*i.e.*, since enactment of the PRA in 1970).[3] *See* FY 2011 ACD, p. 119. Attributable costs are designed essentially to represent long-run marginal costs.

Moreover, after a lengthy and detailed joint investigation reported in *Periodicals Mail Study, Joint Report of the United States Postal Service and the Postal Regulatory Commission*

---

[3] The Postal Service's costing system, as used here, refers primarily to the Cost and Revenue Analysis ("CRA") and to the sampling systems that feed the CRA, including the In-Office Cost System ("IOCS"), the Carrier Cost System ("CCS") and the Transportation Cost System ("TRACS").

(September 2011), the following conclusion, with which the Commission concurred, was reached with respect to the attributable costs for Standard Flats and Periodicals:

> the Commission and the Postal Service agree that the cost estimates are **reasonably adequate for rate-making purposes.** [*Id.*, p. 91 (emphasis added).]

Moreover, a recent paper by the Postal Service's Office of the Inspector General ("OIG"), *A Primer on Postal Costing Issues* (March 12, 2012) begins by stating:

> The **current costing system** was developed over time with much thought and insight from **well-known economists** including William Baumol, John Panzar, and William Vickery. It is worth noting that the **Postal Service's cost procedures have been thoroughly reviewed over the years.** In addition to numerous audits, the cost methodologies are reviewed annually by the PRC and have been debated during numerous proceedings. In addition, a joint 1999 study by the Postal Service, the PRC and the Government Accountability Office found **Postal Service costing methods adequate for ratemaking purposes**. [*Id.*, p. 2 (emphasis added).]

An even more recent OIG study, authored by Professor Michael Bradley, entitled *Short-Run Costs and Postal Pricing* (January 3, 2013), simply states that "The Postal Service **already has a vetted costing system** for calculating long-run marginal cost." *Id.*, p. 12 (emphasis added).

In sum, among a wide group of knowledgeable parties, a consensus exists that the current methodology produces costs which are adequate for setting prices. ACMA, however, would defy that consensus.

ACMA certainly has not succeeded in convincing anyone but itself that there is a problem with the costing methodologies. The Postal Service's ACR submission does not address any of ACMA's "questions" about the attributable cost of Standard Flats. Nor does the recent OIG *Primer on Postal Costing Issues* mentioned above discuss any of ACMA's cost indices or address any "questions on the costs … raised by ACMA on numerous occasions." Docket No. R2013-1, ACMA Comments (Nov. 1, 2012), p. 2 n.1. Even the OIG's *Flat-Shaped Mail Costs Audit Report* (January 4, 2013) fails to mention — much less address — any of the various cost questions raised by ACMA. Of course, Dr. Bradley's recent report on *Short-Run Costs and Postal Pricing* addresses a broad issue mentioned by ACMA — excess capacity — but that study fails to reach conclusions that would support ACMA's desired end. *See* section F, *infra*. None of these four recent expert studies indicated that any of the ACMA costing "questions" is worthy of attention. ACMA's bogus challenges to postal costing have been repeatedly rejected by the Commission. *See* FY 2010 ACD, pp. 105-106; FY 2011 ACD, p. 119.

Yet, solely to justify its below-cost pricing of Standard Flats, the Postal Service recently seemed to join ACMA in an assault on the integrity of **its own** costing system. In Docket No. R2013-1, the Postal Service made the following astonishing statement:

> Though this [decline in volume] would not pose a significant problem if processing **costs** were **perfectly correlated** to **volume**, this is simply not the case. Given the fixed nature of processing equipment and the inflexibility of union contracts, processing costs would fall less quickly than volumes. [Docket No. R2013-1, USPS Notice of Market-Dominant Price Adjustment, p. 22 (emphasis added).]

Although no one is operating under the delusion that "perfect correlation" is the standard, if the Postal Service truly believes that its costing system does not measure attributable, volume variable costs, it could file cost methodology changes that would address the issue. In the absence of a Postal Service filing to address such a problem, this statement about "perfect correlation" should be seen as nothing more than a carefully worded argument, employed to justify an indefensible position — that is, a rationalization for abusive and illegal pricing of Standard Mail to subsidize Standard Flats.

Of course, the Postal Service cannot permit these illegal prices by itself, and the Commission keeps allowing the Postal Service to get away with it. To date, Valpak, the Public Representative, L.L. Bean, and those who oppose cross-subsidies get all the rhetoric, and ACMA and the Postal Service get all the action (with the last two price increases for Standard Flats only infinitesimally — less than a tenth of a percentage point — above CPI). Not knowing why this keeps happening, Valpak feels compelled to address (again) ACMA's major costing "questions."

Going back to its cost indices, ACMA asserts:

> They support analyses of behaviors and outcomes that can be intractable. [ACMA Initial Comments, p. 6.]

ACMA's argument that unwarranted labor hours have been charged to Standard Flats rests on its cost indices. ACMA does not identify any behaviors or outcomes that should be subjected to analysis. Indeed, a critical shortcoming of those cost indices is that they provide little meaningful insight to cost causation or proper pricing.

ACMA's cost indices demonstrate only that the unit cost of handling flat-shaped mail has increased significantly — a fact which no one denies. For instance, ACMA refers to its Graph 1 (p. 8) and asks the rhetorical question: what does the cost index tell us about the 2012 outcome? The answer, of course, is: the cost index tells us that unit costs continued to creep upward. Beyond that, the cost index itself tells us nothing. The index perhaps hints faintly at productivity issues, but these are not mentioned by ACMA (*see* section C, *infra*). From these vague data, ACMA leaps to a conclusion:

> ACMA **believes** it is **clear** that the rise in the cost index for Standard Flats … is due to costs of **excess capacity** being attributed. [*Id.*, p. 9 (emphasis added).]

In truth, ACMA's conclusion here about excess capacity is pure speculation. ACMA's cost indices tell us nothing about the root causes of cost increases, nor do they point to issues that need to be investigated. It seems reasonably clear that the problem is not excess capacity. *See* section C, *infra*. Rather than seek a deeper explanation and understanding as to why the attributable cost of Standard Flats has risen, ACMA's strategy is to ask questions to generate confusion, to sow as much doubt as possible about the costing system generally, and the cost of Standard Flats in particular. If ACMA had any purpose other than an effort to obscure unlawful rates, it would suggest methodological changes that might improve the Postal Service costing system, or seek a rulemaking docket to consider methodological changes, particularly since it was specifically encouraged to do so by the Commission. FY 2011 ACD, p. 119.[4]

---

[4] Of course, the present system is not inexpensive to operate, and any system based on sampling will always be subject to sampling error. From time to time, various changes that might improve the costing system have been suggested. For example, it has been suggested that the Postal Service: (i) use IMb data to improve cost accuracy, (ii) employ bottom-up costing, (iii) get rid of IOCS and rely on model costs reconciled with audited total costs, or (iv) base price adjustments on short-run costs. Extensive discussion on complex suggestions such as these belong in a rulemaking docket.

C. ACMA's Ignores All Factors that Could Be the Source of Increased Unit Mail Processing Costs for Standard Flats Other Than Excess Capacity.

ACMA states that "The indication is that excess capacity and large factor price increases have caused reductions in cost coverage." ACMA Initial Comments, p. 14. ACMA also states "a low cost coverage is caused by the excess capacity" (*Id.*, pp. 15-17 (italics omitted)). This conclusion is problematic in a number of respects.

First, as the OIG study by Dr. Bradley explains, excess capacity — when it exists — should be viewed as a short-run phenomenon while the firm adjusts its input mix in a manner that will return it to a long-run equilibrium condition. "By definition, the short-run is a 'temporary' condition." *Flat-Shaped Mail Costs Audit Report*, p. 20. The unit attributable cost for Flats was **$0.448** in FY 2009 and has risen gradually to **$0.465** in FY 2012; *see* Table II-1, *infra*. Continuation of high unit cost **over four years does not reflect a short-run phenomenon**. If attributable costs do reflect excess capacity, as ACMA alleges throughout its ACR comments, then the unit cost should have begun to show some decline, as adjustments were made to reduce whatever excess capacity exists. That does not seem to be happening, however. Unit costs have crept upwards, even while the Postal Service has been making significant staff reductions. In the five-year span from 2008 to 2012, the number of "clerks/nurses" declined by 28 percent, from 194,907 to 139,666, and mailhandlers declined by 12 percent, from 55,812 to 49,033.[5] 2012 Report on Form 10-K, p. 107. Despite these rather extensive reductions in the size of the mail processing labor force, the unit cost of

---

[5] As the OIG Report explains, a first step is identify the particular input(s) with excess capacity, *i.e.*, inputs that cannot be adjusted to their optimal levels. *Id.*, p. 15. In the case of Flats, the source of any excess capacity necessarily would be labor.

