

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

Before Commissioners:

Ruth Y. Goldway, Chairman;
Tony L. Hammond, Vice Chairman;
Mark Acton;
Dan G. Blair; and
Nanci E. Langley

Consideration of Workshare Discount
Rate Design

Docket No. RM2009-3

ORDER ADOPTING ANALYTICAL PRINCIPLES
REGARDING WORKSHARE DISCOUNT METHODOLOGY



Washington, DC 20268-0001

September 14, 2010

TABLE OF CONTENTS

	<i>Page</i>
EXECUTIVE SUMMARY.....	1
I. PROCEDURAL ISSUES	5
A. Background.....	5
B. Issues Resolved in the Current Docket.....	7
C. Issues to Be Resolved in the Follow-On Docket.....	9
II. IS THERE A RELEVANT STATUTORY PREFERENCE FOR SINGLE-PIECE FIRST-CLASS MAIL?	11
III. THE COMMISSION’S ROLE IN REVIEWING WORKSHARE DISCOUNTS.....	16
A. The Commission’s Pricing Role Under the PAEA is Greatly Narrowed Relative to the Former Law.....	16
B. Under the Structure of the PAEA, the Commission has a Limited Role in Before-the-Fact Review of Price Adjustments	18
C. The Commission’s Duty to Apply the PAEA’s Few Quantitative Pricing Standards	19
D. Measuring Costs Avoided by Worksharing	19
E. The Need to Select a Base Group	20
F. Selecting a Base Group is a Factual Determination	21
IV. THE COMMISSION’S ROLE IN ENFORCING THE WORKSHARE DISCOUNT CEILING IN SECTION 3622(e)	23
A. The Postal Service and a Number of Bulk Mailers Argue That Section 3622(e) is Limited to Discounts Within Products.....	23
B. Commission’s Analysis of the Role of the Term “Product”	24
1. Significance of the Term “Product”	24
2. The Term “Product” Does Not Inherit the Role Played By the Term “Subclass” Under the Former Law	26
3. Significance of the Failure of Section 3622(e) to Use the Term “Product”	27

- 4. The Role of Commission Judgment in Applying Section 3622(e) 29
- 5. The Role of Data Reporting in Determining What Mail is Covered By Subsection 3622(e)..... 30
- C. The Argument That Application of the Workshare Discount Standard Should be Qualitative and Ad Hoc 32
 - 1. The Premise That Flexibility and Other Qualitative Pricing Standards Have a Pre-eminent Role in Enforcing Section 3622(e)..... 32
- D. Commission Analysis of the Role of “Pricing Flexibility” and Other Qualitative Pricing Standards in Enforcing Section 3622(e)..... 33
 - 1. The Role of Qualitative Pricing Standards in the Modern System of Rate Regulation 33
 - 2. Quantitative Pricing Standards are Applied Differently Than Qualitative Standards in the Modern System of Rate Regulation..... 34
 - 3. The Status of the Efficient Component Pricing Rule 37
 - 4. Selecting a Base Group or “Benchmark” is Necessary to Measure Cost Avoidance 38
 - 5. The Argument That the Use of Consistent Benchmarks Should be Avoided 39
 - 6. Special Considerations with Respect to Presort First-Class Mail..... 40
- E. The Scope of Section 3622(e) Workshare Characteristics Should Be Interpreted to Be Consistent With Its Purpose 41
 - 1. “Inherent” Versus Added Characteristics 41
 - 2. Guidelines for Defining Worksharing..... 44
- V. THE ROLE OF MARKETS IN APPLYING 3622(e)..... 48
 - A. Overview..... 48
 - B. Application to Classes..... 49
 - 1. First-Class Mail 49
 - 2. Standard Mail..... 59

VI. IDENTIFYING BASE GROUPS.....62

 A. Overview.....62

 B. Application to Classes.....62

Concurring Opinion of Commissioner Dan G. Blair

Appendix—Comments and Reply Comments

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Tony L. Hammond, Vice Chairman;
Mark Acton;
Dan G. Blair; and
Nanci E. Langley

Consideration of Workshare
Discount Rate Design

Docket No. RM2009-3

FINAL RULE ADOPTING ANALYTICAL PRINCIPLES
REGARDING WORKSHARE DISCOUNT METHODOLOGY

(Issued September 14, 2010)

EXECUTIVE SUMMARY

Background. 39 U.S.C. 3622(e) limits workshare discounts to the costs avoided by worksharing. In Docket No. R2009-2, the Postal Service proposed workshare discounts that departed from established methods for calculating the costs avoided by workshared mail when calculating proposed rates for presort First-Class, Standard High Density, and Standard Saturation mail. The Postal Service maintained that under its interpretation of section 3622(e), its cost avoidance calculations were consistent with established methods. The Commission initiated this docket to develop a full record on issues concerning the proper interpretation, scope, and application of section 3622(e).

Principal conclusions.

- Section 3622(e) may apply both within and across products.
- A worksharing relationship exists if a factual inquiry shows that a workshared category serves the same market as a less workshared category at a reduced cost.
- The cost avoided by workshared mail is calculated by comparing its costs to the costs of a benchmark, which is that portion of the less workshared category that is most likely to convert to the workshared category in response to price.
- First-Class Bulk Letter Mail has a worksharing relationship with First-Class Single-Piece Letter Mail.
- Docket No. RM2010-13 is established concurrently with this order to establish new benchmarks for workshared mail.
- The established Bulk Metered Mail (BMM) benchmark for First-Class Bulk Letters is no longer valid, and further adjustment of First-Class Bulk Mail rates to comply with section 3622(e) is not required while Docket No. RM2010-13 is pending.
- Established benchmarks relating Standard High Density to Standard Basic Mail are unaltered pending the outcome of Docket No. RM2010-13.
- Section 3622(e) does not apply to Standard Saturation Mail because that product serves a unique market.
- Measures of the costs avoided by the four workshare activities named in section 3622(e) include integral associated attributes mailer requirements that materially affect the amount of costs that the named characteristic avoids.

Grounds for conclusions. In this docket, some commenters argue that Congress designed this limit on workshare discounts as a means of protecting the interests of users of Single-Piece First-Class Mail. The Commission finds no inference in section 3622(e) itself, or in the Postal Accountability and Enhancement Act (PAEA) general pricing standards, that the limit on workshare discounts is intended to benefit any specific category of service more than any another. (See page 15.)

The Commission recognizes that the PAEA considerably narrows the regulator's role in reviewing the pricing of postal services relative to the regulatory regime under the former Postal Reorganization Act. Nevertheless, the PAEA establishes three objective, quantitative, and mandatory pricing constraints that constitute clear "out of bounds" lines that the Commission must enforce. One is the limit on workshare discounts. (See pages 15-18 and 33-36.)

Some commenters argue that the limit on workshare discounts should be viewed as subordinate to or conditioned upon the set of subjective, qualitative standards found in sections 3622(b) and (c), with particular emphasis on the objective of pricing flexibility. The Commission does not find this argument to be consistent with the language of section 3622(e) or the structure of the PAEA. The Commission concludes that the nature and extent of the flexibility available in enforcing the workshare discount limit was comprehensibly addressed by Congress in the exceptions that it incorporated into section 3622(e). (See page 33-36.)

The Commission concludes that the purpose underlying the limit on workshare discounts is to encourage the Postal Service to provide the workshared component of a service if it is the most efficient provider of that component. (See page 20.)

To apply the workshare discount limit to a particular service, the Commission must find that it is a workshared variant of another service rather than a distinct product serving a distinct market. This is a factual, rather than a policy, determination. (See pages 19-21.)

The Commission finds that First-Class Bulk is a workshared variant of a substantial portion of Single-Piece First-Class Mail. (See pages 48-58.)

Previous analysis of the First-Class Bulk Mail discount structure assumed that Bulk Business Mail is representative of the portion of Single-Piece First-Class Mail that could convert to Presort (the non-workshared "benchmark"). The Commission concludes that this assumption is no longer valid. A follow-on rulemaking is established

in a companion order to reevaluate what the new benchmark should be, and how its avoidable costs should be calculated. Until that follow-on rulemaking is completed and a representative benchmark is identified, the Commission will not require that the Postal Service reduce the discount for Automation Mixed AADC First-Class Bulk Mail below its current level. (See pages 39-40.)

The Commission concludes that within Standard Mail, Saturation mail is not a workshared variant of High Density. (See pages 58-60.)

Section 3622(e) states that workshare discounts are discounts offered for “presorting, prebarcoding, handling, or transportation of mail, *as further defined by the [Commission]....*” (Emphasis added.) The Commission concludes that the cost impact of the named workshare characteristic must be estimated in the context in which such workshared mail is actually presented if the economic efficiency goal underlying the limit on workshare discounts is to be achieved.

Exercising its discretion to further define the characteristics of workshared mail, the Commission concludes that the four workshare characteristics named in section 3622(e) include integral associated workshare characteristics. If mail with one of the four workshare characteristics named in section 3622(e) must also have an integrally-related characteristic in order to avoid all of the costs that the named workshare characteristic is designed to avoid, the associated characteristic will be included in the avoided cost calculation. (See pages 41-43.)

The Commission adopts three guidelines for determining if an associated closely related characteristic should be reflected in the avoided costs of a named workshare activity. (See pages 45-46.) Based on this record, it concludes that address hygiene is sufficiently related to prebarcoding to satisfy the guidelines. (See page 44.) It also concludes that density is sufficiently related to presorting to satisfy the guidelines, at least in the context of First-Class Mail. (See pages 44-45.)

I. PROCEDURAL ISSUES

A. Background

This docket was instituted to examine in more depth the “legal, factual, and economic bases” underlying the discounts for First-Class and Standard Mail approved in Docket No. R2009-2 and any alternative workshare discount rate design and cost avoidance methodologies that participants wished to propose.¹

The comments received on May 26 and 27, 2009 were numerous and wide-ranging.² They included legal interpretations of the relevant portions of the Postal Accountability and Enhancement Act, (PAEA) Pub L. 109-435, 120 Stat. 3198 (2006), offered arguments concerning the market position of various categories of First-Class and Standard Mail, and argued that certain traditional benchmarks used to quantify the costs avoided by various mail characteristics associated with workshare discounts should be retained or abandoned. Several participants offered classification proposals designed to recognize the unique cost characteristics of various subsets of First-Class Mail. Specifically, Stamps.com proposed that a “Qualified PC Postage” mail category be established to reflect the reduced costs that would accompany Single-Piece First-Class Mail to which the mailer has applied CASS certified software and a full-service Intelligent Mail barcode (IMb). Stamps.com Comments at 1. In addition, the officer of the Commission appointed to represent the interests of the general public (Public Representative) proposed that if the link between Single-Piece First-Class Mail costs and presorted First-Class Mail rates is to be abandoned, that Single-Piece First-Class

¹ See Notice of Proposed Rulemaking on Application of Workshare Discount Rate Design Principles, March 16, 2009; Order on Further Procedural Steps, March 16, 2009 (Order No. 192).

² For convenience, participant comments are identified in the Appendix attached to this order. In addition, the following motions were received: American Postal Workers Union, AFL-CIO Motion for Late Acceptance of Initial Presentation, May 26, 2009; Bank of America Corporation Motion for Acceptance of Late Filing, May 27, 2009. These motions are granted.

Mail be established as a separate class of mail for rate setting purposes.

PR Comments at 23-27.

Recognizing that many of the issues surrounding workshare discount methodology had substantial public policy implications, the Commission held a public forum on August 11, 2009, to encourage a dialogue on the issue of whether there is a statutory basis for affording Single-Piece First-Class Mail preferential status in setting rates, and if so, what form that preference should take. The public forum also addressed the issue of how worksharing activities should be defined for purposes of applying the limit on workshare discounts provided in section 3622(e) of the PAEA, and what position various First-Class and Standard Mail services occupy in the markets that they serve.

To further clarify issues concerning how worksharing activities should be defined, the Commission issued Notice of Inquiry No. 1 (NOI No. 1) on August 27, 2009. Reply comments that addressed the issues raised in the initial comments, those discussed in the public forum, and those framed in NOI No. 1, were received on September 11, 2009.³

Order No. 243 recognized that resolving some issues raised by this docket would be contingent on resolving some logically prior issues.⁴ For example, if the Commission were to conclude that First-Class Mail may not be further subdivided for purposes of applying caps to rates, it would nullify the Public Representative's basis and rationale for proposing to establish Single-Piece First-Class Mail as a separate class of mail.

³ For convenience, participant reply comments are identified in the Appendix attached to this Order. In addition, the following motions were received: Motion of the United States Postal Service to Extend Due Date for Filing of Reply Comments, August 26, 2009; Motion of the Direct Marketing Association to Accept an Errata to the Direct Marketing Association Comments filed September 11, 2009 and September 15, 2009. These motions are granted.

⁴ See Order on Further Procedural steps, July 10, 2009 (Order No. 243).

Another logically prior issue is whether, as a legal matter, the worksharing discount standards of 39 U.S.C. 3622(e) apply only to components of individual “products” as defined in the lists that the Commission maintains under the mandate of section 3642. The Postal Service and a number of bulk mailers urge this interpretation of section 3622(e). If the Commission were to accept the legal conclusion that they advocate, it would render moot any consideration of the role that the relevant categories of First-Class and Standard Mail categories play in the markets that they serve.

Similarly, if the Commission were to reach the legal conclusion that section 3622(e) may be applied within or across products, but reach the factual conclusion that each product at issue serves a separate and distinct market, that factual conclusion would dispense with the need to consider the issue of what benchmark would be most appropriate for measuring the cost avoided by the worksharing characteristics of those products.

Because these issues are mutually dependent, Commission Order No. 243 directed that they be considered together in the current phase of this proceeding. It deferred technical issues of how avoided costs should be calculated to a follow-on proceeding to be held if the Commission were to decide that there is still a need to identify benchmarks for purposes of applying the workshare discount ceiling prescribed in section 3622(e). Order No. 243 at 3-4.

