

**BEFORE THE POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001**

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**Postal Rate and Fee Changes, 2005**

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**Docket No. R2005-1**

**BRIEF OF PITNEY BOWES INC. IN SUPPORT OF SETTLEMENT**

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DATED: September 26, 2005

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## I. INTRODUCTION

Pitney Bowes Inc. (“Pitney Bowes”) submits this brief in support of the United States Postal Service’s (“Postal Service”) across-the-board request.

Pitney Bowes is a leading provider of integrated mail and document management systems, services and solutions. Pitney Bowes helps organizations of all sizes efficiently and effectively manage their mission-critical mail and document flow in physical, digital and hybrid formats. Pitney Bowes solutions range from addressing software and metering systems to print stream management, electronic bill presentment and presort mail services. The company’s 80-plus years of technological leadership have produced many major innovations in the mailing industry, and it is consistently on the Intellectual Property Owners Association’s annual list of top U.S. patent holders. With approximately 35,000 employees worldwide, Pitney Bowes serves more than 2 million businesses through direct and dealer operations.

Pitney Bowes is a signatory to the Stipulation and Agreement (“Settlement Agreement”) in this proceeding. In view of the unique circumstances presented in this docket, however, Pitney Bowes has agreed to defer its arguments as to alternative rates or classifications to a future proceeding.

As a signatory to the Settlement Agreement, Pitney Bowes believes that for purposes of this proceeding the rates embodied in the Settlement Agreement are acceptable under the circumstances.<sup>1</sup> The rates and fees embodied in the Settlement Agreement are consistent with the applicable statutory requirements of the Postal Reorganization Act of 1970 (“Act” or “PRA”), 39 U.S.C. §§ 101 et seq. (2005). Moreover, the rates and fees embodied in the Settlement Agreement are supported by the evidentiary record as set forth in the request,

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<sup>1</sup> Under ordinary circumstances, Pitney Bowes would have argued in favor of rates, classifications, ratemaking methodologies and estimated costs different from those embodied in the Settlement Agreement.

testimony, and materials filed in response to interrogatories and cross-examination on behalf of the Postal Service. Pitney Bowes also notes that the Settlement Agreement has been signed by the substantial majority of the parties in this case. The signatories to the Settlement Agreement represent every major class, subclass, and service. The Settlement Agreement properly protects the interests of all stakeholders.

Accordingly, Pitney Bowes respectfully requests that the Postal Rate Commission (“Commission”) recommend the rates and fees embodied in the Settlement Agreement for approval by the Board of Governors.

## **II. SUMMARY OF ARGUMENT**

The Postal Service has proposed an across-the-board increase in rates and fees to meet a Congressionally-imposed escrow obligation that is unrelated to the provision of any particular class of mail. The substantial majority of the parties in this proceeding have signed the Settlement Agreement supporting the Postal Service’s request. The Commission should approve the Settlement Agreement because the Postal Service’s request for an across-the-board rate increase request is appropriate under the unique circumstances of this case. The proposed across-the-board increase is also consistent with applicable statutory requirements and is supported by the evidentiary record in this case. Moreover, the across-the-board proposal produces reasonable rate increases for all classes of mail for what is expected to be a relatively short interim period before the next omnibus case is filed.

In particular, the Commission should approve the First-Class Mail automation discounts presented in the Settlement Agreement because the rates are consistent with the applicable statutory requirements, are supported by the evidentiary record, and are generally consistent with efficient component pricing principles. The value of First-Class workshared mail cannot be

overstated. It is a “profitable” product which makes a substantial contribution to institutional costs. Its contribution per piece (20.5 cents) exceeds that for single-piece First-Class Mail (18.9 cents). Simply stated, maintaining and expanding the volume of First-Class workshared mail is essential to the Postal Service’s continued viability.

Furthermore, with respect to proposed rates for this mail, the Commission may satisfy itself that because the rates proposed are based on Postal Service mail processing models that understate the full measure of costs avoided by the Postal Service, the passthrough percentages for such costs avoided are overstated. Deficiencies in the Postal Service’s mail processing models do not impair the Postal Service’s request in this case, but underscore the fact that more accurate cost analysis could and should be made, and that any suggestion that First-Class Mail automation discounts are “excessive” is without basis. Accordingly, the First-Class workshare automation and non-automation letter mail rates presented in the Settlement Agreement should be recommended without modification.