Standard Flats has inched up, not down. ACMA's hypothesis does not appear to be well-supported by available evidence, and ACMA ignores other factors.

The OIG's *Flat-Shaped Mail Costs Audit Report* notes that flat mail is not homogenous, but rather includes a wide variety of shapes, sizes, weights, and thicknesses (*e.g.*, large envelopes, newspapers, catalogs, magazines) — which makes such mail more difficult and costly to process than relatively uniform letters. *Id.*, p. 4. For five flat-shaped products, the CRA unit cost over the last five years is shown here in Table II-1.

Table II-1

Unit Attributable Cost of Flat-Shaped Products
2008 – 2012

Fiscal Year	First-Class Flats	Carrier Route	Standard Flats	Outside County Periodicals	BPM Flats
2008	0.761	0.150	0.389	0.339	0.544
2009	0.753	0.160	0.448	0.363	0.498
2010	0.865	0.165	0.448	0.364	0.563
2011	0.872	0.177	0.463	0.365	0.498
2012	0.874	0.189	0.465	0.377	0.600
Change, 2008-12	14.8%	26.0%	19.5%	11.2%	10.3%

Source: CRA Reports for each respective year.

As can be seen from Table II-1, over the five-year period shown, the cost of each of the five products in Table II-1 has increased by varying percentage amounts. Also, the CRA consistently shows that flat-shaped products are expensive to handle, relative to letters. In general, the more the Postal Service handles a product, the higher the cost.[6] The most costly flat-shaped product by far is First-Class Flats, which require extensive handling because they are completely unsorted, followed by BPM flats. The unit cost of these two products exceeds by a substantial amount the cost of Standard Flats, which are presorted to varying degrees. Flats (catalogs) presorted to Carrier Route, which require no individual handling before reaching the carrier, are the least costly to handle, as one would expect.

The sole reason proffered by ACMA for the increase in mail processing cost of Standard Flats is excess capacity. However, other causal factors that have nothing to do with excess capacity help explain increased mail processing costs of Flats, such as :

- **Increased reject rates on SPBS equipment.** The response to ChIR No. 5, question 21 notes that increased reject rate on SPBS equipment caused the TPH/TPF ratio to decline. Although the response provides no information on why reject rates increased, three conclusions can be drawn at this point: 1. Higher reject rates increase costs. 2. Higher reject rates neither reflect nor are caused by excess capacity. 3. Higher reject rates provide no support to ACMA's automation refugee hypothesis.

- **Lower productivity on AFSM operations.** The response to ChIR No. 5, question 23(c) confirms that AFSM Incoming Secondary productivity declined 17.7 percent from FY 2008 to FY 2012. This response likewise offers no reasons that might explain such a major decline in productivity. However, no link exists between lower productivity for mail processed on AFSMs and excess capacity. This finding, although troublesome, also provides no support for ACMA's hypothesis about excess capacity being the cause of increased Flats cost.

---

[6] A major factor underlying increased postal labor cost has been **employee benefits**. From 1972 to 2011, Postal Service benefits increased by "an astounding 448 percent above inflation." USPS OIG, *The Cost Structure of the Postal Service: Facts, Trends, and Policy Implications,* Report No. RARC-WP-11-007, p. i. (July 20, 2011). **This contributes to widening of the gap between manual and automated sortation**.

- **High FSS costs.** The response to ChIR No. 5, question 24(b) states "It appears that in FY 2012, FSS raised costs for these three products [Periodicals, Standard Flats, Carrier Route] as compared with FY 2010 costs." At this point, FSS machines have a troubled history. Although the productivity issue with respect to FSS helps explain the increase in ACMA's cost index, none of the problems with FSS relates to excess capacity, again undermining ACMA's hypothesis.

Although each of the above sources of lower productivity and higher unit costs is troubling and worthy of further investigation, none supports ACMA's excess capacity hypothesis. Nor does any justify continued cross-subsidization by other profitable products. It is appropriate to hold the Postal Service accountable for such performance. However, even if the Postal Service overcomes the underlying problems and achieves a moderately dramatic increase in productivity over the next few years, and even if any resulting reduction in cost were to cause Standard Flats coverage finally to exceed 100 percent, coverage still would be quite low in comparison to other products in Standard Mail.[7]

Unwarranted manual sortation of Standard Flats, yet another potential source of increased mail processing costs, lies at the very heart of ACMA's assertions about excess capacity. However, increased manual sortation can result from several factors other than excess capacity. The *Flat-Shaped Mail Costs Audit Report* indicates that, as recently as 2011, almost 31 percent of all flat-shaped mail was processed manually. *Id.*, p. 2. In 2009 the percentage of all flat-shaped mail processed manually was still a high 34.8 percent; that percentage has declined only gradually, to 29.3 percent by 2012. *Id.*, p. 6. Most of the

[7] If the rate for flats were increased to $0.45 (approximately 100 percent cost coverage), the cost of flats would need to decrease to $0.30 in order to achieve a respectable coverage (for Standard Mail) of 150 percent

decline from 34.8 to 29.3 percent occurred in the last two years, and is attributed to deployment and utilization of the Flat Sequencing System ("FSS").[8] The Base Year for many of ACMA's cost indices is 1998. In most of the 13-year period covered by ACMA's cost indices (1998-2011), it would appear likely that over one-third of all flat-shaped mail was being processed manually.

The Audit Report does not distinguish between Carrier Route, Standard Flats, Periodicals, or First-Class flats, so it is entirely conceivable that, in recent years, the share of Standard Flats processed manually was even higher than the percentage for all flats. According to that Audit Report, at facilities with flats automation equipment, only 11 percent of flat-shaped pieces are processed manually. Some (perhaps many) of those pieces are sorted manually because they are **non-automatable** (*e.g.*, newspapers). *Id.*, p. 2, Table 2. This finding does not support ACMA's belief in automation refugees, which says that Standard flats are processed manually even though they are automatable and automation equipment may be available (and idle).

The Audit Report tells us that "[t]he Postal Service has 170 SCFs, serving 190 3-digit ZIP Codes and 1,400 5-digit ZIP Codes that do **not** have flat mail processing equipment." *Id.*, p. 7 (emphasis added). These Non-MODS facilities account for 72 percent of all manual processing of flat-shaped mail. This finding — that flats are sorted manually because many

---

[8] A higher percentage of Flats processed on FSS does not necessarily reflect a reduction in unit cost. In FY 2012, FSS sorting cost per piece for Carrier Route was 1.84 cents, which more than offset "a decline of 0.49 cents per piece in Cost Segment 6, in-office city carrier labor costs, between FY 2010 and FY 2012." Response to ChIR No. 3, Q. 5, (Jan. 22, 2012).

Non-MODS facilities still do not have automation equipment for sorting flats — likewise offers no support for ACMA's conclusion that flats are sorted manually because of excess labor capacity. The Audit Report also notes that:

> In general, the Postal Service does not process flats on automated equipment when:
>
> * * *
>
> - **Thresholds for automated processing cannot be met.** For example, the mail submission has too few mailpieces to process on automated equipment or the submission has insufficient mail processing densities to meet automation processing thresholds.
>
> - **Other classes of mail may have a higher processing priority** in order to meet delivery schedule windows and automation machinery assets are limited. For example, a manager may direct First-Class Mail with overnight service requirements to receive a higher automated processing priority than machinable flats. Thus, automation equipment is not available to process certain types of flat mail and the mail is processed manually to meet delivery standards. [*Id.*, p. 4 (footnote omitted, emphasis added).]

With respect to the first bullet above, the significant decline in Standard Flats volume may well have increased the number of occasions when thresholds for automated processing are not met, causing more Standard Flats to be processed manually, and contributing to increased unit costs discussed by ACMA. If ACMA believes that failure to meet requisite thresholds for automated processing is an indication of excess capacity, it needs to explain why that is so.

With respect to the second bullet above, efforts by the Postal Service to improve service performance, especially for First-Class and Periodicals, may have pre-empted automation equipment and caused manual processing of Standard Flats to increase, not decline — despite

ACMA's preference for automated handling — because Standard Flats receive lower priority in processing than either First-Class or Periodicals. Notably, that lower processing priority assigned to Standard Flats has nothing to do with excess capacity.