B. Issues Resolved in the Current Docket

In the current docket, the Commission concludes that, as a legal matter, the worksharing discount pricing constraint established in 39 U.S.C. 3622(e) may apply within or across products, as that term is defined and employed in the PAEA. The Commission concludes that the relevant policy considerations have already been resolved in the PAEA itself, and that identifying the groups of mail between which worksharing relationships should be recognized for purposes of section 3622(e) is a factual determination. Whether the limit on workshare discounts prescribed by section

3622(e) applies to particular groups of mail depends on whether the groups in question serve the same or different markets. If they serve the same market, the selection of an appropriate benchmark depends on what types of mail within the base group would have incentive to shift to the workshared group in response to changes in their relative prices.⁵

In the current docket, the Commission concludes that there is a substantial subset of Single-Piece First-Class Mail that serves essentially the same market that presort First-Class Mail serves and that a worksharing relationship exists between that subset and presort First-Class Mail. The applicability of this finding is prospective, and does not give rise to a need to adjust existing rates for these two groups of mail.

Although a worksharing relationship exists between this portion of Single-Piece First-Class and presort First-Class Mail, the Commission acknowledges that the reference group or “benchmark” currently used to measure presort First-Class Mail avoided costs is obsolete. In the follow-on proceeding instituted simultaneously with this Order, the Commission solicits comments on whether the current Bulk Metered Mail (BMM) reference group should be discarded in favor of a number of alternatives, including Information Based Indicia (IBI) mail, a weighted average of BMM and IBI mail, “Qualified PC Postage” mail, or some other group of Single-Piece First-Class Mail. Also ripe for re-examination are the specific cost characteristics to be included in the reference group selected. Among the elements of avoided cost that will be considered for inclusion are collection costs.

The Commission concludes that the relevant policies and standards articulated in the PAEA do not support an inference that Congress intends that Single-Piece First-Class Mail enjoy a general rate preference over other mail. While 39 U.S.C. 3622(a)

⁵ The phrase “types of mail within the group” refers to mail with distinct cost or handling characteristics that are not recognized by rate differences. An example in Single-Piece First-Class Mail would be “PC Postage” as defined in Stamps.com Comments at 1-2.

appears to allow the Commission to establish Single-Piece First-Class Mail as a separate class, it also appears that such a newly established class would not satisfy the requirements of section 3622(d)(2) for separate application of the class cap. The Commission also concludes that Saturation Mail occupies a unique market niche within Standard Mail, and therefore is not in a worksharing relationship with other groups of Standard Mail. Accordingly, there is no need to further examine the issue of an appropriate reference group for pricing Saturation Mail in a follow-on proceeding.

Section 3622(e) names four activities that qualify as worksharing for purposes of applying the limit on workshare discounts “as further defined by the Postal Regulatory Commission.” The Commission concludes that to effectuate the policy underlying the limit on workshare discounts, a named worksharing activity should be defined broadly enough to include an associated activity that is such an integral aspect of the named activity that it either enables the named activity to avoid costs, or substantially alters the amount of costs that the named activity avoids. The Commission offers a set of guidelines to help determine what associated activities are integral to named activities covered by section 3622(e). Under these guidelines, address hygiene is deemed an integral part of pre-barcoding. Similarly, density is deemed an integral part of presorting, at least in the context of First-Class Mail.

C. Issues to Be Resolved in the Follow-On Docket

Order No. 243 contemplated a follow-on proceeding for addressing various technical proposals to revise or refine the manner in which avoided costs are modeled. The Postal Service’s comments, for example, mention its intention to propose changes to the way some cost pools are classified for purposes of cost avoidance analysis (whether they should be treated as proportional, fixed, or non-worksharing related). See Postal Service Comments at 46-47. The comments of APWU express a more general desire to re-evaluate and modify the current method of classifying avoided cost pools. APWU Comments at 7.

Major Mailers Association (MMA) expresses an intent to propose changes to the way delivery and other costs are estimated in calculating the costs avoided by presort First-Class Mail. MMA Comments at 12. Pitney Bowes expresses an intent to propose de-averaging rates for First-Class Mail by indicia and to propose the use of two Cost and Revenue Analysis (CRA) adjustment factors to develop workshare discounts. Pitney Bowes Comments at 12-13. Finally, Stamps.com expresses an intent to propose a form of pre-barcoding discount that would recognize the savings generated by Single-Piece First-Class Mail that is CASS-certified and bears a full-service IMb. Stamps.com Comments at 5-15.

Given the Commission's conclusions in the current docket summarized above, all of these issues remain relevant and therefore appropriate to pursue in the follow-on docket that is being instituted simultaneously with this order.

II. IS THERE A RELEVANT STATUTORY PREFERENCE FOR SINGLE-PIECE FIRST-CLASS MAIL?

The Public Representative argues that the worksharing relationship between Single-Piece and presort First-Class Mail that the Commission has historically recognized should be retained. PR Comments at 4-21. He contends that the consequence of severing the link between the two categories signaled by the recent pricing proposals of the Postal Service would be to extract more institutional cost contribution from Single-Piece Mail and less from presort mail. The Public Representative asserts that the purpose of awarding monopoly protection to the Postal Service is to provide a source of funding of the Universal Service Obligation (USO), and that the intended beneficiary of the USO is Single-Piece First-Class Mail. *Id.* at 22-23.

The Public Representative argues that if there were no monopoly protection for the Postal Service and no USO, private businesses would compete for the opportunity to provide services for bulk First-Class Mail, but would largely avoid providing service for single-piece mailers. He concludes that monopoly protection is given to the Postal Service primarily to fund universal service to Single-Piece First-Class Mail by altering this free-market outcome. *Id.* The Public Representative observes that the Postal Service's objective in urging that the worksharing relationship between single-piece and presort mail be severed is to shift the cost of funding the USO to its intended beneficiary—single-piece mail, which conflicts with the basic purpose underlying the PAEA. *Id.* at 22.

If the worksharing relationship between single-piece and presort mail were severed, the Public Representative proposes establishing Single-Piece First-Class Mail as a separate class of mail for purposes of applying the cap on class rates, thereby preventing further shifts of institutional cost burdens to Single-Piece First-Class Mail. *Id.* at 23-26.

The American Postal Workers Union (APWU) also perceives a fundamental statutory purpose to provide universal service to Single-Piece First-Class Mail. It infers this purpose from the requirement in section 404(c) of the PAEA that the rate for what is understood to be First-Class Mail be geographically uniform. Section 404(c) provides

[t]he Postal Service shall maintain one or more classes of mail for the transmission of letters sealed against inspection. The rate for each such class shall be uniform throughout the United States, its territories, and possessions.

APWU quotes from the opinion that the former Postal Rate Commission expressed when it conducted its last omnibus review of classification policy in Docket No. MC95-1. There the Commission commented that the geographic uniformity requirement in what was the equivalent of PAEA section 404(c) was necessary to meet “the first and most enduring objective of postal policy...to bind the nation together.” APWU Comments at 3, quoting PRC Op. MC95-1, ¶¶ 2048 and 3005. APWU asserts that the subsidy intended by Congress in adopting section 404(c) was not one running from other classes of mail to First-Class, but one running from presort First-Class Mail to single-piece mail. APWU concludes that section 404(c) sanctions the kind of intra-class cross-subsidy that the Postal Service is seeking to avoid. *Id.* at 3-4.

It is clear from section 101(a) of title 39 that one fundamental policy objective of postal law is that postal services should be designed to bind the nation together. The APWU makes a plausible argument that the uniform rate requirement in section 404(c) is intended to promote that policy objective through an intra-class subsidy. APWU Comments at 3-4.

In their discussions, the commenters appear to be using the term “cross-subsidy” in the non-technical sense of bearing a disproportionate share of institutional costs. Most commenters, whether they support or oppose de-linking, appear to assume that if the Postal Service could price presort mail independently of any single-piece mail benchmark, it would extract the amount of revenue allowed under the class cap by raising the price of single-piece mail and reducing the price of presort mail. They

assume that this re-pricing of First-Class Mail would shift the mix of First-Class volume toward presort mail. Because the per-piece contribution of presort mail is greater than that of Single-Piece Mail, the expectation is that the institutional cost contribution of First-Class Mail as a whole would go up. See, e.g., NPPC Reply Comments at 23-26.

Whether this assumption is correct, however, depends on the circumstances. It requires, among other things, that the price elasticity of presort mail be greater than that of single-piece mail. It also requires that the per-piece contribution of presort mail be greater than single-piece mail. There is no assurance that these conditions will always hold. In fact, there is no assurance that they accurately describe current conditions.

The table on page 53 *infra* shows the Postal Service's estimates of price elasticity for both categories estimated over the years. The table shows that in terms of price elasticity, the two categories frequently swap places, and that their relative elasticity is essentially unpredictable from year to year. There is therefore no assurance that the demand elasticity of presort mail will be greater than that of single-piece mail going forward.⁶

Similarly, the per-piece contribution of presort mail currently is substantially above that of single-piece mail. However, if a benchmark component within single-piece mail were identified that was truly representative of the costs of the marginal pieces that could be expected to shift between single-piece mail and presort in response to changes in the discount, and the costs thereby avoided were accurately

⁶ Econometric models of the demand for postal products by the academic community provide reason to believe that the price elasticity of single-piece exceeds that of presort. See, e.g., Hong, Seung-Hyun and Wolak, Frank, A. Relative Prices and Electronic Substitution: Changes in Household-level Demand for Postal Delivery Services from 1986 to 2004, *Journal of Econometrics*, April 2007. Decomposing the price elasticities estimated in another contemporaneous academic paper yields a similar conclusion. See Pearsall, E.S. (2005), "The Effects of Worksharing and Other Product Innovations on U.S. Postal Volumes and Revenues," in M. A. Crew and P. R. Kleindorfer (editors) *Regulatory and Economic Challenges in the Postal and Delivery Sector*, Boston, MA, Kluwer Academic Publishers. Under current circumstances, there is no assurance that the price elasticity of presort will be higher than that of single-piece in any future year.

calculated, there should, in fact, be no cross-subsidy of either Single-Piece Mail or presort mail when the discount is equal to the level of avoided costs.

Unequal per-piece contribution might remain to the extent that single-piece mail had higher intrinsic costs than presort mail. Intrinsic cost differences, however, should be minimized by identifying a truly representative benchmark and accurately measuring the costs avoided by worksharing benchmark pieces. If there were still substantial intrinsic cost differences, these could be further minimized by disaggregating single-piece mail into more homogeneous components, charging a separate rate for each, and discounting that rate where offering a workshared variant is feasible. Pitney Bowes and Stamps.com have made such proposals.⁷ If the cost of benchmark mail were truly representative of marginal mail, the components of single-piece mail were reconfigured into more homogeneous categories, and workshare discounts were equal to avoided cost, cross-subsidy could be largely eliminated.

This, in the Commission's view, is what Congress sought to accomplish by imposing a limit on workshare discounts in section 3622(e). The policy preferences in favor of Single-Piece First-Class Mail for which the Public Representative and APWU argue are not meant to be implemented through the limit on workshare discounts. For reasons explained in section IV.D.3 of this order, the Commission reads the purpose of section 3622(e) to be the pursuit of economic efficiency goals by limiting discounts to the amount of costs avoided. It believes that subsection 3622(e) does not address the question of what groups of mail should enjoy preferences over others, or what form those preferences should take.⁸

⁷ See Pitney Bowes Inc. Comments at 5-6; Stamps.com Comments at 10-39.

⁸ While the Commission does not view section 3622(e) as reflecting a statutory preference for any specific class of mail, that section does reveal a Congressional intent that non-worksharing mailers using a particular service not be adversely affected by the creation of a workshared variant of that service. See 39 U.S.C. 3622(e)(4)(C).

The Commission agrees with the Public Representative and APWU that Single-Piece First-Class and presort First-Class Mail remain in a worksharing relationship. A follow-on rulemaking docket instituted simultaneously with this order will consider the issue of what benchmark is appropriate to measure the cost differences that this relationship exhibits. Accordingly, there is no need in this docket to decide whether Single-Piece First-Class Mail can or should be established as a separate class as an alternative means of preserving a perceived statutory preference for Single-Piece First-Class Mail.

III. THE COMMISSION'S ROLE IN REVIEWING WORKSHARE DISCOUNTS

A. The Commission's Pricing Role Under the PAEA is Greatly Narrowed Relative to the Former Law

In this docket, a common theme running through the comments was the need to properly interpret the role of the Commission in pricing under the PAEA. To address the specific issues raised in this docket in a clear and effective way, it is helpful to first address this more general issue.

Under the PAEA, the Postal Service enjoys a general prerogative to set rates. It has virtually unfettered discretion to set prices for its competitive products, as long as its rates remain above costs and competitive products as a group make a reasonable contribution to institutional costs. This contrasts sharply with the prior regulatory system under the Postal Reorganization Act (PRA) of 1970, Pub L. 91-375, 84 Stat. 719, 39 U.S.C. §§ 101 *et seq.* In a general rate case under the PRA, the Commission reviewed all prices that the Postal Service proposed for both what are now defined as market dominant and competitive products according to a list of qualitative and quantitative ratemaking factors, and of the many hundreds of rates proposed, modified a majority of them. The PAEA tasked the Commission to design a “modern system for regulating” market dominant rates. See section 3622(a). Under the system that the Commission has established, the Postal Service enjoys a general prerogative to set market dominant rates, subject to only a few, clear “out-of-bounds” lines drawn by the PAEA. These “out-of-bounds” lines consist of pricing restrictions in three areas—the cap on class prices (see section 3622(d)), the limit on workshare discounts (see section 3622(e)), and revenue ceilings for the various categories of preferred mail (see section 3626). Congress framed each of these requirements as objective, quantitative pricing standards, made their application mandatory, and placed each in a self-contained section of the PAEA.