### **III. ARGUMENT**

#### **A. The Commission Should Approve The Settlement Agreement In Support Of The Postal Service’s Across-The-Board Request Because The Request Is Appropriate Under the Circumstances, Is Consistent With The Applicable Statutory Requirements, Is Supported By The Evidentiary Record, And Is Reasonable For All Classes Of Mail.**

Pitney Bowes strongly supports the Postal Service’s across-the-board request.<sup>2</sup> Given the unique circumstances of this case, an across-the-board proposal is appropriate and generates reasonable rate increases for all classes of mail. In addition to the compelling policy rationale underpinning the across-the-board proposal, the Postal Service’s request, endorsed by the

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<sup>2</sup> Pitney Bowes understands that a number of other parties to this proceeding are filing briefs in support of the Postal Service’s across-the-board request, *see e.g.*, Joint Initial Brief of American Bankers Association and National Association of Presort Mailers, accordingly, this brief focuses specifically on the issue of the First-Class Mail Automation Discounts.

Settlement Agreement, is consistent with the applicable statutory requirements and is supported by the evidentiary record.

As discussed in the testimony of Postal Service witnesses Potter and Robinson, the Postal Service's request for a 5.4 percent across-the-board increase is responsive to the unique revenue demands imposed by the Congressionally-mandated \$3.1 billion Test Year escrow payment. *See* USPS-T-1 at 2 (Potter); USPS-T-27 at 9 (Robinson). In 2003, Congress recognized that without changes to the way the Postal Service funded its Civil Service Retirement System (CSRS) obligation, it (and, therefore, postal ratepayers) would significantly overfund postal pensions. To correct this, Congress enacted the Postal Service Civil Service Retirement System Reform Act of 2003 (Pub. L. 108-18). The net effect of the law was to reduce the present value of future Postal Service retirement payments by \$78 billion and Test Year retirement payments by approximately \$3.1 billion. *See* USPS-T-6 at 11 (Tayman); USPS-T-1 at 3 (Potter).

As discussed by Postal Service witness Tayman, while the law allowed the Postal Service to use the savings from FY 2003 through 2005 to reduce debt and delay or mitigate rate increases, it also required that,

[a]ny savings after FY 2005 . . . be considered operating expenses of the Postal Service and, until otherwise provided for by law, are to be held in escrow and may not be obligated or expended. To date, Congress has provided no legislative direction concerning the use of escrowed funds.

USPS-T-6 at 11-12 (Tayman).

Because the escrow requirement was not caused by or attributable to any particular type of mail, the proposed across-the-board increase, which requires all mailers to share the escrow burden equally, is the most "fair and equitable" rate design approach. As noted by witness Robinson, under the circumstances, any deviation from an across-the-board approach that would unfairly require some mailers to pay a disproportionate share of the universal burden caused by

the escrow obligation would arguably be violative of the statutory requirement that the Commission recommend rates and fees that, among other factors, reflect “the establishment and maintenance of a fair and equitable schedule.” *See* Tr. 3/431 (Robinson); 39 U.S.C. § 3622(b)(1).

The rates and fees proposed in the Postal Service’s across-the-board request also meet the statutory requirement that each class of mail cover its costs. *See* 39 U.S.C. § 3622(b)(3); USPS-T-27 Exh. USPS-27B (Robinson). Furthermore, where the law mandates that a particular rate increase deviates from the across-the-board increase, the Postal Service has made the necessary adjustments. *See* USPS-T-27 at 9-10 (Robinson); USPS-T-28 at 2-3 (Taufique).

Witness Robinson also correctly observes that statutory ratemaking requirements are implicitly taken into account by applying the across-the-board increase to the current set of postal rates because the current rates “embody a cumulative evaluation of the rate-making criteria and the relative weightings of each of these criteria.” USPS-T-27 at 23 (Robinson).