A recommendation contained in the recent Audit Report is that the Vice President for Network Operations should ensure that:

> [a] processing strategy is developed to move single-piece First-Class Mail flats from manual to automated operations in facilities that have flat automation equipment." [*Id.*, p. 9.]

Nothing about this recommendation to give priority on automation equipment to First-Class flats would increase the percentage of Standard Flats processed on such equipment, and it could well lead to (i) an increase in the percent of Standard Flats processed manually, and (ii) a yet further increase in ACMA's cost index.

ACMA does not explicitly allege that increased manual processing of Standard Flats has occurred. ACMA prefers to deal in "questions." However, even if a higher percent of Standard Flats is being processed manually, that would not necessarily support ACMA's implicit automation refugee hypothesis. As explained above, sound reasons could account for such increased manual processing and help explain trends in processing costs for Standard Flats shown in ACMA's cost indices.

Finally, the *Flat-Shaped Mail Cost Audit Report* notes that coverage of Standard Flats (and Periodicals) is deeply underwater, and says that reducing expensive manual sortation to the "stretch goal" of 20 percent **could achieve only about 10 percent of the cost reduction needed** to increase coverage of Standard Flats to 100 percent. It then states:

> these improvements are important because they help establish a clearer picture of the **pricing changes needed to ensure flat mail products cover their attributable costs**. [*Id.*, p. 3 (emphasis added).]

Thus, the OIG Audit Report (unlike Postal Service personnel responsible for pricing) views costs as the *raison d'etre* for price changes, designed to ensure that Standard Flats cover their attributable costs.

ACMA's position on costs and pricing differs starkly from the OIG. ACMA attempts to use its "analysis" of increased flats cost to cast doubt on the integrity of both (i) the cost system, and (ii) postal operations. However, it is neither constructive nor particularly helpful merely to raise questions, as ACMA does, without at least proffering for investigation hypotheses that might help explain underlying causes of cost behavior and, possibly, even help improve operations.

To sum up, ACMA's "belief" that costs of excess capacity are being attributed to Standard Flats is unsupported by any evidence. Its cost indices indicate that productivity in the handling of Standard Flats appears to have declined — for reasons unknown and unexplored by ACMA. ACMA has not provided even one credible reason to conclude that attributable costs produced by the Postal Service costing system should not be the basis for assessing adequacy of prices.

D. Use of Short-Run Marginal Costs Fails to Provide Support for ACMA's Pleas to Continue Below-Cost Prices for Standard Flats.

Even in the unlikely event that excess capacity helps explain some meaningful fraction of the recorded increase in the unit cost of Standard Flats, that alone does not justify below-cost pricing for Standard Flats. Following its discussion of excess capacity, ACMA attacks the use of long-run attributable costs:

> As appears to be happening, the costs of the **excess capacity** get attributed and distributed to products in an ordinary long-run costing exercise. The long-run attributable cost that results turns out to be too high. It will not be causal or based on volume variability. It will not be an efficient cost. *It will be an excessive cost.* … the costs of excess capacity should be estimated, and, presumably, should be removed from the attributable costs. This is both logical and good business practice. **It is true that the costs of excess capacity must be paid** by the Postal Service overall, but it is not true that they are properly attributed to specific products. [ACMA Initial Comments, pp. 16-17 (italics original, emphasis added).]

Needless to say, if the costs of excess capacity somehow could be identified and cease to be attributed — thereby increasing the already high level of institutional costs — ACMA then would resist fiercely any suggestion that Standard Flats be assessed a coverage significantly exceeding 100 percent, in order to help pay for the increased base of non-attributable (institutional) costs. Although acknowledging that costs of excess capacity must be paid along with all other institutional costs, ACMA doubtless would argue that Standard Flats should under no circumstances ever pay more than (reduced) attributable costs, and that other mailers should be responsible for covering all institutional costs.

The issue of excess capacity is discussed extensively in Dr. Bradley's study, *Short-Run Costs and Postal Pricing*,[9] because excess capacity is the sole rationale for considering the use of short-run cost as the basis for setting prices. Thus, although that study never expressly mentions pricing of Standard Flats, it is pertinent to evaluating ACMA's assertions.

---

[9] USPS OIG Report RARC-WP-13-004 (Jan. 9, 2013).

Probably the most important point in Dr. Bradley's OIG study relating to pricing of Standard Flats is that the existence of excess capacity does not mean attributable costs are not relevant for rate purposes. ACMA's belief that excess capacity exists and its costs somehow are being attributed to flat-shaped mail gives rise to questions that Dr. Bradley helps us answer:

- First, is excess capacity the primary or sole source of growth in the attributable cost of **only** Standard Flats, or rather **all flat-shaped** products, including First-Class flats, Carrier Route, and Bound Printed Matter flats? (*see* Table II-1, *infra*)
  - If so, is the cost of all flat-shaped products being affected more or less **equally**, or has the cost of Standard Flats somehow increased **disproportionately** to the cost of other flat-shaped products? If the latter, why?
- If excess capacity is the principal factor causing attributable costs of Standard Flats to increase, would it be appropriate to use **short-run costs** when pricing Flats?

Dr. Bradley's comments in the OIG Report are highly pertinent to whether short-run costs should be employed for pricing Standard Flats, at least on some interim basis, in lieu of long-run costs:[10]

> The primary advantage of using **long-run marginal cost** as the basis for pricing is that its use is **consistent with the "best" outcome**, in which **resources are efficiently allocated** given the market structure. This is the efficient outcome because consumers and firms are responding to the set of **price signals** that lead them to their overall **optimal choices** of consumption and production. In other words, the use of long-run marginal costs as the basis for prices facilitates moving the market to its long-run, most profitable position. [*Id.*, p. 5 (emphasis added).]

---

[10] The OIG Report goes into some detail about issues and problems involved in measuring short-run costs. They are not insurmountable, and need not be an issue here.

However, the OIG Report also notes that, under certain specific conditions, some advantages possibly can result from using short-run marginal cost (when lower) to justify a reduced price. Even if excess capacity exists and short-run marginal cost is less than long-run marginal cost, that alone is far from a sufficient reason to base prices on short-run costs, as ACMA would prefer to believe. Dr. Bradley explains:

> The primary advantage of using **short-run costs** is that the resulting prices can match demand to supply during a period of suboptimal capacity. However, such a matching is **dependent upon the responsiveness of consumers to price changes.** Consider the situation in which the firm has excess capacity, so that the short-run marginal cost is less than the long-run marginal cost, and the short-run price will be below the long-run price. **If consumers respond** to the lower price by **expanding purchases in a timely fashion,** then output will expand and the firm will be able to make better use of its excess capacity.
>
> However, if **consumers are generally unresponsive** to the price change, then the firm **will just lose revenue as a result of lowering the price.** In this instance, it is **better** for the firm **to use long-run prices** rather than short-run prices. Similarly, if consumers' response to price changes is very slow, there may not be enough time for them to respond to a price decrease before the excess capacity is eliminated. This **also leads to a preference for long-run prices.**
>
> The responsiveness of consumers to a price change may be unknown or difficult to measure. If so, **the risk** associated with using lower short-run prices **produces an advantage for sticking with long-run prices.** [*Id.*, pp. 7-8 (emphasis added).]

The Postal Service's Christensen Associates model, discussed in Section I, *supra*, states that, over the last several years, Standard Flats has been subject to an **autonomous secular**

decline averaging -8.7 percent per annum.[11] The model assumes that the own price elasticity of Standard Flats is -0.600, an assumption that is somewhat more elastic than the -0.437 elasticity estimate submitted by the Postal Service on January 22, 2013. With Standard Flats already priced well below long-run marginal cost, and volume nevertheless in fairly sharp decline, no evidence suggests that below-cost pricing of Standard Flats will result in expanding volume. Rather, by keeping the price of Standard Flats artificially low, well below long-run attributable costs, the Postal Service is just losing revenue and contribution, exactly as Dr. Bradley's analysis suggests.

E. ACMA's Argument Concerning Excess Capacity in City Carrier Street Costs Fails to Recognize that Access and Load Time Can Be Expected to Increase when Volume Declines.

The Postal Service's response to ChIR No. 5, question 24 indicates that, between FY 2010 and FY 2012, Standard Flats' unit cost for delivery (including indirect costs) actually declined by a very small amount, from $0.1595 to $0.1583. ACMA's Graph 2 (p. 10), on the other hand, shows increased city carrier marginal street time per piece for Standard Flats.[12] One might expect an increase in time per piece to be reflected in increased unit cost.