In addition to these few, clear “out-of-bounds” lines, the system that the Commission has established requires that market dominant rates be developed with consideration for the qualitative rate and classification objectives and factors identified in sections 3622(b) and (c). Consistent with the PAEA’s directive, the system that the Commission has developed requires that each objective and factor be considered by the Postal Service in conjunction with the others. Under that system, rates should also be consistent with the more general qualitative standards found in 39 U.S.C. 101(d), 403(c) and 404a(1).

When the Postal Service proposes changes to market dominant rates, the changes are subject to scrutiny by the Commission for compatibility with these qualitative standards. This scrutiny, however, is typically light, since it must be concluded in the very short time frame required by statute. Consequently, reviewing market dominant rates for consistency with the PAEA’s many qualitative pricing standards is largely deferred by the Commission until after rates are implemented, in its Annual Compliance Determination. See 39 U.S.C 3653.

Because each of the PAEA’s qualitative standards is conditioned upon all of the others, and because they are largely confined to post-implementation review, the qualitative standards usually remain in the background when the Postal Service selects and implements market dominant rates. As a result, of the many hundreds of rates that the Commission has reviewed since the inception of the PAEA, it has required the Postal Service to adjust only two before they went into effect.⁹ To afford the Postal Service this degree of latitude in pricing, there is no need to posit the existence of an

⁹ These were the rate for Standard Regular Non-auto Machinable Mixed ADC letters, and the rate for Platinum Confirm. The former had a passthrough of over 500 percent, while the latter a passthrough of several thousand percent. The Commission also rejected the Postal Service’s proposal to apply a severe penalty to Standard Mail that the Postal Service considered to be non-compliant with its Move Update requirements.

overarching standard of “pricing flexibility” that trumps not just the other qualitative standards of the new law, but its quantitative standards as well.¹⁰

B. Under the Structure of the PAEA, the Commission has a Limited Role in Before-the-Fact Review of Price Adjustments

As noted, the PAEA establishes only a few clearly defined boundaries that the Postal Service must observe in pricing market dominant services. With respect to those boundaries, the Commission’s role is analogous to that of a referee whose duty is to determine when Postal Service pricing has stepped “out of bounds.”

The PAEA requires that market dominant rates observe three pricing standards that are objective, quantitative, and framed in mandatory terms:

- (1) Prices for each class are capped at Consumer Price Index (CPI) (section 3622(d));
- (2) Workshare discounts are limited to avoided costs (section 3622(e)); and
- (3) Preferred category revenues are restricted to specified percentages of corresponding regular-rate category revenues (section 3626).

The PAEA assigns enforcement of each of these quantitative standards to the Commission. For example, section 3622(e)(2) states that the Commission “shall ensure that such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity.”

¹⁰ See Postal Service Comments at 11-12; Postal Service Reply Comments at 17; Pitney Bowes Inc., Comments at 4-8; Valassis/SMC Comments at 2-3; PostCom Reply Comments at 2-15; NPPC Reply Comments at 5-13. There is nothing in the text of the PAEA, or its official legislative history, that singles out any of the qualitative pricing standards to override all others, much less to override its quantitative pricing standards.

C. The Commission's Duty to Apply the PAEA's Few Quantitative Pricing Standards

The Commission's duty to apply the PAEA's few objective pricing standards is prescribed by statute, leaving only narrow aspects to the Commission's discretion. Since each of these standards is expressed in quantitative terms, it is the Commission's duty to determine how the relevant quantity is to be measured. With respect to the cap on class prices, it is how the CPI is to be used to measure price changes. With respect to the limit on workshare discounts, it is how avoided cost is to be measured. With respect to preferred rate categories, it is how host category revenue is to be measured.

In each instance, the source of this duty is the statutory provision that establishes the standard, coupled with section 3652(a)(1). Section 3652(a)(1) requires the Commission to prescribe the methods used to measure all quantities that the Postal Service reports to the Commission to support the Commission's determinations of compliance with the PAEA's standards. Applied to workshare discounts, the Commission's section 3652(a)(1) duty is to prescribe the methods of measuring the costs avoided by worksharing.

D. Measuring Costs Avoided by Worksharing

Section 3622(e)(2) states that the Commission "shall ensure that [workshare] discounts do not exceed the cost that the Postal Service avoids as a result of the workshare activity..." To apply this standard, it is necessary to measure the "cost...avoided" by the worksharing. To measure the "cost...avoided" by worksharing, it is necessary to identify two reference points—a workshared group of mail and a base group with which it is compared.¹¹ Use of the term "discount" in section 3622(e) implies

¹¹ The comparison could take several forms and still be compatible with the language of section 3622(e). For example, a representative piece from each group could be identified and its costs analyzed. Likewise, a marginal piece deemed likely to shift its status from non-workshared to workshared could be identified and its costs calculated if sufficiently detailed cost data were available.

that the workshared group's rate is defined with reference to the base group's rate. In other words, the two rates are linked. Use of the phrase "cost avoided" in section 3622(e) implies that the base group and the workshared group have similar cost characteristics and that the costs of the workshared group are a subset of the costs of the base group.

E. The Need to Select a Base Group

The selection of the base group defines the extent of the costs avoided, and therefore, the maximum size of the discount. The Commission, the Postal Service, and most mailers have agreed, both before and after the passage of the PAEA, that tying workshare discounts to the costs avoided by worksharing makes economic sense only in the following circumstance: Mail in the base group and the workshared group must be alike in all respects that are important to the mailer, apart from the workshared characteristics. This means that if a mailer's business purpose can be served equally well if it uses either service, the mailer will choose the workshared service when the reward (the discount) is greater than the cost of performing the worksharing activity.

Limiting workshare incentives to the amount of the costs avoided by worksharing gives the mailer an incentive to do the work only if it is the least-cost producer. Society benefits from the section 3622(e) pricing rule because it lowers the costs incurred by the postal industry as a whole.¹² This logic was understood and accepted by the mailing community as postal workshare discounts evolved and, based on the comments filed in

¹² This is the economic logic underlying the Efficient Component Pricing (ECP) rule. The applicability of that logic to the pricing of workshare discounts for postal products was examined in depth by a wide range of testimony in Docket No. MC95-1 under the former regulatory regime. There, most of the mailing community and the Commission endorsed applying the ECP rule to postal workshare discounts in principle. See summary of testimony and the Commission's conclusions at PRC Op. MC95-1, ¶¶ 4253-4302. That endorsement continues to the present. The debate in this docket is not over whether the ECP rule should be applied to workshare discounts, but rather which categories of mail are actually in a worksharing relationship, and how much weight should be given to other considerations where such a relationship exists.

this docket, it remains understood and accepted today.¹³ The purpose of 3622(e) is to ensure that workshare discounts do not violate this economic logic unless an enumerated exception applies. Disagreement of the commenters persists only on the issue of whether particular groups of mail share cost and market characteristics to a sufficient degree to justify limiting discounts to the amount of avoided costs.

To measure the costs avoided by worksharing in a way that has economic meaning, the first task is to correctly identify the base group that is deemed likely to convert to the discounted group, given sufficient price incentive. (The appropriate base group has been labeled the “benchmark” group in past Commission practice.)

F. Selecting a Base Group is a Factual Determination

A factual inquiry is required to identify an appropriate base group. The purpose of the inquiry is to determine what mail shares the cost and demand characteristics of the workshared group, and therefore, is likely to convert if a large enough discount is offered. When the Postal Service proposes a discount for mail on which a specified worksharing activity is performed, it usually accompanies that proposal with evidence that the costs of handling, transporting, and delivering the two groups of mail are similar, except for the worksharing activity. Consequently, identifying a base group that will serve as an appropriate reference point for measuring avoided cost has usually focused on whether mail in a candidate base group serves the same market as mail in the workshared group, making the discount subject to the section 3622(e) limit. As explained above, the Commission has a responsibility under section 3652(a) to choose the methods used for making that determination.

¹³ Postal Service Comments at 6; NPPC Reply Comments at 26-27; PostCom Reply Comments at 8-10; Pitney Bowes Reply Comments at 7-8; Valassis Reply Comments at 10-11. When a workshare discount matches its avoided cost, the Postal Service should be indifferent whether mailers chose to purchase mail from the workshare group or the base group, since it should have no effect on the Postal Service’s net revenue. Similarly, users of other categories of mail in the same class (for rate cap analysis) should be indifferent because the share of revenue of the remaining categories should not change.

The factual determination required to apply section 3622(e) is not aided by assertions that the candidate base group and the workshared group serve different markets if the assertion is unsupported. Nor is it aided by noting that the Commission has agreed to include a group of mail in the list of “products” that it maintains under the authority of section 3642. The definition of the term “product” in section 102(6) is so general (“a postal service with a distinct cost or market characteristic”) that almost any category of mail nominated would qualify. The process by which the Commission places a group of mail on the list does not inquire into the issue of whether groups of mail are workshared variants of other groups of mail. Nothing prevents multiple products that serve the same market from appearing separately on the section 3642 list. Therefore, obtaining separate “product” status on that list implies nothing about whether products on that list have, or do not have, a worksharing relationship.

IV. THE COMMISSION'S ROLE IN ENFORCING THE WORKSHARE DISCOUNT CEILING IN SECTION 3622(E)

A. The Postal Service and a Number of Bulk Mailers Argue That Section 3622(e) is Limited to Discounts Within Products

The Postal Service and a number of bulk mailers¹⁴ assert that to discover what kind of mail is subject to section 3622(e) and how that mail is to be identified, it is necessary to look outside section 3622(e). They conclude that the PAEA's general information reporting requirement (section 3652) determines the reach of section 3622(e).

They note that section 3652(b) requires that unit avoided costs be reported for each market dominant product for which a workshare discount was in effect. They also note the fact that section 3652(b) does not require the provision of such information at higher levels of aggregation or across products. In the Postal Service's words

it is illogical to suggest that section 3622(e) would apply to a relationship for which section 3652(b) does not mandate the provision of cost information.

Postal Service Comments at 15.

These commenters also find it significant that the PAEA defines the term "product" broadly. In the PAEA, a "product" is a service that has "a distinct cost or market characteristic." They compare this broad definition with the more restrictive definition of "subclass" developed by the Commission under the former law, which required a service to exhibit both distinct cost and market characteristics to qualify. So defined, a "subclass" boundary was the equivalent of a market boundary. Therefore,

¹⁴ Postal Service Comments at 11-17; Postal Service Reply Comments at 4,13; Valpak Comments at 19-20; NPPC Comments at 14-19.

under the former regulatory regime, worksharing relationships could exist within, but not across, subclasses.

These parties argue that the primary level at which pricing standards were applied under the former law was the “subclass,” while the primary level at which pricing standards are applied under the PAEA is the “product.” They assert that the PAEA intends “product” to play the role that “subclass” played under the former law so that worksharing relationships now can only exist within products. See Postal Service Comments at 12-13.

B. Commission’s Analysis of the Role of the Term “Product”

1. Significance of the Term “Product”

“Product” is a concept that plays a much less important role in the PAEA as a whole than these commenters contend. They assert that the “product” level is the primary level at which pricing standards are applied under the PAEA, but neither the language nor the structure of the PAEA supports that assertion. When there is a need to formulate and apply a pricing standard for a market dominant service, the term “product” rarely appears. On the few occasions that it is used, the use is unrelated to the issue of at what level the pricing standard should apply.

The sections of the PAEA that articulate or imply standards governing market dominant prices are sections 101, 403, 404a, 3622(b)(1) through (8),

3622(c), 3622(e), and 3626. It is significant that none of them use the term “product” in defining pricing standards.¹⁵ Instead, they use an assortment of very general terms that appear intended to avoid dictating the level at which the standard is to be applied. The terms that specify the mail to which the pricing standards in these sections apply include “mail,” “service,” “class or type,” “subclass,” and “category.” They are all non-restrictive terms.

Generally, the PAEA uses the term “product” to establish or re-establish the distinction between market dominant and competitive services.¹⁶ It seldom uses the term when the role that the market dominant/competitive distinction plays in a given provision of the PAEA is already understood. It uses the term “product” in provisions that hinge on the distinction between market dominant and competitive services because it needs to identify the mail to which that division applies in the most detailed and comprehensive manner possible. Use of the generic term “product” ensures that when that division is made, all services are allocated in a comprehensive way to either the market dominant or competitive basket and no portion of the mail will be unaccounted for.

¹⁵ The term “product” is used only twice. “Market dominant” product is mentioned in section 3622(d) (establishing the price cap on mail classes). Its mention there, however, does not support the Postal Service’s theory that market dominant prices are meant to be regulated primarily at the product level since that price cap explicitly applies at the class level. The term “products” also appears in section 3622(b)(9), but this does not support the Postal Service’s theory either. The section 3622(b)(9) standard, which uses the phrase “market-dominant and competitive products” uses the term “product” because it is meant to police the division of revenue between the Postal Service’s market dominant and competitive lines of business. “Products” are being referenced only in a collective sense in section 3622(b)(9). The Postal Service, presumably, would not support a suggestion that section 3622(b)(9) therefore applies at the individual product level.

¹⁶ This occurs in section 3622(a), which establishes the framework for regulating market dominant rates; section 3633, which establishes the framework for regulating competitive rates; section 3642, which establishes the procedure for assigning services market dominant or competitive status; section 3652, which establishes general data reporting requirements; and section 3691, which prescribes procedures for establishing service standards and monitoring service performance for market dominant services.

Significantly, section 3622(e) itself makes no use of the term “product.” Because section 3622(e) falls within a set of provisions that deal only with market dominant mail, there is no need to use the term “product” to make the applicability of the market dominant/competitive distinction clear. Hence, there is no need to use the generic term “product.”

