



March 8, 2007

The Honorable James C. Miller III
Chairman, Board of Governors
United States Postal Service
475 L'Enfant Plaza SW Room 10300
Washington, DC 20260-1000

Dear Chairman Miller:

The Direct Marketing Association (DMA) appreciates this opportunity to write to the Governors concerning your decision on the Recommended Decision of the Postal Regulatory Commission (PRC) in Docket R2006-1. Having thoroughly reviewed that document, we regretfully must request that the Governors reject recommendations concerning flat-shaped mail and resubmit those rates to the PRC for reconsideration.

We had hoped, from reading the press release and summary documents offered by the PRC, that its recommended rates would fall within a reasonable range of the 9.3% increase for Standard Mail cited in those documents. But as we began analyzing the details, we found to our deep disappointment that recommendations for flat-shaped mail will increase postage costs for many commercial mailers by up to 40%. Obviously, these recommendations far exceed what was expected after the US Postal Service made its request in May 2006, and will have a substantially negative effect on many commercial and nonprofit mailers.

Since the PRC released its recommendations on February 26, we have heard from hundreds of our members who have had a chance to analyze how these unplanned increases will affect their specific operations. And while the effects will vary for everyone, it has become abundantly clear that these rate increases would be far more damaging than the PRC may have anticipated.

In fact, DMA believes that the rates recommended by the PRC for flat-shaped mail, especially within Standard Mail, will have such a significantly negative impact on volume that Postal Service revenues will fall short of estimates in the test year.

I would like to share with you some of the specific concerns that have been voiced by our mailers, who generate the majority of the USPS's volume in flat and Standard Mail.

Steep Decline Likely in Mail Volumes

The vast majority of our catalog members have indicated that if flat-shaped rates were to rise based on the PRC recommendations, their only option would be to significantly reduce the number of mailings for 2007/2008.

The reason is simple – mailing budgets for most of our members have already been established based upon the expected 11% to 12% postage increase for flat-shaped Standard Mail that was proposed by the USPS last May. In a shaky economy, few companies have extra funds that could be reallocated to offset higher-than-anticipated postage increases.

Here are just a few examples of how significant the mail volume loss will be:

- A major national veteran's organization faces a 58% postage increase for its flat-shaped mail, which will severely curtail its ability to raise funds for programs that assist the millions of men and women who have served our country.
- A large national retailer and catalog mailer estimates that these new recommendations will force it to reduce mailing volumes by 1.6 million pieces in 2007 alone.
- A medium-sized catalog mailer who had budgeted for an 8% increase in postage costs will now face an increase of 17%. The company had planned to mail 38 million catalogs this year, but now anticipates having to cut its mail volume by 10% or more.
- The continuing education department of a Jesuit college had already cut its mail volume by 8% after the January 2006 postage increase. Now, under the new PRC recommendations, they see postage costs for mailing recruitment brochures and course catalogs increasing by 24% – more than double the 9.1% increase they had expected and budgeted for. Forced to choose between funding student programs or marketing costs, the school expects to cut its mailing volumes even more severely.
- A small but growing niche catalog mailed 1.5 million pieces last year, and planned to increase circulation by 11% in 2007. Based on the May 2006 USPS request, the company budgeted an additional \$85,000 for postage this year. But with the 19% increase, it would now need \$130,000 to meet the postage needs for its catalog campaign. The company says it must now reduce its catalog volume by 10% or more, which will severely impact its plans for growth.

Decisions like those described above are happening at large and small businesses throughout the country. DMA believes that the PRC's volume projection – that its recommended rates will produce one billion more pieces of Standard Mail – is simply incorrect. Not only do these examples indicate that many marketers will decrease catalog mail volumes, we also anticipate negative indirect effects that will ripple throughout 2007 and beyond.

One concern is the “multiplier effect” on every sale made by a cataloger. Similar to the phenomenon reflected in the recently approved Negotiated Service Agreement with Bookspan, with a dramatically decreased volume of catalogs mailed, there will be a direct and corresponding decrease in “multiplier” mail volume. Catalog mailing lists are a major source of prospective customers and donors to businesses and charities. If catalog volume falls, so will the number of potential customers and donors on lists. The ripple effect of a volume loss could be very deep and very wide.

Not only do we caution about the impact that steep declines in mail volumes will have on Postal Service revenues, we also fear a long-term ripple effect that will create a negative spiral for mailing businesses, the Postal Service, and the economy as a whole.

Reductions in catalog volumes will most likely lead to declines in sales revenue for many companies, which will in turn tighten future mailing budgets and force marketers to seek alternative means of communicating with current and future customers. The result could be a continuing spiral of revenue loss for the Postal Service.

As you know, this rate case also ushered in a significant change in rate design as the Postal Service requested rate changes that tilted rates toward shape and away from weight. This shift to shape-based rates resulted in closer scrutiny of a letter-shaped/flat-shaped differential in both First-Class and Standard Mail. However, in order to avoid rate shock in accordance with section 3622 (b)(4) of Title 39, the USPS's request mitigated the effect of the differential. Its volume estimates were predicated upon that mitigation, which in Standard Mail would have been burdened with 11% to 12% rate increase for flats – well above the average increase for all mail.

With the emphasis on shape in this case, many parties argued that the historic econometric model used to estimate mail volumes would not be as reliable as it has been in past rate proceedings. The PRC used that historic model to estimate volumes for its recommended rates and ignored the Postal Service's position of the letter/flat differential. Consequently, the rates it recommended for Standard Mail flats between 3.5 and about 4 ounces represent an increase of between 21% and 36% – at least double the increase requested. Since the recommended rates are so far outside the expected range, the elasticity and migration factors implicit in the PRC's volume estimates are not reliable.