---

[11] "[In FY 2012,] the volume of flats decreased 12.4 percent, somewhat more than the decrease for letters." ACMA Initial Comments, p. 11.

[12] ACMA states that "the results displayed in [the same] Graph 2 … for city carrier street time show excess capacity clearly." ACMA Initial Comments, p. 13. The graph shows no such thing. Aside from the fact that ACMA's argument requires it to find excess capacity everywhere, ACMA does not bother to explain (i) how a graph exhibiting marginal time per piece ever could be expected to reflect excess capacity, or (ii) how one should estimate the extent of any excess capacity in the city carrier labor force.

However, since total cost is essentially flat, the decline in volume may help account for some or all or ACMA's increased time per piece.

In Docket No. R2013-1, ACMA's discussion about city carrier street costs attributed to Standard Flats began with the following statement:

> We have assembled data from FY 2007 to FY 2011, and have used carrier wage rates for each year to convert the unit costs into marginal seconds per piece. Though elemental and small in and of themselves, marginal seconds get multiplied by billions of pieces, and then magnified when piggyback costs and indirect costs are layered on. Therefore, they account for a significant proportion of the costs reported. [Docket No. R2013-1, ACMA Comments, p. 12.]

The discussion about the observed increase in city carrier street costs continued with the following "analysis:"

> Several **questions** arise. The R2005-1 Recommended Decision (at 68) shows additional times of 1.7 seconds for both letters and flats, but in the FY 2007 CRA, letters had crept up to 2.0 seconds and flats to as high as 2.3 seconds. Then by FY 2011, the additional times ranged from 2.3 to 2.7 seconds. If one thinks of 1.7 seconds as being characteristic of the behavior of the delivery system (additional time to finger an additional piece, to carry an additional tray when needed, and so forth), these increases are startling. **We know of no changes in operations that might explain them.** [*Id.*, p. 13 (emphasis added).]

In what might be described as its "customary" fashion, ACMA does not offer hypotheses that might add perspective and insight to what may be happening in city carrier operations, or about how costs might be expected to behave when volume declines by a significant amount.

Volume variability on city carrier routes derives in part from coverage on the route. Access time especially, and load time to some extent, resemble an on-off switch: zero if the address has no mail for delivery that day, and a positive amount if the carrier has any mail to deliver. If access to a residence is necessary, access time is fixed. Further, except for "fingering time," which may be *de minimis*, load time at individual residences also is close to being fixed. That makes those two cost elements subject to quite substantial **economies of scale** when volume **increases**. This is especially the case for walk and loop routes that serve single-family detached houses. And, of course, when volume **decreases**, costs can be said to reflect **diseconomies of scale**.

To illustrate, consider a park and loop route where mail is delivered to the door of each house. For each residence for which the carrier has mail, assume it takes 30 seconds to walk from the sidewalk to the door (access), then load mail into the receptacle and return to the sidewalk (*i.e.*, back to the route). When a house receives **six pieces** of mail, the average access and load time is **five seconds** per piece. However, when a house receives **three pieces** of mail, the average access and load time is **10 seconds** per piece. And when a house receives only **one piece** of mail, the access and load time is **30 seconds** for that one piece. It stands to reason that when a carrier has **fewer pieces** to deliver, the **average time per piece** can be expected to **increase**. Importantly, with respect to ACMA's statement, such an increase in average time per piece does not mean the carrier is working any slower, or taking longer to finger the mail. Nor has there been any change in operations in this hypothetical example. The carrier is simply delivering to each residence the mail which the carrier has to deliver.

To be sure, not all routes are of the park and loop variety. Some city carrier routes include large apartment buildings, where access time per recipient is *de minimis*, but time to sort and load mail into every individual receptacle in the entire building is not fixed. Also, some neighborhoods with single-family residences receive their mail in curbside mailboxes, and on those routes access time for any residence receiving mail is much less than on park and loop routes with delivery to each individual door. Nevertheless, as volume declines, and the average number of pieces per delivery point declines over the entire universe of city carrier routes (which includes many thousands of park and loop routes providing door delivery), the expectation would be that declining volume will necessarily result in a higher average time per piece for access and load time.

Therefore, the answer to ACMA's implied "question" is: no change in operations is required in order to explain increasing city carrier time (and cost) per piece when mail volume declines significantly, as in fact has occurred. Further, since the volume of flats and letters both have declined, an increase in the average time per piece for each is to be expected, which appears to be what ACMA found. Moreover, since the volume of flat-shaped pieces has declined more rapidly than letters, a larger increase in the average time per flat is to be expected, also in line with ACMA's results. The question that needs an answer is why ACMA believes that some change in operations is necessary to explain its observed changes in city carrier time (and cost).

F. Advertising Matter in Catalogs Has the Same Value as Other Standard Mail Advertising Matter.

ACMA claims that catalogs have "considerable value," citing factor (1) in the ratemaking system, and arguing that prices must take into account "the **value** of the **mail service** actually provided each **class or type of mail service** to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery" under 39 U.S.C. § 3622(c)(1) (emphasis added).[13] ACMA Initial Comments, p. 22.

If ACMA's argument is referring to the "value" of the **mail piece**, the response is that all Standard Mail is advertising mail. Mailers decide to use various types of advertising based on the audience they are reaching, the approach they are using, the amount of information they need to convey, and other factors. If mailers did not believe that each type of advertising they were using had value to them and their customers, they certainly would not send it. Catalogs are but one type of mail that makes use of the Standard Mail class. Some mailers like catalogs, some like coupons, some like other formats, and some like all of it. It would be impossible to distinguish some Standard Mail from the rest, and therefore ACMA's argument fails. Alternatively, if ACMA is arguing that factor (1) refers to the "value" of the **service provided** by the Postal Service, ACMA's argument fares no better. Standard Mail is designed to provide a level of service to mailers not requiring the level of service provided for First-Class Mail (sealed against inspection, entitled to forwarding/return to sender), Priority Mail, or Express Mail. Standard Mail has certain preparation requirements and qualifications that apply uniformly across the class. Processing varies by shape and point of entry, but all Standard Mail generally has the same "mode of transportation, and priority of delivery."

ACMA, seeking to wish away nonprofit mail, asserts that "Commercial catalogs are certainly a 'type of mail service...'" under factor (1). *Id.* However, if commercial catalogs

---

[13] ACMA mentions an unscientific survey that it commissioned (that it attached to its comments in Docket No. R2013-1), which purportedly found that "[o]f unsolicited mail, 46 percent found catalogs useful while 5 percent found non-catalogs useful." ACMA Initial Comments, p. 22.

are to be considered a "type of mail service" as ACMA argues, factor (2) — "the requirement that each class of mail or **type of mail service** bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships **plus that portion of all other costs** of the Postal Service reasonably assignable to such class or type" (39 U.S.C. § 3622(c)(2) (emphasis added)) — would require that they pay substantially more than they do.

ACMA even goes so far as to claim that a "good deal of information in catalogs qualifies as educational, cultural, or scientific, factors mentioned in § 3622(c)(11)." ACMA Initial Comments, p. 22. Factor (11) requires consideration of "the educational, cultural, scientific, and informational value to the recipient of mail matter." This consideration, known as "ECSI," to date has been recognized as applying only to Periodicals and, to some degree, Library Mail/Media Mail. *See* FY 2010 ACD, pp. 90, 95, 120; FY 2011 ACD, pp. 102, 106-107. It has been so limited, despite the efforts of various types of mailers to invoke its protection. Probably any Standard Mail user could assert that some of its content contains some ECSI value, but that has not been recognized historically.

Therefore, ACMA's argument that advertising through catalogs has greater value than other Standard Mail advertising and deserves "recognition in postal rates" (p. 23) fails.

III. DIRECT MARKETING ASSOCIATION

The Direct Marketing Association ("DMA") filed brief Initial Comments in support of continued low price increases for underwater products generally, and Standard Flats in particular, managing to confuse three important issues.