2. The Term “Product” Does Not Inherit the Role Played By the Term “Subclass” Under the Former Law

It is possible to argue that pricing standards for *competitive* services are applied primarily at the product level since one of the important constraints on competitive service prices is that each product cover its attributable cost. See sections 3633(a)(1) and (2). The PAEA takes a different approach in regulating prices for market dominant services. Of the nearly two dozen provisions that explicitly or implicitly regulate market dominant prices, none use the term “product” to indicate the level at which the standard applies.

The most specific pricing constraints for market dominant services are the price cap (see section 3622(d)) and the attributable cost floor (see section 3622(c)(2)). The price cap is expressly applied at the class level, not the product level. The attributable cost floor applies to each “class or type of mail.” While this phrase is broad enough to include an individual “product,” it is not confined to an individual “product.” Next in importance is the limit on workshare discounts. As noted above, this pricing standard may be applied variously to “mail,” a “postal service,” a “category,” or a “subclass,” as the occasion requires. See section 3622(e). Here, too, mail to which the standard may

be applied is broad enough to include an individual “product,” but is not confined to an individual “product.”¹⁷ Thus, there is nothing in section 3622, the pricing section of the PAEA, that supports the Postal Service’s theory that the PAEA contemplated regulation of market dominant prices primarily at the product level.

3. Significance of the Failure of Section 3622(e) to Use the Term “Product”

There are five provisions in section 3622(e) that address the issue of the level of detail at which the workshare discount limit is to apply. On each occasion, section 3622(e) avoids using the term “product.” These occasions are shown in bold below.

Section 3622(e)(1):

[T]he term ‘workshare discount’ refers to rate discounts provided to mailers for the presorting, barcoding, handling, or transportation **of mail**, as further defined by the Postal Regulatory Commission....

Section 3622(e)(2)(A)(i):

[The discount is] associated with a new **postal service**, a change to an existing **postal service**, or with a new **work share initiative** related to an existing **postal service**;

¹⁷ The concept of “product” takes on significance in the system for regulating market dominant services only in areas that are unrelated to price. Section 3642, for example, gives the Commission responsibility for reviewing proposed new “products.” It is reasonable to presume that the term “product” is used because Congress intended this procedure to be comprehensively applied. This procedure requires the Commission to assign each new product to either the market dominant or the competitive regulatory system. Section 3642 uses the generic term “product” because it is necessary to determine what mail is subject to which of the two systems, and, in doing so, it is crucial that both postal and nonpostal products be assigned. The concept of “product” is also instrumental in regulating service standards. Section 3691 requires the Postal Service to establish service standards and to measure performance for market dominant services at the “product” level.

Section 3622(e)(2)(C):

[T]he discount is provided in connection with **subclasses of mail** consisting exclusively of **mail matter** of educational, cultural, scientific, or informational value....

Section 3622(e)(3)(A):

[The discount would] lead to a loss of volume in the affected **category or subclass of mail** and reduce the aggregate contribution to the institutional costs of the Postal Service from the **category or subclass** subject to the discount below what it otherwise would have been if the discount had not been reduced or eliminated....

Section 3622(e)(4)(C):

[Submit to the Postal Service a detailed report that] certifies that the discount will not adversely affect rates or services provided to users of **postal services** who do not take advantage of the discount rate.

The Postal Service argues, in effect, that Congress meant to substitute the term “products” for every term in bold above, and to substitute the term “within” wherever a preposition is used in conjunction with a bolded term. Neither the Postal Service nor others offering similar arguments have provided any legislative history to support their counter-intuitive position. Their argument violates the basic canon of statutory construction that

[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.

United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972). See also *United States v. Wooten*, 688 F.2d 941, 950 (4th Cir. 1982). Similarly, different terms used within the same statute should not be construed to embody the same meaning. *Russello v. United States*, 464 U.S. 16 (1983).

Congress identifies the services to which a pricing standard applies where that is its intent. For example, section 3622(b)(8) (establishing the “just and reasonable” standard) specifies that it applies “within, between, or among classes of mail.”

Congress also specifies when a pricing requirement applies to individual “products” and when a pricing requirement applies at a more general level.¹⁸ This conclusion is corroborated by noting that Congress also applies non-price requirements at the product level when that is its intent.¹⁹

4. The Role of Commission Judgment in Applying Section 3622(e)

It has been demonstrated above that Congress knew how to apply a requirement only at the “product” level. The most plausible explanation for why section 3622(e) fails to use the phrase “within products” when it specifies the services that it covers is that Congress consciously selected the terms that appear each time the issue of applicability comes up. The terms Congress used in section 3622(e) are:

“mail,” “postal service,” “workshare initiative,” “subclasses,” and “category or subclass of mail.”

It is more plausible to attribute Congressional use of these non-restrictive terms to a deliberate intent on its part not to impose upon the Commission or the Postal Service a specific definition of the groups of mail to which a workshare discount should apply, than to some unsupported allegation of drafting negligence.

The definition of “workshare discount” in paragraph 3622(e)(1) lends additional support to this conclusion.

¹⁸ Compare the wording of subparagraph 3633(a)(2) “ensure that **each competitive product** covers its costs attributable” with the wording of subparagraph 3633(a)(3) “ensure that **all competitive products collectively** cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.” (Emphasis added.)

¹⁹ For example, section 3691(a)(1)(D) explicitly applies the obligation to measure service performance to “each market-dominant product.”

[T]he term ‘workshare discount’ refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, **as further defined by the Postal Regulatory Commission....**

(Emphasis added.) The phrase “as further defined by the Postal Regulatory Commission work out the details.

This mandate to work out the details may reasonably be read as applying to the entire definition of worksharing discount. This becomes apparent when the definition of workshare discount in section 3622(e)(1) is read together with the set of terms used throughout the rest of section 3622(e) to identify the groups of mail to which the discount limit applies. These terms are an assortment of alternative, highly general terms and phrases—“mail,” “postal service,” “category” or “subclass.” By giving the Commission authority to further define “workshare discount,” and avoiding the use of a narrow term or phrase that would restrict the groups of mail to which workshare discounts could apply, section 3622(e) reflects a legislative decision to leave the details of that determination to the Commission.

5. The Role of Data Reporting in Determining What Mail is Covered By Subsection 3622(e)

For help in identifying the type of mail covered by section 3622(e), the Postal Service and a number of bulk mailers refer to section 3652, the PAEA’s general data reporting provision. This effort is unnecessary as section 3622(e) itself directly addresses the issue. Even if there were a need to refer to sections outside of 3622(e), the general reporting provision of the PAEA does not support the inference that these commenters draw from it.

Section 3652 (a)(1) requires the Postal Service each year to report to the Commission the costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe, and in sufficient detail to demonstrate that **all products** during such year complied with all applicable

requirements of title 39. This reporting requirement applies across the board to all services, market dominant and competitive. In Section 3652, the market dominant/competitive distinction has to be re-established. *Compare* paragraph 3652(1) with paragraph 3652(2). This is an instance where the granular term “product” is needed to describe the mail being divided in a detailed and comprehensive way, to ensure that all mail falls into either the market dominant or the competitive basket.

The use of the phrase “for each market-dominant product” in section 3652(b) is to be expected, since the 3652(b) report on workshare discounts is explicitly incorporated in the general annual compliance report required by 3652(a), all of which Congress required to be presented at the product (granular) level. The term “product” is used in 3652(b) for the same reason that it is used in 3652(a), to make sure that there is granular reporting of data on all products, so that no mail is left out.

The Postal Service and a number of bulk mailers, however, read much more into the use of the term “product” in section 3652(b). Since data reporting is a tool for bringing about compliance with standards and requirements, they reason failure of 3652(b) to explicitly require that compliance tools be provided at all levels of aggregation, and for all combinations of workshared services, implies a legislative intent that the 3622(e) standard be evaluated only at the level for which data is made available.

Reported data that are granular and comprehensive, however, provide a tool for analysis at the most detailed level and at all levels above. They also provide a tool that is necessary to analyze the relationship between any pair of services at the granular level or above. Since granular reporting is an all-purpose tool, it does not support an inference that Congress wanted the relevant standard (such as the ceiling on workshare discounts) to be evaluated at any particular level.

The inference that the granular reporting required by section 3652(b) determines the scope that Congress intended for section 3622(e) is unsupported. This can be seen

by examining the other pricing standards of the PAEA. The price cap established in section 3622(d) expressly applies only at the class level. It is not plausible to contend that the cap requirement instead applies at the product level because the only compliance tool that is provided in section 3652(a) is data reported at the granular (“product”) level. Similarly, the attributable cost floor for market dominant products established in section 3622(c)(2) applies to “each class or type of mail service.” It is not plausible to contend that despite this broad language, the attributable cost floor applies at the product level and no higher because the only compliance tool that section 3652(a) provides is data reported at the product level.²⁰

Section 3622(e) itself provides that the ceiling on workshare discounts may apply, variously, to “mail,” “a postal service,” a “category,” or a “subclass,” as appropriate. The contention that these terms were used by Congress inadvertently when it actually meant to apply section 3622(e) only within products is rejected.²¹

C. The Argument That Application of the Workshare Discount Standard Should be Qualitative and Ad Hoc

1. The Premise That Flexibility and Other Qualitative Pricing Standards Have a Pre-eminent Role in Enforcing Section 3622(e)

The Postal Service and others argue that it is the Commission’s duty to base enforcement of the section 3622(e) workshare discount ceiling on a wide array of public policies, testing the impact of each discount for consistency with those policies. Postal Service Comments at 28; Postal Service Reply Comments at 17; Joint Comments of

²⁰ The same reasoning that the Postal Service urges the Commission to apply to pricing standards could be applied to the regulation of service standards where it would also be invalid. Section 3691 requires service performance to be measured “for each market-dominant product.” The Postal Service does not contend that the PAEA bars it from establishing class-wide or subclass-wide service standards in addition to the product-level service standards required by section 3691, simply because section 3691 does not explicitly require measuring service performance above the product level.

²¹ It should be noted that that the preposition “within,” which the Postal Service repeatedly uses in its descriptions of section 3652(b), cannot be found there.

BOA et al., at 5; Pitney Bowes Comments at 4-8; PostCom Reply Comments at 5-12, 36. The policies that these commenters would have the Commission weigh each time a workshare discount is adjusted are the 22 objectives and factors that are listed together in sections 3622(b) and (c). They would also include the more general public policy goals of section 403(c) (barring undue discrimination among, or granting unreasonable preferences to, mailers) and section 404a(1) (barring the Postal Service from imposing any regulations whose effect is to secure a competitive advantage to itself).

Of the 22 qualitative pricing standards in sections 3622(b) and (c), two mention pricing flexibility. See sections 3622(b)(4) and (c)(7). These commenters assert that pricing flexibility “overarches” the remaining qualitative goals and standards in the PAEA, and therefore should shape the Commission’s enforcement of the limit on workshare discounts.

They contend as well that Commission evaluation of workshare discounts should focus on the undue discrimination prohibition in section 403(c). They say that this would serve to moderate differences in institutional cost contribution between workshare groups and base groups. They further argue that the Commission’s review should emphasize section 404a(1), which bars regulations that give the Postal Service an unfair competitive advantage. They contend that this would dissuade the Postal Service from designing discounts that are less than avoided costs, which would discourage private mailers from performing the work, and secure a competitive advantage to itself. PostCom Reply Comments at 7-10; NPPC Reply Comments at 4.

D. Commission Analysis of the Role of “Pricing Flexibility” and Other Qualitative Pricing Standards in Enforcing Section 3622(e)

1. The Role of Qualitative Pricing Standards in the Modern System of Rate Regulation

The 22 qualitative pricing and classification standards embodied in sections 3622(b) and (c) apply to market dominant services. They are not self-executing.

Congress provided them as guides to the Commission in carrying out the task of designing a modern system of regulating rates and classifications assigned to it by section 3622(a). The Commission's rules require that they be applied both by the Postal Service when designing rate adjustments, and by the Commission during its post-implementation review of compliance with the requirements of the PAEA.²²

The Commission's regulations reflect its conclusion that application of the qualitative standards must largely be deferred to post-implementation compliance review under section 3653, except in circumstances that exhibit blatant disregard for a given standard. See Order No. 43 at 12-13,²³ 39 CFR 3010.13 and 3010.14. The Commission regards this as consistent with Congress's apparent intent—reflected in the very short period provided in the PAEA for pre-implementation review of proposed rate adjustments—that such review focus on the few pricing standards that Congress has chosen to cast in objective, quantitative, and mandatory form. See sections 3622(d), 3622(e) and 3626.

2. Quantitative Pricing Standards are Applied Differently Than Qualitative Standards in the Modern System of Rate Regulation

Each of the PAEA's few quantitative pricing standards is referred to as a "requirement." Each is presented separately, in a provision devoted exclusively to that standard. See sections 3622(d), 3622(e) and 3626. Each provision directly and comprehensively addresses how the mail to which its standard applies should be identified. These provisions also directly and comprehensively address issues of flexibility, including when deviations from the standard are warranted, and the procedures to be followed in such situations.

²² See the Commission's discussion in its FY2009 Annual Compliance Determination, at 13-17.

²³ Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007 (Order No. 43).

For example, section 3622(d) caps price changes for mail classes at the level of CPI. Section 3622(d)(2)(C) authorizes the Postal Service to bank unused rate authority. If that degree of flexibility proves insufficient, section 3622(d)(1)(E) authorizes the Postal Service, in certain limited circumstances, to file an exigent rate case, following prescribed procedures.

Section 3622(e) gives the Commission responsibility for ensuring that the limit on workshare discounts is observed. It specifies the circumstances that justify deviation from the limit in sections 3622(e)(2)(A)(i) and (ii).²⁴ How long a warranted deviation should persist is addressed in sections 3622(e)(2)(A)(ii) and 3622(e)(2)(B)(ii). Sections 3622(e)(2)(B)(i), 3622(e)(C) and 3622(e)(2)(D) specify additional circumstances under which deviation is warranted. Finally, sections 3622(e)(3)(A) and (B) specify circumstances under which remedies for deviation may and may not be pursued.²⁵

The PAEA quantitative pricing standards are all price caps in various forms. Their purpose is to limit the Postal Service's pricing flexibility in the manner specified. Congress cast these pricing standards in quantitative and mandatory terms, anticipating issues of coverage, circumstances warranting flexibility, and the procedures to be followed when flexibility is warranted. This evidences Congressional intent to resolve these issues in the statute itself, rather than leave them to the Commission to resolve according to its subjective balancing of a host of qualitative pricing standards.