Nor does the Postal Service’s across-the-board proposal result in radical or unreasonable departures from the subclass markups that were found to be consistent with the applicable statutory requirements in the last case. In fact, as witness Robinson testified, “most of the relative [markup] relationships resulting from the prior docket are maintained.” USPS-T-27 at 24 (Robinson).

The Postal Service has also acknowledged that it plans to file another, more traditional request for rate and fee changes in the near future. *See* Tr. 2/78. Therefore, not only is the across-the-board request appropriately tailored to meet a unique revenue obligation imposed by Congress and unrelated to the provision of any particular class of mail, but it is likely that all interested parties will soon be afforded an opportunity to fully litigate all issues in a

follow-on case.

Accordingly, the proposed across-the-board increase, endorsed by the Settlement Agreement, is appropriate under the unique circumstances of this case, is consistent with the applicable statutory requirements, is supported by the evidentiary record, and produces reasonable rates for all classes of mail.

**B. The Commission Should Approve The First-Class Mail Automation Discounts Presented In The Settlement Agreement Because The Rates Are Consistent With The Applicable Statutory Requirements, Are Supported By The Evidentiary Record, And Are Generally Consistent With Efficient Component Pricing Principles.**

1. First-Class Workshared Mail Is Essential To The Postal Service's Continued Financial Viability.

First-Class workshared mail makes an enormously valuable contribution to the Postal Service's finances. It is very "profitable" mail. With revenues of \$14.47 billion in the Base Year and volume variable costs of only \$4.77 billion, First-Class Mail workshared mail was responsible for \$9.7 billion in contribution to the Postal Service's institutional costs. *See* USPS LR-K-93. Thus, while it accounted for about 20 percent of USPS revenues, it provided about 36 percent of the total contribution. *See* USPS LR-K-93.

Several other financial metrics further demonstrate the importance of First-Class presort and automation letters to the continued financial viability of the Postal Service. The contribution, cost coverage, and markup index for First-Class workshared mail all exceed those for First-Class single-piece letters and sealed parcels. In fact, each financial metric for First-Class workshare mail was substantially larger than the average for all mail, as shown in Table 1.

<b>Table 1. Base Year 2004 Financial Contribution – PRC Version</b>			
	<b>Unit Contribution</b>	<b>Cost Coverage</b>	<b>Markup Index</b>
First-Class Mail Single-Piece Letters and Sealed Parcels	\$0.189	171%	0.948
First-Class Mail Presort and Automation Letters	\$0.205	303%	2.698
<b>Total All Mail</b>	<b>\$0.137</b>	<b>175%</b>	<b>0.998*</b>

\* Total All Mail Markup Index is not equal to 1 as it excludes Special Services.  
Source: USPS LR-K-93.

Further, the cost coverage on First-Class presort and automation letters is substantially higher than that for any subclass of mail (including Standard Mail Enhanced Carrier Route). Because of the significant financial contribution of First-Class workshare mail to the Postal Service, setting rates and discounts for presorted and automation letter mail that elicit this contribution is critically important.

First-Class workshered mail has also been enormously important to the financial viability of the Postal Service as a source of additional mail volume. Worksharing has caused First-Class Mail volume to grow. Importantly, workshare volume increases are increases in *new* mail volumes - perhaps as much as 60 percent of the workshered mail is new mail while only about 40 percent of the workshered mail seems to be from a migration from non-workshered mail. *See The Impact of Using Worksharing to Liberalize a Postal Market*, Robert H. Cohen, William W. Ferguson, John D. Waller, and Spyros Xenakis, at 29 (2001). Not only do workshare discounts generate new First-Class Mail volumes, but as noted above, this mail makes a substantial contribution to overhead.

2. The Commission Favors Establishing Workshare Discounts Consistent With Principles Of Efficient Component Pricing.

Workshare discounts induce mailers to perform activities that lower the total combined system costs of the Postal Service and of mailers. To receive these discounts, mailers perform part of the work involved in the end-to-end mail service and pay less than full price to the Postal Service for completing the job. The Efficient Component Pricing Rule (“ECPR”) is the principle that these discounts should be set at a level equal to the per unit avoided cost of the Postal Service. When discounts are set equal to costs avoided, they will induce mailers to perform work if and only if the mailer can do it less expensively than the Postal Service. Thus, workshare discounts based on ECPR will minimize the total cost of mailing in the economy.