First, with respect to underwater Standard Flats generally, DMA speculates that continued Postal Service cost-cutting efforts will so alter postal costs in FY 2013 that evaluation of product coverage using FY 2012 costs will be meaningless. *See* DMA Initial Comments, p. 1. No evidence whatsoever is presented for this proposition. The Postal Service has devoted considerable attention to cost cutting over the past several years. It reports that it has cut 136,060 total employees between FY 2008 and FY 2012 (USPS FY 2012 Annual Report to Congress, p. 24). As the Postal Service, the Postmaster General, and others are fond of saying, the low-hanging fruit has been gathered.[14] Nevertheless, contrary to DMA's theory, during these years of aggressive cost cutting, coverage levels for most underwater products either have worsened or remained reasonably stable. For example, coverage of Periodicals in the past four years has ranged from 76.04 percent in FY 2009, to 75.46 percent in FY 2010, to 74.94 percent in FY 2011, to 72.10 percent in FY 2012. *See* Valpak Initial Comments, p. 123. If it occurs at all, savings from 5-day delivery will not begin until FY 2014, and cost savings from plant consolidation are not dissimilar to what has occurred in other areas in prior years. Of course, should FY 2013 see some dramatic change it would be noted and accounted for by the Commission in its next ACD. Interestingly, DMA appears to fail to recognize an important implication of its speculation. If costs from one fiscal year are not a sufficient basis for the Commission's evaluation of the lawfulness of postal pricing at the end of that year in an Annual Compliance Review, PAEA's mandated Annual

---

[14] *See, e.g.*, M. White, "Postage prices rise, but USPS still teeters at the edge of ruin," NBC News, http://www.nbcnews.com/business/postage-prices-rise-usps-still-teeters-edge-ruin-1C8146115.

Compliance Review would constitute a regulatory failure — a process created in legislation which DMA supported.

Second, with respect to Standard Flats:

> DMA does not understand the insistence of the Commission to require **its myopic view** of flat-shaped mailings. The Commission should be encouraging the Postal Service to grow volume in order to **spread institutional costs**. [DMA Initial Comments, p. 1 (emphasis added).]

Although DMA calls the Commission's view "myopic," it would prefer for the Commission to be blind[15] to the Postal Service's FY 2012 loss of $532 million, as well as its cumulative five-year loss of $2.6 billion, from Standard Flats. DMA says that it "represents approximately 2,000 member companies" (*id.*, p. 1), and although some of those for-profit companies benefit greatly from the subsidy to Standard Flats, others must pay extra for that subsidy. DMA does not seem to understand that an underwater product not only contributes nothing to institutional costs, it also requires that other mailers, including many of DMA's own members, pay higher rates. Should the Postal Service experience a major increase in Standard Flats volume among which it could "spread [its] institutional costs," it likely would be out of cash by summer.

Third, and last, with respect to Standard Flats, according to DMA, evaluation of compliance of that product:

> **discourages mailers from growing their volume**, from **prospecting** for potential new customers. This type of analysis is **anti-growth** and continues the Postal Service on the road of slow death. [DMA Initial Comments, p. 1 (emphasis added).]

---

[15] DMA's advice is in the best tradition of Leslie Nielsen: "Move on. Nothing to see here. Please disperse. Nothing to see here." http://www.youtube.com/watch?v=rSjK2Oqrgic.

Here, DMA's comments diametrically oppose those filed by L.L Bean, Inc. in Docket No. ACR2011.[16] In the last Annual Compliance Review, L.L. Bean explained:

> **Carrier Route** is far more heavily used by catalogers in **prospecting** for new customers. Catalogs sent to prospects typically generate a lower response rate and return-on-investment than those to current customers. Unlike the "high value" customer addresses to which a cataloger will continue to mail even in hard times, prospect mailings to non-customers consequently have a higher postal-price sensitivity. **The Postal Service's perverse pricing thus discourages prospecting** and impairs the ability of catalogers to expand their businesses – undermining the Postal Service's objective of turning the catalog industry into "a growth segment in its business over the long run." [L.L. Bean Initial Comments, Docket No. ACR2011, p. 3 (Feb. 3, 2012) (emphasis added).]

DMA fails to understand what L.L. Bean explained, that Carrier Route is what catalogers primarily use for prospecting. DMA therefore urges the Postal Service to continue what L.L. Bean described as "perverse pricing."

IV. ALLIANCE OF NONPROFIT MAILERS

The Alliance of Nonprofit Mailers ("ANM") presents an issue to the Commission regarding nonprofit mail rates that has no direct affect on Valpak, but which is illustrative of an important problem increasingly faced by mailers. The problem raised by ANM relates to the Postal Service's refusal to comply with 39 U.S.C. section 403(c), as interpreted by National Easter Seal Society v. U.S. Postal Service, 656 F.2d 754 (D.C. Cir. 1981),[17] and as

---

[16] http://www.prc.gov/Docs/80/80263/L.L.Bean%20ACR2011.pdf.

[17] The Postal Service appears to have accepted its loss in the National Easter Seal Society case about as well as it accepted its loss in U.S. Postal Service v. Postal Regulatory Commission, 676 F.3d 1105 (D.C. Cir. 2012). *See* Docket No. ACR2012, Valpak Initial Comments, Sections III and VI.

applied here to workshare discounts that discriminate between nonprofit and commercial mail without a reasoned justification, and the Commission's apparent willingness to allow it to do so. Valpak is concerned with the Postal Service's refusal to obey in good faith — by using increases of less than a tenth of a percentage point over the cap[18] — the Commission's remedial Standard Flats order for violating a different statute, 39 U.S.C. section 101(d). However, the core of both problems seem to be based largely on an improper understanding of "pricing flexibility."

The Postal Service, and all too often the Commission, invoke the term "pricing flexibility" as though Congress intended the Commission to give a type of Chevron[19] deference to the Postal Service's preferences, as though the Postal Service were the regulatory agency. However, it is the Commission, not the Postal Service, that Congress has established as the regulatory agency. *See* 39 U.S.C. § 503. Therefore, it is the Commission's decisions, not the Postal Service's preferences, that enjoy judicial deference whenever its "decision[s] as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting matters subjected to agency regulations." Chevron,

---

[18] The Commission ordered **above-average price increases** for Standard Flats in its FY 2010 ACD (March 29, 2011), p. 107, but the Postal Service's compliance since then has been *de minimis*.

The Postal Service's price increases since then were a grudging, infinitesimal:

* **0.076 percent** increase over CPI in Docket No. R2012-3, and
* **0.047 percent** increase over CPI in Docket No. R2013-1, the latter increase after remand from the Commission. *See* Order No. 1541 (Nov. 16, 2011).

[19] Chevron U.S.A. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

467 U.S. at 844. *See* U.S. Postal Service v. Postal Regulatory Comm'n, 599 F.3d 705, 710 (D.C. Cir. 2010).

Although the Postal Service has a measure of "pricing flexibility," that flexibility is not unbridled, but is subject to statutory constraints (*see, e.g.,* 39 U.S.C. §§ 101(d), 403(c), 3622(b) and (c)) as well as the Commission's power to enter remedial orders (*see* 39 U.S.C. § 3653(c)). As pointed out in Valpak's Initial Comments, the Postal Service has persistently substituted its judgment for that of the Commission in setting the proper balance between "pricing flexibility" and profitability. *See* Valpak Initial Comments, pp. 38-51. But in PAEA's statutory scheme governing the Postal Service's market dominant products over which it exercises monopoly power, there is no room for the Postal Service's "unregulated discretion to set prices." *See id.*, pp. 52-56. Clearly, it is the Commission's job to ensure that the Postal Service exercises "pricing flexibility" **only** as allowed by law. Otherwise, why did Congress create the Commission and vest it with power to "take any other action they deem necessary and proper to carry out their functions and obligations to the Government of the United States and the people [which] **shall not be subject to any change or supervision by the Postal Service**"? 39 U.S.C. § 503 (emphasis added).

The ANM Initial Comments explain a correct view of pricing flexibility and the prohibition against undue discrimination — which flexibility most definitely is bridled by the provisions of Title 39 and court decisions interpreting those statutes:

> Sections 3622(b)(4) … merely states the **general "objective"** that the Postal Service should have **"pricing flexibility."** Section 403(c) leaves the Postal Service **free** to set its worksharing discounts … as high or as low **as the other provisions of Title 39 allow**, so long as the Postal Service exercises this pricing

> flexibility **evenhandedly**. Compliance with Section 403(c) does not eliminate pricing flexibility because nondiscriminatory prices may be set **anywhere within the zone of maximum and minimum rate reasonableness** defined by the other provisions of the statute. [ANM Initial Comments, p. 14 (emphasis added).]

Pricing flexibility cannot be invoked by the Commission as a substitute for regulation. Indeed, ANM points out the limits of pricing flexibility:

> [T]he **greater pricing flexibility** afforded by PAEA **requires**, if anything, **even stricter scrutiny** of the explanations offered by the Postal Service.... As the Commission noted [previously] *the* "trade-off for the Postal Service's increased price adjustment flexibility [under PAEA] is **increased transparency**." Order No. 191 at 72. [ANM Initial Comments, p. 16 (emphasis added).]