It is important to recognize that the quantitative standards discussed above are different in kind from the qualitative rate and classification standards contained in sections 3622(b) and (c). The PAEA characterizes the quantitative standards as

²⁴ These exceptions to the applicability of the cap on workshare discounts essentially codify the set of reasons that the former Postal Rate Commission had used under the former law when it authorized exceptions to the ECP standard.

²⁵ Section 3626 contains an assortment of revenue caps for various preferred categories of mail. Determining what mail is eligible for the various caps is an issue that this section addresses in great detail. Deviations from those caps, however, appear to be foreclosed.

“requirements.” It frames each in objective terms, in its own self-contained section, where all allowable exceptions are comprehensively itemized. In contrast, the PAEA frames the qualitative standards in discretionary terms.²⁶ They are presented as a group and the application of each is conditioned upon the need to recognize and reflect the others.²⁷

These differences necessarily lead to differences in how the quantitative and the qualitative standards are to be applied in the modern system of ratemaking. Quantitative pricing standards are at the top of the statutory hierarchy. Next in the hierarchy are the qualitative “objectives” listed in section 3622(b), followed by the qualitative “factors” listed in section 3622(c). Under this hierarchy, violations of the three quantitative pricing requirements are “out of bounds.” The Postal Service has broad flexibility to develop prices to achieve the qualitative objectives and factors of sections 3622(b) and (c) so long as its prices are “in bounds” because they satisfy these quantitative requirements.

As noted, the Postal Service and a number of bulk mailers select two of the objectives and factors listed in sections 3622(b) and (c)—those that mention pricing flexibility—to characterize as “overarching” the remaining 20. They do not cite statutory language or official legislative history on which to base this characterization, and the Commission is aware of none. Tension is inherent between most of these qualitative standards. For example, two other standards assert that rates should “maximize incentives to reduce costs and increase efficiency.” See sections 3622(b)(1) and 3622(c)(12).

²⁶ The preamble to section 3622(c) requires that the modern system of ratemaking take all of the listed factors “into account.”

²⁷ The preamble to section 3622(b) requires that under the modern system of ratemaking, each qualitative objective “be applied in conjunction with the others.”

How to resolve the tension between allowing the Postal Service pricing flexibility and ensuring that prices are cost minimizing is a core issue in this docket. Which standard or set of standards should prevail over the rest is not a matter to be resolved through *a priori* assumptions about which ones Congress made pre-eminent over others. The circumstances of each case should determine the relative weight that should be given to each. However, under accepted rules of statutory construction when a general, qualitative pricing standard, such as pricing flexibility, conflicts with a specific quantitative pricing standard, such as the limit on workshare discounts, the pricing standards that are specific and mandatory should prevail over those that are general and discretionary.²⁸

3. The Status of the Efficient Component Pricing Rule

The Efficient Component Pricing (ECP) rule holds that if a workshare discount exceeds the cost avoided by worksharing, it will encourage a less efficient producer (the private mailer) to do the work. There is a consensus among the commenters that the Congressional purpose in limiting workshare discounts at the level of avoided costs is to have workshare discounts comply with this element of the ECP rule.²⁹ If the discount is less than the cost avoided by worksharing, it will likewise encourage a less efficient producer (in this case, the Postal Service) to do the work. Some commenters ask the Commission to apply both elements of the ECP rule when evaluating workshare discounts. NPPC Reply Comments at 9; PostCom Reply Comments 8-10.

The Commission finds that of these two aspects of the ECP rule, only the former is reflected in section 3622(e). While the Commission considers ECP an economically

²⁸ See *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384, (1992); *Doe v. National Bd. of Medical Examiners*, 199 F.3d 146, 154-55 (3rd Cir.1999).

²⁹ NPPC Comments at 26; PostCom Comments at 8-10; Valassis Comments at 11; Response of Pitney Bowes Inc. to Notice of Inquiry No. 1, September 11, 2009, at 7-8. See also Postal Service Comments at 6.

beneficial pricing practice, Congress acted to prevent workshare discounts that are too large, but did not include language specifically to, prevent discounts that do not pass through the full measure of costs avoided.

4. Selecting a Base Group or “Benchmark” is Necessary to Measure Cost Avoidance

The structure of the PAEA and the role assigned to the Commission in section 3652(a)(1) reflects a Congressional intent to allow the Commission to determine the methods to be used to measure the quantitative pricing requirements. The requirement that workshare discounts be no greater than the amount of costs avoided is prescribed by statute. The policy aspects of whether and what kind of discount limit should be applied are resolved in section 3622(e) itself. The task that falls to the Commission is to select an appropriate base group or “benchmark” from which the “costs avoided” may be determined. Because this is a factual determination, it should rest on the empirical evidence provided of relative demand on the part of groups of mailers for a particular pair of services and the empirical evidence that indicates the cost to the Postal Service of providing the unbundled portion of that service.

Specifying the methods to be used to measure the amount of costs avoided by worksharing necessarily involves identification of a workshared group of mail, and a non-workshared base group of mail, with which its costs can be compared. Identification of an appropriate base group or “benchmark” is the culmination of a process that seeks to determine the extent to which groups of mailers have cost characteristics and market characteristics in common. If this analysis is not done, or is done arbitrarily, the underlying purpose of section 3622(e)—which is to preclude a particular kind of economic inefficiency in setting discounts—will be defeated.

Identifying an appropriate base group of mail that will make “avoided cost” an economically meaningful measure of productive efficiency, as section 3622(e) presumably intends, is a factual determination, not a policy determination. The factual

question to be answered is whether a group of mailers is indifferent to using a full-service version of a postal service or an unbundled version of that service, except for the prices charged for each. If the group is indifferent about this decision except for price, it indicates that a workshare relationship exists between the full-service category and the unbundled category. This would make the discount subject to the limit mandated by section 3622(e).

5. The Argument That the Use of Consistent Benchmarks Should be Avoided

PostCom argues that identifying an appropriate base group is making use of a “rigid formula” for applying to section 3622(e) where the PAEA requires the Commission to subjectively balance a list of qualitative pricing standards. It contends that settling on a particular base group as one of the two required reference points for measuring avoided cost from one rate adjustment to the next “unlawfully” forecloses consideration of a wide set of public policy considerations that it believes should influence how avoided cost is measured. It cites a number of cases purporting to support its claim. PostCom Reply Comments at 13; NPPC Reply Comments at 37.

If there is a rigid rule or formula involved in applying the pricing standard of 3622(e), it is the decision to limit workshare discounts at the level of the cost that worksharing avoids.³⁰ Whatever inflexibility this standard imposes on the Postal Service’s pricing decisions has been imposed by statute, not by the Commission. Because selecting a base group of mail from which avoidable costs might be measured is a factual determination, it is rigid only if the Commission refuses to re-evaluate facts or consider new facts when it is asked to modify the analytical principles that it accepts for modeling avoided costs.

³⁰ In fact, the enumerated exceptions in the law make it a reasonably flexible standard.

The Commission recognizes it has the obligation to carefully consider any new facts and proposed new interpretations of the facts that it has previously relied on in identifying an appropriate group of mail to serve as a base group. If there has been a shortcoming in the evaluative process to date under the PAEA, it has been the scarcity of empirical evidence offered on the demand characteristics of relevant groupings of mail, not the unwillingness of the Commission to consider that evidence.

Confirmation of the Commission's willingness to re-think its selection of base groups is provided in Order No. 537, the companion order that is being issued simultaneously with this order. Order No. 537 initiates a follow-on proceeding to identify the most appropriate base groups for measuring worksharing cost avoidance in both First-Class and Standard Mail. The order refers to alternative base groups already suggested by commenters, identifies other possible alternatives, and solicits evidence to help identify the most appropriate base groups for the Commission to employ in its cost avoidance models.

6. Special Considerations with Respect to Presort First-Class Mail

With respect to presort First-Class Mail, the Commission is persuaded that the current BMM benchmark has become obsolete and is no longer likely to be representative of the portion of single-piece mail that is likely to become workshared given appropriate price incentive. An appropriate replacement benchmark will not be identified until the completion of the companion rulemaking instituted concurrently with this order. Under these unique circumstances, the Commission has concluded that it will not further the economic efficiency goals underlying section 3622(e) for the Postal Service to reduce the existing presort First-Class Mail discounts in an effort to more closely approximate 100 percent of avoided cost calculated with reference to that obsolete benchmark. Therefore, pending completion of the companion rulemaking, the Postal Service is not obligated to reduce its presort First-Class Mail discounts below their current levels.

E. The Scope of Section 3622(e) Workshare Characteristics Should Be Interpreted to Be Consistent With Its Purpose

Section 3622(e)(1) provides:

Definition.—In this subsection, the term “workshare discount” refers to rate discounts provided to mailers for the **presorting, prebarcoding, handling, or transportation** of mail, as further defined by the Postal Regulatory Commission...

(Emphasis added.)

The comments in this docket raise the issue of how tight a circle the Commission should draw around each of the bolded terms above. The Postal Service and some bulk mailers recommend that they should be construed as literally as possible. They argue that the workshare discount limit should apply to the four named characteristics and nothing else, no matter how much the value to the Postal Service of the named characteristic might depend on the presence of some related characteristic.

They suggest that each named characteristic must be a direct substitute for an activity that the Postal Service would otherwise have to perform on the mail in question in order to justify a discount. Postal Service Comments at 29-45; Postal Service Reply Comments at 18-31; Valassis Comments at 2-10; Valpak Comments at 6-21; BOA, *et al.* Comments at 9-11. Some further assert that the Postal Service must explicitly represent that a particular named characteristic is the basis of the discount before a workshare activity falls within section 3622(e). Valpak Comments at 8.

1. “Inherent” Versus Added Characteristics

These comments assert that the Commission should not apply the workshare discount limit to any rate differences that reflect “inherent” cost reducing characteristics, as distinguished from characteristics that result from the specified worksharing activities. They cite shape, machinability, and delivery density as examples of

characteristics that are inherent in workshared mail and that the Postal Service cannot itself supply. Postal Service Comments at 29-45; Postal Service Reply Comments at 18-31; Valassis Comments at 2-10; Valpak Comments at 6-21; Joint Reply Comments of BOA, *et al.* at 9-11.

As part of its broad section 3622(a) mandate to establish a modern system of ratemaking for market dominant products, Congress expressly included the authority to “further define” the four categories of worksharing activity that are named in section 3622(e). The law delegates that authority to the Commission to ensure that the limit on workshare discounts is applied in a manner that is consistent with its underlying purpose. As noted above in section III. E., there is a consensus among the commenters that its underlying purpose is to secure the economic efficiencies that are obtained when workshare discounts are no greater than the those identified as optimal by the ECP rule. The economic benefit obtained when the ECP rule is followed is that the Postal Service will do the work required to produce the work-saving characteristic as long as it is the least-cost producer.

To reap the economic benefits of following the ECP rule, it is necessary to measure the cost avoided by each particular worksharing activity in a way that fully reflects its value to the Postal Service in the context in which the workshared mail is presented. For example, the Postal Service may require that mail with the specified workshare characteristic also have related, mailer activities performed. These associated workshare activities may be so closely related to the specified workshare characteristic that its presence substantially increases the amount of Postal Service costs that are avoided. For example, CASS-certifying address lists increases the value of pre-barcoding, and greater density increases the value of presorting.

The Commission concludes that Congress meant workshare discounts to meaningfully reflect the ECP rule, and delegated the authority to the Commission to “further define” workshare activities in a manner that would be consistent with that rule.

To meaningfully reflect the ECP rule, avoided costs must be measured in a way that reflects the full value of the specific workshare characteristic to the Postal Service in the context in which such mail is actually submitted. If the Postal Service requires that mail with one of the four specified workshare traits also have an associated worksharing performed before it may be submitted, and the presence of the associated worksharing substantially increases the amount of Postal Service costs that the specified trait avoids, the associated trait should be viewed as integral, and thereby ancillary to the named trait for purposes of section 3622(e). Taking into account the integral, ancillary trait allows the discount to be based on a complete, rather than a partial measure of the costs that the specified workshared characteristic avoids. Such a discount provides a valid price incentive to mailers deciding whether to produce workshared mail, and secures the economic benefit that compliance with the ECP rule intends. Where an ancillary workshare characteristic bears a relationship of this kind to a specified workshare characteristic, it should be included in the section 3622(e) definition of worksharing.

Defining workshared characteristics in this way also has practical benefits. In the engineering models that the Postal Service uses to estimate the costs avoided by worksharing, there are many instances where the costs avoided by one of the four specified workshare traits cannot be isolated from integral and ancillary mailer activities. Letters presorted to five-digit ZIP Code, for example, would not avoid an outgoing primary, secondary, or any subsequent sort handling if they were entered into the system five pieces at a time. The reason is that it is not feasible to maintain the sort order (in a bundle, tray, sack, etc.) as the five pieces make their way through the system. Only if presorted pieces are entered in densities sufficient to make it worthwhile to maintain their sort through some or all of the sorting steps prior to delivery will presorted mail avoid costs. The value of presorting to the Postal Service cannot be modeled separately from the density associated with various levels of presorting. The costs of presorting, however, can be modeled in the presence of the requisite density.