Understanding its importance for both efficiency and equity, the Commission has long endorsed ECPR, stating, for example:

From the inception of worksharing discounts, the Commission has been concerned with both equity and economic efficiency. It set the first such discount at clearly capturable avoided costs. This provided a rate incentive to mailers which would allow cost-based decisions on whether to engage in the worksharing activity. In effect, the Commission was setting discounts in conformity with what later became known as efficient component pricing. The discount approach led to the lowest cost producer providing the service. This, in turn, minimized the cost of the workshare activity to society as a whole.

PRC Op. MC95-1, para. 3074.

The Commission has also noted the equity benefits of ECPR:

However, when discounts pass through 100 percent of avoided costs to the workshare mailer, the contribution made by that mailer to institutional costs is the same as the mailer would have made without worksharing. Thus, workshare mailers and non-workshare mailers provide the same contribution, which is fair and equitable. In this case the Commission has set the majority of the recommended discounts for First-Class to pass through 100 percent of the avoided costs. This maximizes the discounts and effectively reduces the institutional cost burden on workshare mailers as much as possible.

PRC Op. R2000-1, para. 5060.

While the Commission is a proponent of ECPR, it has recognized that passthroughs do not always have to be equal to the costs avoided.

The Commission is required to consider all of the factors of section 3622(b) when reviewing appropriate discounts for workshared mail . . . The Commission concludes that establishing discounts to pass through 100 percent of avoided costs is an appropriate policy, but that other considerations sometimes preclude its application.

PRC Op. R2001-1, para. 3064.

3. The Postal Service's Model For Estimating Cost Avoidances Is Flawed In Several Key Respects.

Accurate cost avoidance estimates are an integral component of ECPR because cost avoidance measurements underlying the rates must be correctly measured in order to determine how well rates comport with ECPR. In its previous decisions, the Commission has advocated using a hybrid approach for estimating worksharing cost avoidances in First-Class Mail. *See* MC95-1, para 4226. In the current case, the Postal Service estimates mail processing cost avoidances between bulk metered mail (“BMM”) letters,<sup>3</sup> the cost avoidance benchmark for most First-Class Mail presort letters, *see* USPS-T-21 at 11-12 (Abdirahman), and automation letters using a hybrid cost methodology. *See* USPS-T-21 at 3 (Abdirahman).

To compute deaveraged mail processing costs, the USPS combines unit costs from the In-Office Cost System (“IOCS”) with activity-based cost mailflow models. Then, it combines worksharing-related mail processing costs with deaveraged delivery costs in order to derive worksharing-related unit cost savings. USPS erroneously assumes many mail processing costs do not vary with respect to presort level.

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<sup>3</sup> For the purposes of computing cost avoidances, BMM letters are “generally considered to be ‘clean,’ machinable, homogeneous, non-barcoded mail pieces with machine printed addresses that are entered, properly faced, in trays.” Tr. 4/964-65.

In computing worksharing-related mail processing costs, the Postal Service classifies IOCS unit costs for each mail processing activity (e.g., manual letter sorting) or cost pool into one of three categories: worksharing-related proportional, worksharing-related fixed, or non-worksharing-related fixed. *See* USPS-T-21 at 3 (Abdirahman). This classification is a significant determinant of the estimated cost avoidances because the Postal Service’s cost avoidance model treats the classifications very differently.

- Unit costs in worksharing-related proportional cost pools vary with respect to presort level and prebarcoding.
- Unit costs in worksharing-related fixed cost pools vary with respect to whether a piece is workshared or not, but not with respect to presort level.
- Unit costs in non-worksharing-related fixed cost pools are completely unaffected by worksharing.

The use of the term “fixed” in the classifications “worksharing-related fixed” or “non-worksharing-related fixed” does not mean that these costs are fixed with respect to changes in volume. All of the costs used in the cost avoidance models are volume variable unit costs. *See* PB/USPS-T13-1 (Redirected to USPS). As such, no institutional or fixed costs are included with them. Thus, according to the Postal Service, all costs which are classified as worksharing-related fixed or non-worksharing-related fixed are costs that the Postal Service concedes actually vary with some measure of mail volume. And, as we will show below, that measure of volume is directly related to presort level, thus calling into question the Postal Service’s classifications.