Order No. 191 approved price adjustments in Docket No. R2009-2. Dissenting in that same docket, then-Commissioner Goldway, frustrated by what she viewed as the Postal Service "flouting the cost avoidance methodology affirmed by the Commission...," would have rejected First-Class Mail pricing, explaining the limitations of the "pricing flexibility" objective as follows:

> pricing flexibility in the PAEA is in the objectives list of section 3622 (objective 4). Because the PAEA must be interpreted solely on the basis of its text, there is **no way to elevate pricing flexibility above any of the other nine objectives**.... [Docket No. R2009-2, Commissioner Goldway, dissenting, p. 1 (emphasis added).[20]]

Likewise, if the Postal Service is ever to reach the statutory objective of profitability, the Commission can ill afford to continue to allow the Postal Service pricing flexibility to underprice Standard Mail Flats and Periodicals. *See* Valpak Initial Comments, pp. 3-26.

---

20 http://www.prc.gov/Docs/62/62705/Order_No_191.pdf.

Although "pricing flexibility" is one of the nine objectives of the statutory mandate authorizing the Postal Commission to "establish (and … by regulation revise) a modern system for regulating rates and classes for market-dominant products," that flexibility may not be exercised at the expense of "adequate revenues … to maintain financial stability," or of the "establish[ment] and maint[enance] of a just and reasonable schedule for rates and classifications." *See* 39 U.S.C. § 3622(a), (b)(4), (5), and (8). And the factor of "pricing flexibility" requires the Commission to take into account its statutory purpose — "the importance of pricing flexibility to encourage increased mail volume and operational efficiency…." *See* 39 U.S.C. § 3622(c)(7). No statutory references to pricing flexibility allow the Postal Service to violate 39 U.S.C. section 403(c) as ANM argues, or 39 U.S.C. section 101(d) as the Commission has found being violated by Standard Flats pricing. As 39 U.S.C. section 503 specifically provides, **the Postal Regulatory Commission's "actions shall not be subject to any change or supervision by the Postal Service."** (Emphasis added.)

In creating the Postal Regulatory Commission, Congress sought to establish a body that would regulate the Postal Service's pricing over Market Dominant products, where, due to the two monopolies[21] the Postal Service enjoys, it can exert market power. Congress required the President to choose five Commissioners, not more than three from the same political party, "solely on the basis of their technical qualifications, professional standing, and demonstrated expertise in economics, accounting, law, or public administration," and removable "only for

---

[21] *See* 39 U.S.C. §§ 601, *et seq.*, 18 U.S.C. § 1725. *See also* J. Campbell, Jr., "Report on Universal Postal Service and the Postal Monopoly" (2008), http://www.jcampbell.com/index_reports.htm.

cause." *See* 39 U.S.C. § 502(a). The Postal Regulatory Commission is so composed with the expectation that it will employ its "more than ordinary knowledge respecting the matters subject to" its jurisdiction, holding the monopoly Postal Service in regulatory check and thereby earning it the deference accorded it by the Chevron doctrine. *See id.*, 467 U.S. at 844.

V. MARKET DOMINANT NSAs

The most interesting information in this docket concerning Market Dominant Negotiated Service Agreements ("NSAs") arose after the February 1, 2013 deadline for filing Initial Comments, and therefore Valpak addresses this new information here.

A. Discover NSA. In its response to ChIR No. 7, question 8 (Feb. 8, 2013), the Postal Service confirmed that it has a profound disagreement with the Commission's methodology of assessing the net value of an NSA to the Postal Service. In USPS-FY12-30, the Postal Service reported that the net value of the Discover NSA was a **profit of $23,567,688 to $25,513,070.** However, using the Commission-approved methodology, the true net value of that NSA was a **loss of $4,337,569.** The Postal Service explains that it prefers use of its methodology **because it forecasts** Discover's volumes based on Postal Service estimates of Discover's future mailing plans. Although it would be preferable to use certain mailer-specific data (*e.g.*, costs) for NSAs, using mailer-specific forecasts is an entirely different matter. It is entirely unclear how the Postal Service can know what Discover will do in the future based on past volume trends, and even Discover may not know. Certainly the Postal Service should not be allowed to set the bar to determine the success of its own NSA based on self-serving information largely obtained from the mailer which stands to benefit financially from the NSA.

B. Valassis NSA. Since the Valassis NSA was approved by the Commission on August 23, 2012 (Order No. 1448), only a few weeks before the end of FY 2012, no data related to that NSA have been filed with the Postal Service's ACR. Moreover, the Valassis NSA is the subject of a petition for review filed by the Newspaper Association of America ("NAA") — an appeal in which both the National Newspaper Association and Valpak have intervened in support of NAA. NAA has just filed its Petitioner's Brief on February 12, 2013, and the appeal will take some months to resolve. Accordingly, there is no reason to repeat the reasons that Valpak believes that approval of this NSA was in violation of, *inter alia*, 39 U.S.C. section 3622(c)(10). However, one matter is worth mentioning. The Commission's information sheet on the Valassis NSA explains that:

> Neither the Postal Service nor the Commission views [losses] as a plausible result.... the Commission will receive periodic reports from the Postal Service on the costs and revenues of this agreement and can take action if losses begin to accrue.[22]

Although the Discover NSA lost substantial money, $4,337,569 in Contract Year 1 using Commission-approved methodology, the Commission has taken no action. If losses occur with the Valassis NSA, PAEA requires the Commission to do what it has promised — "take action," as authorized by PAEA, which includes terminating the agreement. *See* 39 U.S.C. § 3662.

---

[22] http://www.prc.gov/prc-docs/Newsroom/PressReleases/Valassis%20FAQ_2961.pdf.

VI. PUBLIC REPRESENTATIVE

A. The PR Is Correct about Periodicals and Standard Flats but Does Not Request a Sufficient Remedy.

The PR extensively addresses the problem of the underwater products in his Initial Comments (Periodicals on pp. 25-27, and Standard Flats on pp. 30-39).

With respect to **Periodicals**, the PR states, "Over [the] five year span [since PAEA], the Periodicals class has failed to recover almost $3 billion ($2.959 billion) of its attributable costs, adding significantly to the Postal Service's financial difficulties." *Id.*, p. 25. The PR lists the measures the Postal Service has undertaken to reduce costs, but is disappointed that the result is "an additional $60 million in negative contribution from Periodicals, the worst level since passage of the PAEA." *Id.*, p. 27. In the end, however, the PR only "requests the Commission to direct the Postal Service to further investigate and report why Periodical cost coverages continue to decline in spite of the implementation of cost saving and productivity improving efforts." *Id.* A $3 billion loss requires more than just additional reporting. Every type of investigation known to man has already been conducted on Periodicals. And every excuse known to man has been invoked to defer action that would increase prices and coverage. Instead, the Commission should take the actions suggested by Valpak's Initial Comments for Periodicals by annually increasing the class's prices by a specific increment over CPI, in the range of 5 percent. *See* Valpak Initial Comments, p. 134.

With respect to **Standard Flats**, the PR addressed the continued subsidization of that product by other mailers, and (i) asked the Commission to "require the Postal Service to make a greater effort to reduce the costs of Standard Flats, and report the effect of these efforts in next year's ACR" (p. 32), and also (ii) "suggest[ed] that above-cap price increases or 2-3 percent for Standard Mail Flats would speed the movement toward 100 percent cost coverage and prevent further subsidization of Standard Flats by other Standard Mail products" (p. 39). The PR wisely suggests that the Commission's remedial order specify a certain amount over CPI by which to increase prices for Standard Flats, but Valpak believes that it should be higher. Valpak recommended annual increases in the range of 5 percent over CPI in its Initial Comments. *See* Valpak Initial Comments, pp. 121-22.

B. The PR Appropriately Lauds the Postal Service for Finally Initiating Service Performance Measurement for Standard Mail on a Full-Year Basis.

With respect to on-time delivery of Standard Mail, the PR's Initial Comments concerning service performance for Standard Mail note that:

> For Standard Mail, FY 2012 is the **first year all 4 quarters** used Full Service IMb system data, and new diagnostics were implemented in June 2012. These new systems appear to have made spectacular improvements in on-time delivery of Standard Mail.... The good news for Standard Mail is that the Postal Service cites very improved performance by the fourth quarter for each [category]. [PR Initial Comments, p. 22 (emphasis added).]