The value of pre-barcoding to the Postal Service also depends substantially on the presence of other workshare activities such as assuring readable, cleansed addresses. While pre-barcoding may avoid some Postal Service costs even if the addressing is “dirty,” the amount of costs avoided will not be comparable to the amount avoided if the addressing meets the applicable standard. Defining the four specified workshare activities to include integral workshare activities that substantially impact the value of the specified activity will allow the full amount of costs actually avoided by the named workshared trait to be successfully modeled and measured. The Postal Service recognizes that an excessively literal construction of section 3622(e)(1) would yield a partial measure of the costs actually avoided by workshare characteristics and would send a misleading price signal to mailers deciding whether to engage in worksharing. It therefore suggests that the Commission not define the characteristics of mail that are considered worksharing less liberally than current practice.³¹

2. Guidelines for Defining Worksharing

Section 3622(e) makes the Commission responsible for establishing reasonable definitions of workshare discounts. The Postal Service steers this task in a constructive direction when it analyzes the role of address hygiene.

Example of address hygiene. The Postal Service observes that a mailer who uses an unclesed mailing list to pre-barcode its mail will enter inefficient, high cost mail into the system, due to such things as a higher percentage of undeliverable-as-addressed mail. If the Postal Service had barcoded the same mail based on a cleansed version of the mailing list, the result would be more accurate sorting, cheaper handling, and less undeliverable-as-addressed mail. It states:

³¹ Response of the United States Postal Service to Notice of Inquiry No. 1, September 11, 2009, at 9-12.

[I]n the case of mailings generated from uncleaned address lists, what results from prebarcoding by the mailer is not comparable to what results from barcoding by the Postal Service. This would violate an implicit objective of section 3622(e), which is that the quality of the potential workshare function (for which appropriate incentives are supposed to be established) should be equivalent whether performed by the mailer or the Postal Service. There is no point in setting discounts exactly equal to avoided costs if the quality of the work performed is likewise not equal.

Id. at 10.

What makes the “quality of the work” unequal in the scenario that the Postal Service describes is address hygiene. This is a mail characteristic that is not named in section 3622(e)(1), but its impact on the value of pre-barcoding must be reflected in the size of the pre-barcoding discount if the purpose of the discount is to be fulfilled. That purpose is to provide an economically efficient price incentive to potential mailers of pre-barcoded mail that accurately reflects the costs that pre-barcoding would save the Postal Service under the circumstances in which the pre-barcoded mail would be presented.

Example of density. The reasoning that the Postal Service applies to address hygiene applies as well to density. In response to question 2 of NOI No. 1, the Postal Service analyzes the Commission’s hypothetical in which a mailing with sufficient density to a 3-digit area to produce qualifying 5-digit mail is split into two separate mailings, thus imposing higher handling and sorting costs on the Postal Service because the available density was not exploited. The Postal Service adds quantitative assumptions to the Commission’s hypothetical that turn this conclusion into a close call.³² But increasing the assumed number of pieces going to the 3-digit area to a high enough level would clearly impel the conclusion that when higher density is coupled with presorting, it increases the value of presorting.

³² Under its added assumptions, the Postal Service concludes that presorting the hypothetical mailings separately (*i.e.*, without sufficient density) would increase its cost of handling the mailings slightly, whereas presorting the mailings after they have been combined (*i.e.*, with sufficient density) would reduce Postal Service costs. *Id.* at 2-6.

The Postal Service and some bulk mailers characterize density as an “inherent” characteristic of workshared mail, one that is not optional to the mailer. Other bulk mailers, primarily consolidators of presort First-Class Mail, argue that density is a characteristic that the consolidator generates by aggregating small mailings into large mailings before they are presented to the Postal Service. In the context of First-Class Mail, an economically meaningful measure of avoided costs is one that indicates to the mailer the full measure of Postal Service savings that would be captured when the mail is presented to the Postal Service presorted rather than unsorted. The difficulties inherent in trying to identify and subtract out the influence of density on these savings could cause the savings from presorting to be underestimated, and thus frustrate the acknowledged purpose of section 3622(e). Therefore, in the context of presort First-Class Mail, density should be defined as an integral characteristic of presorting.

Guidelines. The Commission concludes that section 3622(e)(1) should be construed to include the mail characteristics resulting from the four workshare activities named there, and closely related traits that, in the presence of the named activity:

- Materially affect the value to the Postal Service of the named worksharing activity;
- Are practical for the mailer to alter in response to the discount for the named worksharing activity; and
- Whose cost impact cannot feasibly be isolated from the impact of the named worksharing activity, and therefore cannot provide a basis for a separate discount.

These are guidelines. They are too general to serve as “analytical principles” as that term is used in the Commission’s periodic reporting rules. These guidelines are intended to give notice to the postal community of the Commission’s current view of the appropriate approach to take in defining the workshare activity to which section 3622(e) should apply. Since this is, to a degree, uncharted territory, the Commission will be receptive to suggestions as to how this approach might be refined, and how it should

properly be applied (how it should be translated into analytical principles that govern cost avoidance modeling), in the follow-on proceeding instituted simultaneously with this order.

V. THE ROLE OF MARKETS IN APPLYING 3622(e)

A. Overview

When workshare discounts were first established, prior to passage of the PAEA, the Postal Service's rule for determining the size of workshare discounts was that they should not exceed the costs that were demonstrably avoided as a result of private worksharing activity. By adhering to this standard, the Postal Service could be certain that the discount would not reduce its net revenue if mailers chose to perform the workshared portion of the service. The Commission accepted this standard and its underlying rationale. PRC Op. MC73-1 at 16-17.

The demonstrable avoided cost standard was evaluated in subsequent Commission proceedings by leading economists specializing in regulated industries. They deepened the rationale for the avoided cost rule beyond mere revenue protection. They developed economic reasoning that demonstrated that setting discounts for workshared mail equal to the costs that worksharing saved the Postal Service would ensure that the workshared activity would be performed by the producer who could do it at the lowest cost. They pointed out that discounts greater than the Postal Service's savings would provide an incentive for private mailers to do the work even though the Postal Service could do it less expensively. They also reasoned that a discount smaller than the Postal Service's savings would discourage private mailers from doing the work when they could do it less expensively than the Postal Service. That discounts that equal the Postal Service's avoided costs maximize productive efficiency ECP rule was affirmed as the operative standard for evaluating workshare discounts in Docket No. MC95-1 under the former law. See PRC Op. MC95-1, ¶ 4256; PRC Op. R2006-1, ¶¶ 4001-38. One-half of the ECP pricing constraint—the half that set a ceiling on workshare discounts at the level of avoided cost—was carried forward in section 3622(e).

For ECP logic to apply, however, the categories of mail whose rates should be set with reference to each other must be in the same market so that the price of postage is the most important factor in the mailer's decision to use one category or the other. If non-price considerations dominate the mailer's decision to choose one category of mail over another, even a discount that is equal to the difference in cost will not incentivize efficient behavior by mailers. If categories of mail are in different markets, their rates need to reflect those different market conditions if they are to be economically efficient.

It is difficult to definitively determine that two categories of mail are in the same market when there is heterogeneity in one or both categories. Nevertheless, there are several factors that indicate that markets overlap. Categories of mail that serve a similar economic purpose are likely to be in the same market. If the categories of mail are functionally similar as well, the likelihood increases. Functional similarities may include shape and physical format, service level, and read/response rates. The existence of a third-party industry that aggregates mail from one category and converts it to the other for a fee also implies that the two categories of mail serve the same market because price is causing the mailer to move between the respective categories. The implication that two categories of mail serve the same market can be reinforced if a valid econometric model of demand shows that they also have similar own-price elasticities and significant cross-price elasticities.

B. Application to Classes

1. First-Class Mail

The Postal Service argues that single-piece and presort First-Class Mail serve separate markets. In support of this position, it discusses the differences in both the users and uses of single-piece and presort mail. It describes single-piece mailers as mostly households and small businesses that tend to send low volumes of transaction mail or correspondence that is incidental to their business or profession. Presort mailers are described as businesses or organizations that routinely send large volumes

of mail as bills or statements to their existing customers, or as advertising to acquire new customers. For them, the mail is a sufficient focus of their business to warrant an up-front investment in mail production systems that are necessary to adapt mail to the exacting requirements of qualified presort mail. Postal Service Comments at 19-20.

Some of the comments also assert that the market for First-Class Mail has matured, and there is no longer a potential for any meaningful volumes of single-piece mail to convert to presort mail or for presort mail to revert back to single-piece mail. Pitney Bowes states that only 1 percent of the presort First-Class Mail volume it handles is converted to single-piece mail. Pitney Bowes Inc. Reply Comments at 7. NAPM asserts that presort firms are having little success finding additional Single-Piece mail that can be profitably converted to presort mail. NAPM Testimony at 7-9.

In its comments, the Postal Service presents recent volumes for single-piece letters by indicia and points out that the combined volumes of IBI and metered letters have been a stable percentage of total single-piece letter volume. According to the Postal Service, these two types of single-piece mail have been traditionally viewed as the most likely candidates for conversion to presort mail. It argues that the fact that their aggregate share of total First-Class Mail is no longer declining is evidence that this conversion has run its course. See Postal Service Comments at 19-20. DFS addresses the potential for mail that is currently presorted to revert to single-piece mail and concludes that technology has changed to the point that single-piece mail is no longer a viable option for large mailers. It suggests that a more likely result of reduced presort discounts would be a broad exodus of presort mail to electronic alternatives. Joint Reply Comments of BOA, *et al.* at 6-7.

The Commission finds that substantial portions of single-piece and presort First-Class letters serve the same market. The economic purpose of Single-Piece First-Class Mail and the large majority of presort First-Class Mail can be said to be the secure transmission of individualized, confidential, time-sensitive messages and

documents. The main uses for both are transactions (bills, invoices, and statements) or correspondence.³³ For the most part, the basic uses of single-piece and presort First-Class Mail are the same, but the mode is different. Single-piece mail is used to transmit correspondence and conduct transactions at a “retail” level, while presort mail is used to do much the same thing at a “wholesale” level. Aside from the minimum volume requirement for presort mail, the main difference between the two is a long list of quality control requirements that presort mail must meet. Advertising is the third major use of First-Class Mail. It is confined to presort. *Id.* at A-9. To that extent, the economic purposes of the two categories are distinct. On balance, however, the similarities in economic purpose outweigh the dissimilarities.

BMM has traditionally been considered to be the portion of Single-Piece First Class Mail that is a likely candidate for conversion to presort mail, given a sufficient price incentive. This is due, in large part, to its “white mail” characteristics.³⁴ Indeed, all IBI Single-Piece First-Class Mail can be described as functionally similar to presort mail in the sense that it is “white mail.” The Postal Service shows that the pool of single-piece mail that can be considered amenable to conversion to presort mail on this basis is quite large. In FY 2008, there were more than 12 billion metered letters, which constituted over 36 percent of all single-piece volume. See Postal Service Comments at 19-20.

³³ Using the Household Diary Study, the Postal Service shows that the majority of First-Class correspondence mail is non-household originated, while a substantial minority of household originated First-Class is transaction mail. It views non-household originated First-Class Mail as a rough proxy for presort, and household originated First-Class Mail as a rough proxy for Single-Piece First-Class Mail. Postal Service Comments, Technical Appendix, at A-11.

³⁴ BMM is assumed to consist of machinable, homogenous, non-barcoded pieces with machine-printed addresses, properly faced, and entered in trays. See Docket No. R2005-1, Response of the United States Postal Service of Witness Abdirahman to Interrogatories of American Postal Workers Union, AFL-CIO, June 24, 2005, at responses to APWU/USPS-T21-8 (APWU/USPS-T21-8).

A significant industry exists for the purpose of seeking out current users of “white” single-piece mail for conversion to presort mail.³⁵ Those in the industry acknowledge that the factor that most distinguishes presort mail from IBI mail and metered single-piece mail is the cost of meeting the requirements for workshare discounts, as opposed to any non-cost factor that makes one category inherently more suitable than the other for a given mailer’s purposes.³⁶

Several commenters include discussions that strongly suggest that cost differences, as opposed to market differences, are the primary drivers of mailer decisions to enter mail as single-piece or presort. For example, the Postal Service describes what it perceives as market differences between “non-household entities with mailing activity *sufficient to justify* managing [mailing] activity as part of their ordinary course of business on one side” and other mailers with “less focus on mailing issues.” (Emphasis added.) Postal Service Comments, Technical Appendix, at A-4. NAPM also describes single-piece mail as “mail from mail owners that generate too little volume to *justify the costs* to a presort bureau of collecting the mail, transporting it to our facilities, sorting it, delivering it to the Postal Service, and billing the mail owners for our services.” (Emphasis added.) NAPM Testimony at 7-8. These descriptions highlight the fact that the decision to enter mail as single-piece or as presort is based largely on costs, rather than other factors. If the costs of preparing mail to qualify for workshare discounts exceeds the value of the discount, then the mailer cannot justify performing the workshare activities.

³⁵ See, *id.*, Technical Appendix at A-9; Pitney Bowes Reply Comments at 7; NAPM Testimony at 7.

³⁶ Traditionally, it has been assumed that bulk submission of single-piece mail to the Postal Service directly by the single-piece mailer was one of the prerequisites for considering mail a likely candidate to convert to presort. This assumption helped confine the benchmark used for calculating the costs avoided by presorting to BMM. The rise of the industry consolidating First-Class Mail shows that bulk submission directly by the mailer may no longer be an essential characteristic of mail that is subject to conversion, and that the pool of single-piece mail that should be considered a candidate for conversion is considerably broader than BMM.

The Postal Service asserts that the conversion of single-piece mail to presort mail has run its course. The main evidence it offers in support of this assertion is the fact that the sum of IBI and BMM mail volume (the single-piece mail most likely to convert) has remained stable over the last decade. Postal Service Comments at 19-21. This assertion, however, ignores the dynamic aspect of this statistical picture. BMM volumes have rapidly dwindled and IBI volumes have rapidly grown. This could reflect a migration of BMM to presort mail and a contemporaneous conversion of ordinary single-piece to IBI mail facilitated by the widening use of PC software that simplifies the creation of IBI mail. Stamps.com offers a different view of the dynamics of single-piece First-Class Mail volumes. It contends that the most efficient and lowest cost single-piece mail (automation compatible and address corrected) once comprised a substantial part of its customer base. It argues that this component of single-piece mail is rapidly dwindling because there is no financial reward for the extra effort made by these mailers. Stamps.com Reply Comments at 2-3.