From a theoretical perspective, classifying mail processing costs into the three categories may be a reasonable approach. The disparity in treatment in the Postal Service’s cost avoidance model between the classifications, however, counsels in favor of greater scrutiny.

Worksharing-related proportional cost pools include only the following costs:

costs for piece or bundle distribution operations that are directly affected by the presorting and/or prebarcoding activities performed by mailers. These cost pools are “proportional” in that the magnitude of the costs, and therefore worksharing related savings, are directly related to the specific level of presorting and/or prebarcoding. In addition, these cost pools contain the costs for the tasks that have actually been modeled.

USPS-T-21 at 3 (Abdirahman).

Worksharing-related fixed cost pools include only the following costs:

costs for other activities that are also affected by worksharing. However, these costs do not vary as a direct result of the specific worksharing options chosen by a given mailer. These costs represent tasks that have not actually been modeled.

USPS-T-21 at 3 (Abdirahman).

Non-worksharing-related fixed cost pools contain costs “that are not affected at all by the types of worksharing activities covered in this testimony.” USPS-T-21 at 4 (Abdirahman).

Mail processing costs for each of these three classification categories for both BMM and automation letters are represented in Table 2 below. As the table shows, costs labeled proportional account for only 2.27 cents in unit cost or 59 percent of all automation mail processing unit costs and comprise only 11 of the 63 (17 percent) mail processing costs pools. Costs in the two fixed groups account for 1.56 cents in unit costs or 41 percent of all automation mail processing costs and comprise 52 of the 63 (83 percent) mail processing pools. Thus, the Postal Service has modeled less than 60 percent of the costs and less than 20 percent of the pools and has asserted that the costs in the remaining pools are fixed.

<b>Table 2. First-Class Mail BMM and Automation Letters Unit Mail Processing Cost (cents)</b>					
<b>Classification</b>	<b>Number of Cost Pools</b>	<b>BMM Letters</b>		<b>Automation Letters</b>	
		<b>Unit Cost</b>	<b>% of Cost</b>	<b>Unit Cost</b>	<b>% of Cost</b>
Worksharing-Related Proportional	11	7.751	61%	2.272	59%
Worksharing-Related Fixed	13	3.480	27%	1.055	28%
Non-Worksharing-Related Fixed	39	1.541	12%	0.509	13%
<b>Total</b>	<b>63</b>	<b>12.773</b>	<b>100%</b>	<b>3.836</b>	<b>100%</b>
Source: USPS LR-K-110 and Appendix 4.					

Accordingly, the Postal Service’s model understates the cost avoided by worksharing because it makes two critical assumptions: (1) that bulk metered mail is the appropriate benchmark from which to estimate cost avoided, and (2) that letter-sorting and bundle-sorting costs are the only mail processing costs that vary with the amount of worksharing performed. Both of these assumptions are flawed.

- a. *Bulk Metered Mail is an inappropriate benchmark for purposes of calculating cost avoidances because it understates the savings attributable to workshared First-Class letter mail.*

The Postal Service relies on BMM letters as the cost avoidance benchmark for most First-Class Mail presort letters because it believes that BMM is the most likely mail to convert to worksharing. See USPS-T-21 at 11 (Abdirahman). This assumption causes the Postal Service’s model to understate the actual costs avoided by worksharing.

While it is likely that low-cost non-workshared mail, such as BMM, made up a large portion of the mail that converted to worksharing when discounts were first introduced, it is likely to comprise a much smaller portion of the converting mail as worksharing categories

mature. The Commission recognized this in its discussion of First-Class workshared mail in its Opinion and Recommended Decision in Docket No. MC95-1:

As a mature workshare category whose volumes have stabilized, additional volume is considered less likely to come from low-cost nonpresort mail that requires few changes to convert, and more likely to come either from average-cost nonpresort mail that requires more extensive change in order to convert, or from new mail.

PRC Op. MC95-1, IV-102, n.37.