Insufficient Time for Testing New Mailings

While the shift toward shape-based rates does not come as a surprise to the mailing community, the unanticipated severity of the PRC's recommendations places greater pressure on mailers to adjust their mailing profiles. Unfortunately, these mailers do not have sufficient time to adjust before the expected implementation of these excessive increases. The likely timeframe for the rate increases simply does not give mailers adequate time to prepare and test alternatives to flat-shaped mail.

Just as budgets are set far in advance, catalogs are designed and printed, and mailing lists are usually developed, weeks if not months in advance. If these new rates are put into effect in May, there will be no time for mailers to find alternatives for mailings scheduled for summer and early fall, much less to test the response rate for different size catalogs and determine what will be effective with target audiences.

Also, the lack of a heavyweight letter category (as proposed by DMA and other mailers), up to 4 ounces, which can run on the automated letter sorting machines, is an impediment to shifting from flat-shaped to letter-shaped mail for catalogers facing the highest rate increases. Migration will not occur quickly enough to provide the mail volume and revenues necessary for breakeven operation.

New Technology Mitigates Need for Increases

As the key justification for the PRC's request is its ongoing effort to correct the price differential between flat- and letter-shaped mail, it strikes us as ironic that the PRC recommendations came less than a week after the Postal Service announced an investment of more than \$874 million in

new technology that will reduce the differential by making its flats-sorting system more efficient and cost-effective. We do not believe that these new reductions are fully reflected in the PRC recommendations.

We must emphasize that the Postal Service is not the only organization that has invested heavily in new technologies. Many commercial mailers have also made significant investments in equipment and software that help them to design and prepare their mail to move efficiently through the mail stream. Much of this investment has come about due to the growing popularity of Negotiated Service Agreements that consider weight and shape variations, as well as efficiency considerations. Our members have made very clear their disappointment that these exorbitant increases will drive down mail volumes or force the redesign of mailing pieces before they have a chance to recover costs or reap the benefits of their investments.

Nonprofit Mailers Hit Especially Hard

I would like to support the particular concern that many of the DMA Nonprofit Federation's (DMANF) 400-plus members raised in its February 28, 2007, letter to you. Nonprofit mailers, and thus their beneficiaries, cannot withstand the enormous postage increases, which are the highest ever proposed for these types of mail pieces – between 100 and 300%. The nonprofit community needs time to prepare – May 2007 is too soon to make that adjustment. I repeat the DMANF's request that you hold off on the implementation of these specific rates for a period of one year.

Inconsistent With the Spirit of Postal Reform

With the passage of postal reform legislation in December, many mailers hoped that an end had come to unplanned and unjustified postal rate increases. One of the key principles of postal reform – sought by the mailing community and embraced by Congress -- was the need for predictability in future rate increases.

Knowing that this current rate request was already in process long before postal reform legislation was passed, we nonetheless hoped that as the Postal Regulatory Commission adopted its new name and structure, it would also embrace the spirit of progress and predictability that will guide future ratesetting processes. Unfortunately, that did not happen. Less than three months after postal reform was enacted into law, the PRC is undermining the spirit of postal reform and Congressional intent by making recommendations that intensify the very problems that we sought to address.

Conclusions

The Commission's failure to consider adequately the effect of the rate increases on business and nonprofit mailers as required by section 3622 (b)(4) creates two important flaws in its recommended decision. First, contrary to the Postal Service's proposal, the PRC ignored the "rate shock" effect on mailers, resulting in substantial economic damage to a large number of enterprises that depend on the mail. Second, the PRC's decision throws substantial doubt upon the volume and revenue estimates on which the recommended decision is based.

Without action from the Governors to reject these out-of-range increases for flat-shaped Standard Mail, your customers – if they remain your customers and viable businesses – will dramatically shrink their purchase of your service offerings.

We ask that you reject these recommended rates and resubmit the request, specifically requesting that the rates for flat-shaped Standard Mail be lowered to the rates the Service proposed initially.

Moreover, we would like to emphasize that such a reduction in the rates for flat-shaped Standard Mail need not, and should not, result in any increase in the rates for any other mail class or category, including letter-shaped Standard Mail – for two reasons:

- With the rate reduction we earnestly request, the volume and revenue estimates for flat-shaped Standard Mail will become more realistic, correcting the revenue overstatement reflected in the estimates contained in the PRC's recommended decision. Correcting this overstatement will not deprive the Postal Service of any revenues that it can realistically anticipate, and therefore these revenues need not be "recouped" from any other source as they did not exist in the first place.
- Perhaps most importantly, the Commission included a full one-percent "contingency" in the revenue requirement on which the recommended decision is based. DMA demonstrated on the record of R2006-1 that a contingency of this size is not needed, given the current financial strength of the Postal Service. If (and we emphasize that it is a big "if") the revenues realistically estimated to be produced from flat-shaped Standard Mail at the rates and volume levels reflected in the original USPS proposal still yield a revenue "shortfall," this shortfall can and should be "taken" from the contingency.

DMA respectfully submits that the risks that the Postal Service will be undertaking if it implements the flat-shaped Standard Mail rates recommended by the Commission far exceed the risks that the Postal Service currently faces from any other quarter. There will be financial damage to the Postal Service – not to mention the damage to the mailers. The only question is exactly how large that financial damage will be. DMA respectfully suggests that the Postal Service not run the risk of finding out, and asks that the Governors reject these recommendations and resubmit the request to the PRC.

Sincerely,

John A. Greco, Jr.
President & CEO