Assertions that the conversion of single-piece mail to presort mail has slowed or even stopped do not necessarily lead to the conclusion that the remaining single-piece mail has not converted (or will not convert) because it is in a different market. Given a relatively stable discount, it is logical for mail to stabilize according to its cost profile. Mail with “self-sorting” costs³⁷ that are less than the discounts will continue to be entered as presort mail, and mail with “self-sorting” costs that are greater than the discounts will continue to be entered as single-piece mail until the size of the discount relative to the price of undiscounted First-Class Mail changes significantly. NAPM’s explanation that presort bureaus would convert “a larger volume of single-piece mail to presort mail *if we could do so profitably*” is consistent with the proposition that there is market overlap between “white” single-piece and presort First-Class Mail, and the share

³⁷ “Self-sorting” costs here refers to the cost to a mailer of either performing the work necessary to qualify for workshare discounts or paying a third-party firm (such as a presort bureau) to perform the work.

of “white mail” that is entered as presort mail is determined by the profitability of worksharing. NAPM Testimony at 7. (Emphasis added.)³⁸

Close similarities between the economic purpose and the functionality of presort First-Class Mail and a substantial minority of Single-Piece First-Class Mail indicate to the Commission that these two categories are in a worksharing relationship. This conclusion is strengthened by the existence of a viable private industry that converts the former to the latter, and by the essential role that relative price plays in determining the extent of conversion.

The balance of the available econometric evidence reinforces the conclusion that there is market overlap between single-piece and presort First-Class Mail. The table below presents the results of the Postal Service’s demand models submitted to the Commission over the last two decades.

³⁸ Worksharing by the private sector is profitable, of course, where it costs less than the discount offered by the Postal Service.

Table 1

Historical Estimates of First-Class and Standard Mail Own-Price Elasticities, Discounts Elasticities and Other Cross-Effects From Postal Service FY 2009 Demand Models

Row No.	MARKET DOMINANT PRODUCTS	Docket Numbers																			
		R90-1		R94-1		R97-1		R2000-1		R2001-1		R2006-1		R2006-1		As of Nov. 2007		As of Nov. 2008		As of Summer 2009*	
		(1)	(2)	Elasticity (3)	t-Statistic (4)	Elasticity (5)	t-Statistic (6)	Elasticity (7)	t-Statistic (8)	Elasticity (9)	t-Statistic (10)	Elasticity (11)	t-Statistic (12)	Elasticity (13)	t-Statistic (14)	Elasticity (15)	t-Statistic (16)	Elasticity (17)	t-Statistic (18)		
1	First-Class Letters, Flats & Parcels:																				
2	Single-Piece Letters, Flats & Parcels	-	-	-0.189	-1.684	-0.262	-2.998	-0.311	-4.619	-0.176	-2.176	-0.184	-2.354	-0.232	-2.414	-0.218	-2.835	-0.192	-2.407		
3	First-Class Worksharing Discount	-	-	-0.164	-	-0.139	-3.869	-0.027	-2.351	-0.102	-0.562	-0.096	-9.634	-0.051	-1.011	-0.057	-1.293				
4	Cross Price Elasticities																				
5	First-Class Single-Piece Cards	-	-	0.005	1.065	0.006	1.789	0.004	0.995	-	-	-	-	-	-	-	-	-	-	-	-
6	Standard Regular	-	-	0.019	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
7	Gross Volume Elasticities																				
8	Standard Regular	-	-	0.040	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
9	Standard Nonprofit	-	-	0.013	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
10	Workshared Letters, Flats, & Parcels	-	-	-0.289	1.683	-0.251	-1.614	-0.071	-0.149	-0.329	-2.179	-0.130	-2.201	-0.246	-3.855	-0.260	-3.325	-0.436	-5.395		
11	First-Class Worksharing Discount	-	-	0.222	2.704	0.216	3.619	0.027	2.271	0.108	5.554	0.098	9.867	0.134	39.890	0.096	21.728	-	-	-	-
12	Standard Regular Letters Discount (Relative to First Class)	-	-	-	-	-	-	-	-	-0.097	-2.856	-0.111	-3.359	-0.055	-1.672	-0.079	-1.885	-	-	-	-
13	Cross Price Elasticities																				
14	First-Class Workshared Cards	-	-	0.006	0.939	0.009	1.719	0.006	0.897	-	-	-	-	-	-	-	-	-	-	-	-
15	Standard Regular	-	-	0.035	-	0.045	3.298	0.008	0.029	-	-	-	-	-	-	-	-	-	-	-	-
16	Total Letters, Flats, & Parcels	-0.245	-0.189	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
17	Cross Price Elasticities																				
18	First-Class Cards	0.007	0.010	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
19	Standard Regular	0.042	0.024	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
20	Gross Volume Elasticities																				
21	Standard Regular	0.030	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
22	Standard Nonprofit	0.010	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
23	First-Class Cards:																				
24	Single-Piece Cards	-	-	-	-	-	-	-	-	-	-	-0.258	-1.968	-0.110	-1.375	-0.117	-0.704	-0.397	-4.399		
25	First-Class Worksharing Discount	-	-	-	-	-	-	-	-	-	-	-0.105	-1.107	-0.182	-4.897	-0.078	-2.207	-	-	-	-
26	Workshared Cards	-	-	-	-	-	-	-	-	-	-	-0.640	-0.745	-0.633	-1.782	-0.835	-1.782	-1.427	-5.245		
27	First-Class Worksharing Discount Total Cards	-1.241	-0.984	-0.944	-7.255	-0.860	-8.624	-1.157	-8.818	-0.376	-3.411	0.098	1.234	0.198	4.283	0.068	2.367	-	-	-	-
28	Cross Price Elasticities																				
29	First-Class Letters	0.254	0.382	0.197	1.390	0.228	1.844	0.163	1.435	-	-	-	-	-	-	-	-	-	-	-	-
30	Standard Regular	0.161	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
31	First-Class International Mail	-	-	-	-	-	-	-	-	-	-	-	-	-0.605	-1.815	-0.649	-2.034	-0.590	-1.823		
32	Standard Mail:																				
33	Single Piece	-0.477	-0.484	-0.654	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
34	Regular	-0.625	-0.331	-0.382	-3.633	-0.570	-10.200	-0.388	-9.418	-0.267	-3.521	-0.296	-4.092	-0.368	-5.320	-0.311	-3.072	-0.244	-2.939		
35	Standard Regular Letters Discount (Relative to First Class)	-	-	-	-	-	-	-	-	0.075	0.942	0.100	1.224	0.043	0.457	0.096	0.723	-	-	-	-
36	Cross Price Elasticities																				
37	First-Class Letters	0.213	0.065	0.130	-	0.070	3.497	0.012	-	-	-	-	-	-	-	-	-	-	-	-	-
38	First-Class Cards	0.020	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
39	Enhanced Camer Route	-	-0.662	-0.598	-3.616	-0.808	-7.172	-0.770	-6.628	-1.093	-4.973	-1.079	-6.159	-0.711	-6.159	-0.911	-5.093	-0.839	-8.855		
40	Cross Price Elasticities																				
41	First-Class Camer Route Letters	-	0.013	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
42	Nonprofit	-0.258	-0.442	-0.136	-4.909	-0.162	-5.362	-0.230	-7.801	-0.319	-7.801	-0.306	-6.279	-0.105	-2.211	-0.176	-3.709	-0.165	-5.923		
43	Cross Price Elasticities																				
44	Periodicals Nonprofit	0.258	0.221	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
45	Nonprofit ECR	-	-	-	-	-	-	-	-	-	-	-0.284	-2.106	-0.539	-3.116	-0.525	-3.040	-0.524	-3.365		

* From "Demand Analyses Market Dominant," filed by the Postal Service on January 20, 2010

Those models began estimating own-price elasticities and discount elasticities separately for single-piece and presort First-Class Mail in 1997.³⁹ Table 1 shows that in some mail classes, the Postal Service's volume forecasting models estimate a consistent relationship between the own-price elasticities of products that would reinforce an otherwise plausible conclusion that they serve separate markets. For example, the own-price elasticities estimated for Enhanced Carrier Route (ECR) mail are consistently substantially higher than those estimated for Standard Regular mail. Compare row 26 with row 30. This corroborates the qualitative information available that leads one to expect that demand for ECR mail would be consistently more price elastic than Standard Regular mail since most ECR mail faces private competition for home delivered hard copy advertising that Standard Regular mail does not.

Table 1 also shows that the Postal Service's demand models estimate an inconsistent and unstable relationship between single-piece and presort First-Class Mail in terms of what the Postal Service labels their "own-price elasticities."⁴⁰ Compare row 1 with row 7. Of the eight versions of the Postal Service's volume forecasting model submitted to the Commission since 1997, three of them estimate an own-price elasticity for single-piece mail that is higher than that of presort mail and five of them estimate an own-price elasticity for single-piece mail that is lower than that of presort mail. For some versions of the model, the own-price elasticity differences are small, and for others, the own-price elasticity of one category is twice or three times as large as the other. The estimated own-price elasticities of these two categories often swap places

³⁹ Conceptually, the "own-price" elasticity of single-piece mail is the percentage decrease in its volume caused by a 1 percent increase in its price. For presort mail, it is the percentage decrease in its volume caused by a 1 percent increase in its (discounted) price. For either single-piece or presort mail, the discount elasticity is the percent change in that product's volume caused by a 1 percent increase in the *price difference* between single-piece and presort mail.

⁴⁰ Historically, what the Postal Service has labeled "own-price" elasticity for its various products arguably differs from the conventional economic measure of "own-price" elasticity where a discount for that product is offered. The conventional measure would include the effect of mail volume moving between the undiscounted service and the discounted service when the price of the undiscounted service increases, and the discounted price remains fixed.

from one year to the next, and their relationship follows no discernable pattern or trend. The Commission is not aware of any facts or theories that would explain why the own-price elasticities of these categories of First-Class Mail could be expected to vary greatly in size or reverse position from year to year. Because the relationship between these estimated own-price elasticities is inconsistent and unstable, it does not provide a reliable indication of the extent to which these categories are substitutes for one another, and therefore does not provide a reliable indication of the extent to which the markets for these categories overlap.

The Postal Service submitted documentation for its FY 2009 volume model in January of 2010. That model uses time series data through the summer of 2009. Unlike previous models, it omits all terms from which cross-effects could be inferred, including discount elasticities. This presents a significant problem in interpreting its results.⁴¹ The Commission is aware that the immediate purpose of the model is to forecast the Postal Service's volumes, and that they are not specifically designed to estimate the price elasticities of individual products.

⁴¹ The unstable relationship between the own-price elasticities of these two categories that the Postal Service's volume models estimate over time may be due, in part, to changes in the set of explanatory variables from model to model. Holding different sets of explanatory variables constant when evaluating a product's own-price elasticity, in effect, changes what own-price elasticity is measuring. The most dramatic example of this appears to have occurred in the 2009 model. All of the terms found in the preceding models from which one could infer cross-price elasticities have been removed from that model. This includes the prices of all other categories and all worksharing discounts. It is not clear how the apparent redefinition of the own-price elasticities estimated in the 2009 model has affected its results. It should be noted, however, that the own-price elasticity estimated for presort First-Class Mail is abruptly higher than any previous estimate. This provides an additional reason to investigate the 2009 model further before relying on it to determine the price elasticities of the components of First-Class Mail.

Using them for the latter purpose, it is not clear whether the elasticity estimates that are produced by the 2009 model demonstrate that (1) discount elasticities no longer exist,⁴² (2) that the discount elasticities still exist, but are now combined with the “own-price” elasticities for single-piece and presort First-Class Mail, respectively, or (3) the discount elasticities remain, but their effects are absorbed by one or more of the anonymous trend variables that have been added to the model.⁴³

Before the Commission could place confidence in the set of product elasticities produced by this model it would be necessary to conduct an in-depth examination of the econometric decision-making criteria that formed this model, the theoretical underpinning of the resulting model structure, and the uses that are appropriate for its results. In particular, the omission of all cross-effects in the Postal Service’s latest model would need to be explained by a plausible economic theory. An in-depth examination of this kind would be more appropriately undertaken in a different proceeding in which the issue of how demand elasticities should be modeled is more directly presented.⁴⁴

⁴² As noted, the traditional models estimated many important cross-effects, including First-Class Mail discount elasticities and the cross-price elasticities between Standard Regular and presort First-Class Mail. If the proper interpretation of the 2009 model’s results is that these cross-effects no longer exist, its results are counter-intuitive and at odds with other recent Postal Service analyses, such as those that support its seasonal sales, and various volume-based NSAs. See, for example, the Postal Service’s assertion supporting the most recent “Fall Sale,” that a significant portion of Standard Regular mail would “buy up” to presort First-Class Mail in response to the Fall Sale discounts. See Docket No. R2009-5, United States Postal Service Notice of Market-Dominant Price Adjustment, August 11, 2009, at 7.

⁴³ The Postal Service asserts a belief that all discount elasticities are zero. See Docket No. ACR2009-1, Questions 1-5 of Responses to Chairman’s Information Request No. 8, March 8, 2010, response to question 5(b). Its more detailed discussion, however, provides an indication that the atypical own-price elasticity estimate for presort First-Class Mail produced by the 2009 model results primarily from employing a set of dummy variables and anonymous trend terms in place of the discount elasticity variable. See *id.*, attachment entitled “*The Impact of the First-Class Worksharing Discount on First-Class Workshared Mail Volumes.*”

⁴⁴ The historical iterations of the Postal Service’s traditional volume forecasting model were sufficiently documented and explained for the Commission in past proceedings.