Economics and common sense bolster these observations. Given the low cost of converting BMM to workshared mail and the attendant economic benefit, rational behavior would dictate that the vast majority of this mail would be an early converter, leaving far less to convert over time.

Further, the Postal Service has recognized that other types of First-Class Mail letters could convert to worksharing, *see* Tr. 4/1064-65, and that firms that perform worksharing are targeting this less workshared mail for conversion. *See* Response of witness Taufique to P.O. Information Request No. 6, Question 7 (Tr. 3/616-21). Hence, even the Postal Service concedes that BMM is not the only candidate mail to convert to or revert from worksharing.

Single-piece metered letters is a preferable benchmark because it is more likely than BMM to represent “average-cost nonpresort mail” (including BMM letters) that is likely to convert to worksharing.<sup>4</sup>

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<sup>4</sup> Because the Postal Service’s costing systems do not produce cost estimates for BMM, the Postal Service’s cost models use “proxies” to estimate the cost of BMM. For mail processing, the cost proxy is single-piece metered letters. Therefore, this change in benchmark does not impact the estimated mail processing cost avoidance. On the other hand, the Postal Service does not use single-piece metered letters as the proxy for BMM delivery costs. So this change would affect delivery cost avoidance estimates. Because this brief focuses on mail processing costs and cost avoidances, the impact of changing the benchmark to single-piece metered letters on the delivery cost avoidance is not addressed.

- b. *The Postal Service's models fail to reflect that the majority of volume-variable mail processing costs vary with respect to the level of worksharing.*

USPS witnesses Bozzo (USPS-T-12) and Van-Ty-Smith (USPS-T-11) present the Postal Service's methods for estimating the variability of mail processing costs and distributing these variable costs to mail classes and subclasses. The methods and the logic underlying their testimony indicate that most volume variable costs vary with respect to piece-distribution costs.<sup>5</sup>

Witness Bozzo explains that total pieces fed ("TPF") and total pieces handled ("TPH") are the correct volume measures of mail processing output. *See* USPS-T-12 at 12 (Bozzo). Thus, the "Postal Service analysis continues to employ MODS TPF and TPH data to represent "outputs" or "cost drivers" for sorting operations." *See id.* at 13. In discussing why TPF and TPH are the correct measures of output and why First Handling Pieces ("FHP") is a flawed measure, witness Bozzo explains,

increases in mailer worksharing activities will, in general, substitute for Postal Service TPF and TPH handlings, but not necessarily for FHP. Compared to an otherwise identical 3-digit presort piece, for instance, a 5-digit presort piece will avoid the incoming primary TPF and TPH, but not the incoming FHP count. The mailer's worksharing effort has reduced the needed Postal Service effort without being recognized in FHP.

*See id.* at 13-14. It follows that piece handling costs do vary with the level of presort and across worksharing levels.

Taking this one step further, non-piece handling costs also vary with TPF (and TPF, according to witness Bozzo, varies with presort level). Witness Bozzo's testimony states in pertinent part,

Insofar as each piece fed must be brought to and dispatched from the operation, related container handlings (including handlings to send mail back through the operation for subsequent sorting passes) will also be proportional to TPF, as will

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<sup>5</sup> Note that the logic of witness Bozzo's testimony is independent of his econometric analysis. Therefore, it can be accepted even if the Commission does not accept his econometric estimates of variability.

“overhead” not-handling time that is driven by the handling workhours. Handling-mail time and associated overheads account for the vast bulk of workhours in sorting operations, so there is little in the way of causal avenues for workload measures other than TPF to enter the relationship between hours and mail processing “outputs.”

USPS-T-12 at 14 (Bozzo). Thus, the Postal Service has acknowledged that container handlings and overheads do vary across presort levels in the same case that it has classified all such costs as fixed.

Finally, with respect to the volume variability of allied labor and general support operations, witness Bozzo states,

for allied labor and general support operations, it is possible to view cost causation as following a “piggyback” model, in which the costs in support operations are viewed as driven by – and thus volume-variable to the same degree as – the “direct” operations.

USPS-T-12 at 40-41 (Bozzo).