As the PR states, FY 2012 begins a new era with respect to performance measurement of Standard Mail — the last major class of mail to have no performance measurement. Standard Mail finally has a set of initial benchmarks that can be used to start assessing **trends** in service performance.[23] Hopefully, the performance achieved in the fourth quarter will

---

[23] Performance standards for Standard Mail reflect that it uses only surface transportation and is subject to deferral in both processing and transportation. Despite the rather lax performance standards, the Postal Service describes the 90.0 percent target for on-time delivery for Standard Mail as aggressive. The fact that the Postal Service considers a

become the new standard, because on an annual basis only 20 percent of Standard Mail volume achieved the Postal Service's 90.0 percent target for on-time performance. The other 80 percent failed to meet that target, often by wide margin.

The FY 2011 ACD noted optimistically that "Improving service in Standard Mail (advertising) and Package Services (fulfillment), two areas where the market is improving, **may result in volume growth."** FY 2011 ACD, p. 61 (emphasis added). Indeed, for the first quarter of FY 2013, Standard Mail volume reportedly increased by 2.7 percent over the same period in FY 2012. *See* Postal Service Market Preliminary RPW Report, FY 2013, Q.1 (filed Feb. 13, 2013).

C. The PR's Comments Fail to Note that Compliance with the Statute Requires Data on Reliability as Well as Speed of Delivery.

The PR's discussion of Standard Mail service performance states:

> The Postal Service does not include service performance scores for other classes of market dominant mail in the FY 2012 Annual Performance Report where it could more readily be applied to measure progress toward its Service performance goal. Rather, service performance scores are included in the more comprehensive library reference filed pursuant to Part 3055 of the Commission rules. [*Id.*, p. 12.]

The PR does not point out, however, that PAEA requires that the Postal Service monitor and report on, and the Commission determine compliance of, both the **speed** and **reliability** of mail

---

90.0 percent target to be "aggressive" indicates the need to improve both measurement and actual performance of Standard Mail.

delivery for all Market Dominant Products, and the references contain no reliability data.[24]

These two performance standards are separate and distinct:

- Data showing the percent of mail that achieved **on-time delivery** vis-a-vis established service standards is the available statistic which best serves as a measure of, or proxy for, **speed of delivery**.

- Data pertaining to when mail **not delivered on time** actually was delivered serve as a measure of, or proxy for, **reliability**.

Order No. 1609 states that **responsive** information to "Commission issued rules on periodic reporting of service performance measurement … appears in Library Reference USPS-FY12-29." *Id.*, p. 4. Nonetheless, that library reference contains no variance data pertaining to **reliability** of mail delivery, despite the mandate in 39 U.S.C. section 3652(a)(2)(B) to report on reliability of service. In the absence of any data on **reliability**, it is not clear how USPS-FY12-29 can be regarded as fully responsive to Commission-issued rules. It should include summary data on **reliability** (as required by statute).

Further, Commission rules for periodic reporting do not require comparable data on **speed** of delivery **in prior years**. Even though speed of delivery data presented in USPS-FY12-29 may conform to Commission-issued rules, they support no ready comparison of trends, either good or bad.[25] In a future rulemaking, the Commission should consider

---

[24] PAEA requires that the Annual Compliance Report "shall, for each market-dominant product provided in such year, provide — … (B) measures of the quality of service afforded by the Postal Service in connection with such product, including — (i) the level of service (described in terms of **speed** of delivery and **reliability**) provided…." 39 U.S.C. § 3652(a)(2)(B) (emphasis added).

[25] The FY 2011 ACD noted: "This review [of service performance] is also important in relation to the rate cap requirements of 39 U.S.C. 3622(d)(1)(A) when analyzing

expanding the reporting format to include data from at least one prior year (similar to data for Single-Piece First-Class Mail in the *FY 2012 Annual Performance Report*). Inclusion of prior years' data would add important perspective.

D. Reliability: the Most Neglected, but Perhaps the Most Important, Aspect of Service Performance Measurement for Standard Mail.

In his discussion about service performance for Standard Mail, the PR notes that:

> For FY 2012, overall performance fell short by about 20 percentage points from the 90 percent targets in several categories such as Carrier Route, Flats, and Mixed Product Flats and short by about 10 percent from the 90 percent target for Letters and Mixed Product Letters. [PR Initial Comments, p. 22.]

Somewhat surprisingly, in light of the Postal Service's failure to meet the 90 percent target by 10 to 20 percent, the PR offers no comment regarding the lack of compliance as regards reporting on reliability. Recently, in Docket No. N2012-1, Postal Service witness Elmore-Yalch testified that users of **First-Class Mail** considered **reliability** to be more important than **speed**:

> In another example from as far back as 1992 … the Postal Service's customer satisfaction program, which was audited at Congressional request that year and subsequently approved by the GAO in 1993, focused on factors other than transit time…. This early report, titled *Tracking Customer Satisfaction in a Competitive Environment,* and a history of research since, suggest that **predictability and consistency are more important** for Postal Service FCM customers **than speed *per se* can ever be**, given that other market alternatives long ago positioned themselves as the high-speed, more expensive alternatives to the

---

whether quality of service is impacted in order to comply with rate cap requirements." FY 2011 ACD, p. 61 (emphasis added). In order to ascertain whether quality of service in the most recent year has been impacted, a comparison and analysis with performance in prior years necessarily will be required.

> Postal Service. [Docket No. N2012-1, USPS-SRT-4, pp. 6-7 (emphasis added).]

Since Standard Mail is deferrable and has more lax performance standards than First-Class Mail, it stands to reason that predictability and consistency — *i.e.*, **reliability** — should be at least just as important to users of Standard Mail. Witness Elmore-Yalch's testimony strongly indicates that for Standard Mail both the Commission and the Postal Service should give **reliability** as much emphasis as speed of delivery. The fact that a large percentage of Standard Mail is now destination entered could help demonstrate mailer preference for reliability, because origin-entered mail has a much higher variance, hence is less reliable.

The PR also fails to mention that the Postal Service has not published any **targets** related to reliability. For example, the Postal Service has no established targets for the cumulative percent of Standard Mail that it expects to be delivered within 3 days of the established delivery standard. Further, since so much Standard Mail fails to meet the 90 percent target for on-time performance, the Commission should consider requiring the Postal Service to establish and publish targets for the cumulative percent of Standard Mail expected to be delivered within three days of the established delivery standard.

On November 9, 2012, the Postal Service filed with the Commission its "U.S. Postal Service FY 2011 Q4 Service Performance Reports" for all market dominant classes and products.[26] In the FY 2011 ACD, the Commission noted that:

> The inability to identify individual Standard Mail products means that the Postal Service cannot accurately report service

---

[26] http://www.prc.gov/Docs/85/85639/Standard Mail_FY2012_Q4_zip.

> performance measurement by product as required by 39 U.S.C. 3652(a)(2)(B). [*Id.*, p. 64.]

The problem noted by the Commission last year persisted in FY 2012. Mixed categories constituted almost half of the total Standard Mail volume reported in FY 2012. Until more mailers adopt the full-service IMb (mandatory after January 2014), the necessity to report mail in these two mixed categories, coupled with the large percentage so reported, means that mailers and the Commission, six years after enactment of PAEA, still have only limited performance data for individual products within Standard Mail.

Detailed data in the quarterly report provide variance data showing the percentage of mail delivered within one, two, or three days beyond the established delivery standard. By virtue of being the only reported data pertaining to the tail-of-the-mail, they are by default the best available proxy for **reliability** of delivery. Table VI-1 contains national level performance data for all Standard Mail reporting categories.

E. Reliability Reporting Can Be Improved.

The manner in which data are reported for mail not delivered on time will make it difficult to say whether reliability for any given product has improved or deteriorated. The existing format also does not facilitate comparing reliability between products.

Reporting on reliability could be improved in many ways. It starts by focusing on mail not delivered on time. For such mail, the average number of days late has been computed. Results are summarized in Table VI-2. The procedure described herein may be susceptible to improvement, but it represents a start.