The seven previous iterations of the traditional demand model that the Postal Service has submitted to the Commission provide a meaningful indication that single-piece and presort mail are substitutes for one another. They estimate elasticities for single-piece and for presort mail volumes with respect to changes in the size of the presort discount. The volume establishing estimates in Table 1 show that these discount elasticities, in most instances, are statistically significant for both categories and are often very substantial. For this reason, the Commission finds that the two categories are substitutes for one another, and that the markets for each overlap.

2. Standard Mail

As explained above, the purpose underlying the avoided cost ceiling on workshare discounts imposed by section 3622(e) is to ensure that workshare discounts provide economically efficient incentives to mailers. The economic logic that ties workshare discounts to avoided costs applies only where mailers choose among services that serve the same market. With respect to Standard Mail, the Commission finds that High Density and Saturation mail serve separate markets. Accordingly, section 3622(e) does not apply to the rate relationship between these two categories of mail.

There are no econometric estimates available to indicate whether High Density and Saturation mail have similar own-price demand elasticities or exhibit significant cross-price elasticities. However, the Commission finds that the qualitative evidence available is sufficiently convincing to conclude that Saturation mail occupies a unique market niche.

It is generally accepted that Saturation mailers have more delivery alternatives than High Density mailers. Valassis states that private delivery is a less viable option for High Density mailers because such mailings are demographically targeted. Because such mail is selectively addressed, it is more difficult to sort and deliver than Saturation mail. This makes High Density mail difficult for alternative private delivery companies to

process and deliver. See Valassis Comments at 12, n.7. Therefore, demand for it may be presumed to be more elastic than demand for High Density mail.⁴⁵ See Postal Service Reply Comments at 27.

High Density mail is predominately used by newspapers as part of a Total Market Coverage (TMC) program that uses mail to deliver advertising to addresses on a route that do not subscribe to the newspaper. Saturation mail is targeted only in the sense that it is typically confined to a particular geographic area. Mailers such as Valpak and Valassis use Saturation mail to distribute advertising to virtually all addresses on a route.

Saturation mailers use High Density mail on certain routes, while High Density mailers use Saturation mail on certain routes. This does not necessarily imply, however, that the two are in the same market. For example, Valpak sometimes uses High Density mail on a route where, because postal boundaries do not match neighborhood boundaries, there are not enough addresses on a route to qualify for Saturation mail. However, Valpak's decision to use High Density mail reflects marketing requirements rather than the price differential between High Density and Saturation mail. Therefore, Valpak plausibly argues, it would not switch from High Density to Saturation mail even if the Postal Service were to reduce somewhat the Saturation mail rate relative to High Density mail on just those routes. Valpak Reply Comments at 8-9. Similarly, for newspapers, the determining factor in making the election between Saturation and High Density mail has less to do with the price differential between these categories and more to do with the number of households that a newspaper's TMC program needs to reach by mail on a specific route. *Id.* at 9.

NNA contends High Density and Saturation flats are properly classified together because High Density and Saturation flats are components of the same advertising

⁴⁵ In terms of absolute values, this implies that the own-price elasticity for High Density mail is less than the own-price elasticity for Saturation mail.

market, meet the same advertiser demand, and are highly substitutable. NNA Reply Comments at 2-7. While High Density and Saturation flats are ways of meeting the same broad advertising objective, the functionality of the two categories of mail is distinct. Demand for mail that serves the market for geographically dense advertising is derived more directly from the mailer intermediary (such as Valpak and Valassis) than from the advertiser. The advertiser may choose between a newspaper TMC program and a Saturation mailer based on price, but it is the mailer intermediary that makes the decision to buy High Density or Saturation service from the Postal Service as a channel for its clients' advertising. As noted, that decision turns more on marketing needs than on price.

Finally, the lack of a third-party consolidator that takes High Density mail and converts it to Saturation mail, strongly implies that the rate differential between High Density and Saturation mail does not drive a mailer's decision to choose one category over the other. For these reasons, the Commission concludes that section 3622(e) does not apply to the rate relationship between Standard High Density and Standard Saturation mail.

VI. IDENTIFYING BASE GROUPS

A. Overview

To apply the limit on worksharing discounts set forth in section 3622(e), it is necessary to develop a measure of the savings that accrue to the Postal Service as a result of worksharing. The best means of estimating worksharing savings is by comparing the Postal Service's cost of handling mail that is workshared with its cost of handling mail that is not.

To isolate the effects of worksharing from other cost driving effects, the analysis must focus on the costs affected by worksharing. The non-workshared mail used for comparison (referred to as the "base group" or "benchmark") should be as similar to the workshared mail as possible. Selecting a base group that shares market characteristics with the workshared mail helps ensure that the decision to use either of the two categories is primarily based on the mailer's total combined cost of preparation and postage as opposed to non-cost considerations. (See the discussion of markets above.) To best isolate the Postal Service's savings from worksharing, the base group should also share non-worksharing cost-driving characteristics, such as shape and machinability, with the workshared group. As discussed above, it is important to include the cost effects of closely related mail traits that affect the value to the Postal Service of the worksharing activity in question.

B. Application to Classes

It is not appropriate to select a base group that is in a separate market from its associated workshare category. Since the Commission has concluded that Standard Saturation mail occupies a unique market niche, using Standard High Density mail as a base group for setting rates for Saturation mail is no longer appropriate. See section V. B. 2., above.

Since Docket No. R97-1, the Commission and the Postal Service have used BMM as the base group for estimating the worksharing savings for First-Class letters. BMM consists of letters that pay single-piece rates, have metered indicia, are machinable, with printed addresses, and are entered at Postal Service facilities as full trays of faced mail. See PRC Op. R97-1, ¶¶ 292-94. Many commenters argue that BMM no longer serves as a relevant base group for setting discounts for any type of mail. They argue that what volumes may have existed in the past have been converted to presort First-Class Mail, and the mail that remains in single-piece is not cost effective to convert. NAPM Testimony at 6-17; Pitney Bowes Reply Comments at 6-7. Most of the commenters taking this position argue that the markets for single-piece and presort are separate. Some, however, assert that the only single-piece mail that remains a likely candidate for conversion to presort mail is collection mail. NAPM Testimony at 6; NPPC Reply Comments at 3-4.

In the discussion of First-Class Mail, the Commission concludes that there is still a significant market overlap between presort mail and a substantial part of single-piece mail. However, the evidence presented in this case strongly suggests that the current BMM benchmark is obsolete. For example, the assumption that significant amounts of single-piece mail are entered faced in full trays at Postal Service mail processing facilities needs to be re-examined. Several parties assert that the mail that is targeted by presort firms is mail that would otherwise be collected by the Postal Service. If true, the work done by presort firms collecting mail from businesses and entering it at Postal Service facilities as faced mail in full trays would avoid Postal Service collection costs.⁴⁶

Letters that use IBI are another source of mail that is a potential candidate for conversion to presort First-Class Mail. Until fairly recently, this mail was a relatively

⁴⁶ Presumably, collection costs would fall within the term “handling” in section 3622(e)(1). The Postal Service would also save (mail preparation costs in facing and cancelling. Since Docket No. R2001-1, mail preparation costs of metered letters have been used as a proxy for those of BMM.) Therefore, these savings are reflected in the estimates produced using the current methodology.

small share of single-piece letter volumes. Between 2004 and 2008, however, it increased from 2 billion to 9.5 billion pieces. It now represents over 28 percent of single-piece letter volume, and exceeds the volume of metered letters, which dropped from 12.9 billion to 2.6 billion pieces over the same period. Postal Service Comments at 20. Consequently, IBI letters, or a weighted average of IBI and metered letters, might serve as a more appropriate base group. Qualified PC Postage is another plausible candidate for serving as a base group for setting presort mail rates. It would consist of CASS-certified, automation compatible letters bearing an Intelligent Mail barcode (IMb). See Stamps.com Comments at 1. If Qualified PC Postage were found to constitute an appropriate base group for setting automation presort letter discounts, the Postal Service would have the option of proposing additional workshare discounts for this pre-barcode mail. Under that circumstance, rates for automation presort letters would not be directly tied to the undiscounted Single-Piece First-Class Mail rate.

Identifying an appropriate base group for setting discounts for presort First-Class Mail is an issue that will be addressed in the follow-on proceeding instituted simultaneously with this order.

It is Ordered:

The Commission hereby adopts the analytical principles underlying the design of workshare discounts summarized in section I.B. and more fully described in the balance of this Order.

By the Commission.

Shoshana M. Grove
Secretary

Concurring Opinion of Commissioner Dan G. Blair

I concur with the Commission's decision regarding the establishment of a new rulemaking to determine an appropriate benchmark for the First-Class Mail discount structure. Further, I support the Commission's decision not to require the Postal Service to reduce the discount for Automation Mixed AADC First-Class Bulk Mail until the rulemaking is complete.

I believe it is important that the Commission develop rules that provide appropriate workshare incentives for mailers engaged in workshare activities. The Commission's 2009 Annual Compliance Determination found that presort First-Class Mail is the most successful postal product financially. Recognizing that this mail is highly vulnerable to electronic diversion trends, it is important to maintain a discount structure that recognizes the value of the activities of this mailing segment.

To qualify for such discounts, mailers must follow strict guidelines issued by the Postal Service when preparing presort mail; something most single-piece mailers do not. Activities performed by presort mailers include, but are not limited to, presorting, pre-barcoding, handling, or transportation of mail. Due to this extensive mailer preparation, presort First-Class Mail has approximately a five cent higher cost contribution than single-piece First-Class Mail.

I expect this future rulemaking to identify an appropriate benchmark that results in a discount structure that will better encourage and retain low-cost, high-profit presort First-Class Mail volumes.

COMMENTS AND REPLY COMMENTS¹

COMMENTS		
PARTICIPANT	TITLE	FILING DATE
American Postal Workers Union, AFL-CIO (APWU Comments)	Initial Presentation of American Postal Workers Union, AFL-CIO	May 27, 2009
Bank of America Corporation, Discover Financial Services, J.P. Morgan Chase & Co., and the American Bankers Association (Joint Comments of BOA et al.)	Initial Comments of Bank of America Corporation, Discover Financial Services, J.P. Morgan Chase & Co., and the Bankers Association	May 27, 2009
Greeting Card Association	Initial Comments of the Greeting Card Association	May 26, 2009
John Haldi (Haldi Comments)	Statement of John Haldi, Ph.D. Concerning Workshare Discounts	May 26, 2009
Mail Order Association of America	Comments of Mail Order Association of America	May 26, 2009
Major Mailers Association (MMA Comments)	Initial Comments of Major Mailers Association	May 26, 2009
Public Representatives (Public Representatives Comments)	Comments of the Public Representatives	May 26, 2009
Stamps.com (Stamps.com Comments)	Initial Presentation of Stamps.com	May 26, 2009
United States Postal Service (Postal Service Comments)	Initial Comments of the United States Postal Service	May 26, 2009
Valassis Direct Mail, Inc. and Saturation Mailers Coalition (Valassis/SMC Comments)	Comments of Valassis Direct Mail, Inc. and Saturation Mailers Coalition	May 26, 2009
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak Comments)	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments Regarding Standard Mail Volume Incentive Pricing Program	May 26, 2009

¹ Comments refer to comments received in response to Order No. 192. Reply comments refer to comments received in response to Order No. 243.

REPLY COMMENTS		
PARTICIPANT	TITLE	FILING DATE
American Postal Workers Union, AFL-CIO (APWU Reply Comments)	Comments of American Postal Workers Union, AFL-CIO	September 11, 2009
Association for Postal Commerce (PostCom Reply Comments)	Comments of the Association for Postal Commerce Concerning Issues Specific to Standard Mail in Response to Order No. 243	September 11, 2009
Bank of America Corporation, Discover Financial Services, J.P. Morgan Chase & Co., and the American Bankers Association (Joint Reply Comments of BOA, et al.)	Joint Comments of the Bank of America Corporation, Discover Financial Services, J.P. Morgan Chase & Co., and U.S. Bank N.A.	September 11, 2009
Direct Marketing Association	Comments of the Direct Marketing Association	September 11, 2009
Discover Financial Services	Comments of Discover Financial Services	September 9, 2009
Lubenow & Associates	Comments of Lubenow & Associates	September 11, 2009
Major Mailers Association	Supplemental Comments of Major Mailers Association	September 11, 2009
National Association of Presort Mailers (NAPM Testimony)	Testimony of Elizabeth A. Bell, Mary L. Williams, Patrick W. Parvin, Jay P. Gillotte and Richard Gebbie on Behalf of the National Association of Presort Mailers	September 11, 2009
National Newspaper Association (NNA Reply Comments)	Comments of the National Newspaper Association	September 11, 2009
National Postal Policy Council (NPPC Reply Comments)	Comments of National Postal Policy Council on Order No. 243	September 11, 2009
Newspaper Association of America	Comments of the Newspaper Association of America on Order on Further Procedural Steps	September 11, 2009
Pitney Bowes Inc. (Pitney Bowes Reply Comments)	Comments of Pitney Bowes Inc.	September 11, 2009
Public Representative	Public Representative Comments in Response to Order No. 243 Concerning Proposed Rulemaking on Application of Workshare Discount Rate Design Principles	September 11, 2009
Stamps.com	Reply Comments of Stamps.com	September 11, 2009
United States Postal Service (Postal Service Reply Comments)	Reply Comments of the United States Postal Service	September 11, 2009
Valassis Direct Mail, Inc. and the Saturation Mailers Coalition (Valassis Reply Comments)	Comments of Valassis Direct Mail, Inc. and the Saturation Mailers Coalition in Response to Order No. 243	September 11, 2009

REPLY COMMENTS (continued)		
PARTICIPANT	TITLE	FILING DATE
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak Reply Comments)	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on Worksharing Issues in Response to Order No. 243	September 11, 2009