Witness Van-Ty-Smith’s distribution method for support and miscellaneous cost pools also follows the piggyback approach discussed by witness Bozzo. Specifically, witness Van Ty-Smith stated:

In this docket, as was proposed by the Postal Service in Docket No. R2001-1, the two support cost pools at the plants are consolidated into one “piggyback” cost pool (see discussion in USPS-T-12, section III E). The two plant support cost pools are quasi-administrative pools characterized by a high percentage of not-handling-mail activities. The volume-variable costs for the “piggyback” cost pool are distributed to subclasses in proportion to the volume-variable costs for subclasses in the cost pools they support . . . .

For the Miscellaneous cost pool at post-offices, stations, and branches, the handling tallies are used and the distribution key for the not-handling tallies is based on all mail processing handling tallies at post-offices, stations, and branches.

USPS-T-11 at 18-19 (Van-Ty-Smith).

Thus, according to both the attribution and distribution theory of the Postal Service, a large number of pools comprising a significant amount of cost that are classified as fixed actually vary with respect to presort level. The unit costs in these allied labor, general support, and tray sorting pools are aggregated in Table 3 below.

<b>Table 3. First-Class Mail BMM and Automation Letters Unit Mail Processing Costs by Select Operations (cents)</b>			
<b>Operations</b>	<b>Number of Cost Pools</b>	<b>BMM Letters</b>	<b>Automation Letters</b>
		<b>Unit Cost</b>	<b>Unit Cost</b>
Allied Labor*	10	2.733	0.898
General Support	6	0.703	0.176
Tray Sorting	2	0.230	0.149
<b>Total</b>	<b>18</b>	<b>3.665</b>	<b>1.223</b>
* Includes the allied cost pool in non-MODS facilities and all LDC 17 cost pools except cancellation, metered mail preparation, and flats preparation.			
Source: USPS LR-K-110 and Appendix 2.			

Table 3 shows that these 18 cost pools account for 1.223 cents in unit costs and, therefore, comprise 78 percent of the total of all costs that are classified as non-proportional. Yet witnesses Bozzo and Van-Ty-Smyth acknowledge that these costs vary in the same way as do the direct operations and the direct operations vary with the degree of worksharing.

Accordingly, these cost pools should be classified as proportional.

- i. Analysis of Postal Service mail flows and operations indicate that most mail processing costs vary with the amount of worksharing performed.

The Postal Service’s activity-based cost letter mailflow models only model piece sortation/handling and package sorting activities and ignore container handling, tray handling, allied labor, mail processing support, and network-related activities (“non-modeled” activities). See Tr. 4/1068; Tr. 4/1070 (Redirected to Tr. 4/1068). Furthermore, the Postal Service simply asserts without providing a full, reasoned analysis that the costs for these non-modeled activities

are fixed within the classification of IOCS mail processing costs. *See* Response to P.O. Information Request No. 4, Question 11(a) (Tr. 4/1078-1105).

An analysis of the non-modeled activities reveals that their mail processing costs are not fixed with respect to worksharing, but rather that such activities vary with presortation and worksharing levels. Included in the record evidence before the Commission is the overview of current and test year mail processing operations, and the generalized description of mail flows for First-Class Mail letters. *See* Tr. 5/1650-75. Witness McCrery also testified as to how the preparation of certain workshared First-Class Mail letters avoids costly operations of the Postal Service. *See* Tr. 5/1682; Tr. 5/1777. This evidence and testimony underscores the fact that many mail processing costs currently classified as fixed do vary directly or indirectly with the presort level of the letter tray. Therefore, the Postal Service's classification of many of these cost pools as fixed is in error.

For example, mailers and presort bureaus prepare pallet separations based upon the presort level of the letter tray, *see* Tr. 5/1644-45, that allow the Postal Service to bypass time-consuming operational steps that reduce postal service costs. *See* Tr. 5/1682; Tr. 5/1777. Pallet separations are related to the size of the mailing, *see* Tr. 5/1776-77, and the size of the mailing is generally related to the presort level of the letter trays: the larger the mailing, the greater the depth of presort. Therefore, the presort level of letter trays is strongly correlated with the ability to perform beneficial pallet separations.