Table VI-1
Performance Data For Standard Mail
Fiscal Year 2012

A. DESTINATION ENTRY

	Percent with 2-Day Service Standard				Percent with 3 to 4 Days Service Std.				Percent with 5+ Days Service Std.			
	On	--Days Late--			On	--Days Late--			On	--Days Late--		
	Time	1	2	3	Time	1	2	3	Time	1	2	3
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
LETTERS												
1. Standard	n/a	n/a	n/a	n/a	86.9	95.5	98.0	98.9	86.3	94.4	97.2	98.4
2. Mixed	n/a	n/a	n/a	n/a	83.9	94.3	97.5	98.7	83.3	92.6	96.0	97.6
3. H-D & Sat.	n/a	n/a	n/a	n/a	87.3	95.6	98.1	99.1	87.8	95.0	97.9	98.8
FLATS												
4. Standard	n/a	n/a	n/a	n/a	73.2	86.6	92.6	95.5	73.5	84.6	90.3	93.5
5. Carrier Rte	n/a	n/a	n/a	n/a	69.5	83.6	90.6	94.3	80.0	88.4	93.0	95.5
6. Mixed Flts/Pcls	n/a	n/a	n/a	n/a	68.2	83.4	90.6	94.5	75.1	85.8	91.2	94.4
7. H-D & Sat.	94.7	98.6	99.7	100.0	83.8	93.9	96.8	98.0	90.4	94.3	96.9	98.0

B. END-TO-END

	Percent with 3 to 5 Days Service Std.				Percent with 6 to 10 Days Service Std.				Percent with 11+ Days Service Std.			
	On	--Days Late--			On	--Days Late--			On	--Days Late--		
	Time	1	2	3	Time	1	2	3	Time	1	2	3
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
LETTERS												
1. Standard	75.7	87.5	93.4	96.3	55.7	71.0	81.8	88.9	26.4	38.7	40.7	59.2
2. Mixed	96.2	92.9	96.0	97.5	52.8	67.2	78.0	85.6	34.7	48.5	57.5	63.9
3. H-D & Sat.	91.4	95.7	98.1	99.2	82.3	92.7	96.1	98.1	22.5	48.4	55.1	70.6
FLATS												
4. Standard	73.9	85.3	91.2	94.7	59.8	73.4	82.7	88.6	42.7	55.1	64.7	70.6
5. Carrier Rte	82.0	89.4	92.5	95.1	74.3	85.0	90.9	94.5	65.7	72.3	79.1	85.0
6. Mixed Flts/Pcls	61.9	75.9	85.5	90.6	46.1	60.7	72.7	80.5	23.9	34.1	45.1	54.2

Source: USPS FY 2012 Q4 Service Performance Report, Standard Mail.
Spreadsheets for each respective product and delivery standard shown.

Table VI-2
Analysis Showing Percent Late and Average Days Late for Standard Mail
Fiscal Year 2012

A. DESTINATION ENTRY

	3 to 4 Days Service Standard		**5+ Days Service Standard**	
	Percent Late	Average No. of Days Late	Percent Late	Average No. of Days Late
LETTERS				
1. Standard	13.1	1.58	13.7	1.73
2. Mixed	16.1	1.59	16.7	1.83
3. H-D & Saturation	12.7	1.57	12.2	1.68
FLATS				
1. Standard	26.8	1.94	26.5	2.19
2. Carrier Route	30.5	2.03	20.0	2.16
3. Mixed	3.8	1.99	24.9	2.15
4. H-D & Saturation	16.8	1.70	9.6	2.13

B. END-TO-END ENTRY

	6 to 10 Days Service Standard		**11+ Days Service Standard**	
	Percent Late	Average No. of Days Late	Percent Late	Average No. of Days Late
LETTERS				
1. Standard	44.3	2.32	73.6	3.75
2. Mixed	47.2	2.64	65.3	3.54
3. H-D & Saturation	17.7	1.74	77.5	3.00
FLATS				
1. Standard	40.2	2.59	57.3	3.43
2. Carrier Route	25.7	2.15	34.3	3.29
3. Mixed	53.9	2.66	76.1	3.79

The format in Table VI-2 would facilitate comparisons in a more straightforward way than the cumulative variance distributions in Table VI-1. To illustrate, assume that average number of days late is a reasonable proxy for reliability of mail not delivered on time. Then, when data become available for FY 2013 (and subsequent years), it should be easier to say with some assurance whether the average number of days late (*i.e.*, "reliability") has improved or deteriorated for any particular product.[27]

Computation of the average number of days late is straightforward, up to a point. For each product, the percent that is 1, 2, or 3 days late is computed by taking differences from the cumulative data in Table VI-1. The only issue is how to deal with those residual pieces not delivered by the third day, for which no other data are reported.

For destination-entered products in Part A of Table VI-1, the percentage delivered no more than three days late was in the mid- to high-ninety percent range, and it was assumed that all remaining late mail was delivered four days late. That gives the Postal Service the benefit of all possible doubt concerning when the residual pieces were delivered.

For some end-to-end products in Part B of Table VI-1, often fewer than three-fourths of the pieces were delivered within the established performance standard. When that was the case, the assumption that all remaining pieces — more than one-fourth of all late pieces — miraculously were delivered on the fourth day seemed untenable. At the same time, no additional information is reported for mail not delivered by the third day after the service standard.

For three end-to-end products with a 6 to 10 day service standard — *i.e.*, (i) mixed letters, (ii) Standard Flats, and (iii) Carrier Route Flats — it was assumed arbitrarily that on day number 4, the percentage of late pieces delivered was equal to the average of the preceding

---

[27] When dealing with mail not delivered within the established service standard — *i.e.*, mail that by definition is late — the best that can be achieved is for the mail to be delivered on the next day, or one day late. Thus, for such mail, 1.0 day late is a "perfect" score.

three days, and the balance was delivered on the fifth day. This procedure gives the Postal Service the benefit of doubt concerning any stragglers that may have been delivered more than 5 days beyond the service standard.

For end-to-end products with a service standard of 11+ days, fewer than 43 percent of pieces were delivered timely for all but one product, Carrier Route, which had an on-time performance of 65.7 percent. It was assumed arbitrarily that of the pieces not delivered by 3 days late, one-third were delivered 4 days late, one-third were delivered 5 days late, and the last one-third were delivered 6 days late. This procedure gives the Postal Service the benefit of doubt concerning the possibility of any stragglers arriving more than 6 days beyond the established service standard. The need to make arbitrary assumptions for such a large proportion of late-delivered mail indicates the desirability of more detailed reporting on tail-of-the-mail for all products with a significant percentage not delivered within 3 days of the service standard.

VII. THE POSTAL SERVICE'S RESPONSE TO ChIR NO. 5, QUESTION 24

On February 6, 2013, after Initial Comments were due, the Postal Service submitted its response to ChIR No. 5, question 24, a question which followed up on the Postal Service's response to ChIR No. 3, question 5. There, the Postal Service revealed the source of the increase in costs for Carrier Route over the last two years. The Commission's follow-up question stated, "The increase in FSS costs accounts for over 79 percent of the increase in Carrier Route costs since FY 2010," and asked for the same breakdown for Periodicals and Standard Mail Flats.

The Postal Service's response to the follow-up question confirmed that FSS also was driving up costs for Periodicals and Standard Flats. For **Periodicals**, unit costs increased 1.37 cents over the last two years, with mail processing costs accounting for 1.31 cents (nearly 96 percent) of that increase. Likewise, **Standard Flats** unit costs increased 1.65 cents over the last two years, with mail processing costs accounting for 1.50 cents (almost 91 percent) of the increase.

FSS was intended to reduce total costs for processing and delivering flat-shaped mail. The Periodicals Mail Study stated:

> By sorting mail in delivery sequence order, Flats Sequencing System (FSS) will reduce the amount of time carriers spend manually sorting mail and increase the time available to delivery mail. Improving delivery efficiencies will enable the Postal Service to reduce flats processing costs.... Deployment of FSS in 2011 is expected to have a significant impact on Periodicals costs. [Periodicals Mail Study, p. 81.]

In the last two Annual Compliance Determinations, the Commission (i) took no action with respect to Periodicals and (ii) ordered the Postal Service to increase cost coverage of Standard Flats "through a combination of above-average price adjustments ... and cost reductions...." FY 2010 ACD, p. 106. The Postal Service's response to ChIR No. 5, question 24 confirms that costs of processing and delivering flats are not decreasing, and are not even in line with CPI. These increases are contrasted with actual cost reductions for High Density/Saturation Letters. *See* Valpak Initial Comments, p. 113. Any further reliance on FSS cost cutting to improve cost coverage for these two products is now demonstrated to be futile. Significant above-CPI price increases are needed. *Id.*, pp. 38-59, 122-34.

Respectfully submitted,

William J. Olson
Jeremiah L. Morgan
John S. Miles
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.