Application of PostalOne! technologies provide another example of how the mail processing costs of non-modeled activities are not fixed with respect to worksharing, but rather that such activities vary with presortation and worksharing levels. The PostalOne! Transportation Management system is integrated into participating customers' facilities and

books air and surface transportation assignments for First-Class Mail letter trays. The Postal Service concedes that when mailers use PostalOne! the Postal Service avoids transportation and mail processing costs. *See e.g.*, MMA/USPS-T21-33, MMA/USPS-6, and MMA/USPS-7. Yet in its classification of cost pools the Postal Service fails to connect the dots and recognize the relationships between PostalOne!, pallet separations, and the presort level of letter trays.

The record evidence in this case establishes that many of the costs avoided by the Postal Service from pallet separations and PostalOne! correlate with the presort level of the letter tray. *See* Tr. 5/1644-45; Tr. 5/1774-76 and 1780-84. Witness McCrery confirmed that mixed AADC letter trays on pallet separations go through more mail processing, platform, container handling, bullpen and opening unit, tray sorting, piece distribution, allied labor, and dispatch activities at origin than 5-digit letter trays on pallet separations. *See* Tr. 5/1780-1784. Thus, Postal Service mail processing costs at origin vary with respect to pallet separations and the presort level of letter trays.

Moreover, even in the atypical scenarios where First-Class Mail workshared letters only differ in terms of the presort level of the letter tray, many mail processing costs vary with respect to presortation. There is no “one-size-fits-all” mail flow of letters within the Postal Service network: mail processing is a complex marriage of containers, trays, letters, equipment, staffing, and time. Consequently, there are a large number of permutations of the flow of letters through the Postal Service mail processing network. The Postal Service’s desire to simplify and generalize its mail flow models in order to compute activity-based mail processing costs is understandable, but, unfortunately, by focusing only on piece and bundle sorting costs the model fails to account for the critical cost relationships in other essential activities.

- ii. The record evidence establishes that important cost pools currently classified as fixed actually vary with presort level and the amount of worksharing.

The record evidence establishes that important cost pools currently classified as fixed actually vary with presort level and the amount of worksharing. Correcting these misclassifications of cost pools allows more accurate estimates of cost avoidance. The following examples underscore the point.

*Opening Unit Operations:* The unit costs for opening unit operations total 0.174 cents for First-Class Mail automation presort letters. *See* USPS LR-K-110; Appendix 2. These units, among other activities, break down containers of letter trays, separate letter trays into mail transport equipment, remove strapping and sleeves from letter trays, and stage worked containers. *See* Tr. 5/1676-77. Originating letters in mixed AADC trays could incur opening unit costs at an origin plant and at *two* destinating plants.<sup>6</sup> Originating letters in 5-digit trays, in contrast, could incur opening unit costs at an origin plant and at *one* destinating plant. Further, letters in 5-digit trays on pallet separations could bypass the opening unit costs at the origin plant. These costs vary with presort level and, therefore, are improperly classified as fixed.

In addition to the incidence of opening unit costs, the magnitude of opening unit costs varies with respect to worksharing. It is less costly to sort a letter tray from one container to another than to remove and dispose of strapping and sleeves and then sort the letter tray from one container to another. The Postal Service removes strapping and sleeves from letter trays in preparation for piece sortation operations at the plant. Originating letters in mixed AADC trays could incur the costs for removing strapping and sleeving once at origin and once at the

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<sup>6</sup> Witness McCrery presents generalized mail flows that assume that incoming primary and incoming secondary distribution takes place at the same facility as managed mail program distribution; however, that is not always the case. *See* Tr. 5/1650-75; ABA & NAPM/USPS-T21-64 (Redirected to T29). First-Class Mail letters in AADC trays, after being sorted at an AADC, are sometimes sent to another destinating facility where letters in 3-digit and 5-digit trays are sent directly from the originating postal facility. *See* ABA & NAPM/USPS-T21-63 subpart k.

destinating plant. Originating letters in 5-digit trays, in contrast, would incur the costs for removing strapping and sleeving only once at the destinating plant. *See* Tr. 5/1650-75. Accordingly, these costs vary with presort level and should be classified as proportional.

*Letter Tray Sorting Operations - Mechanical Tray Sorters / Robotics:* The unit costs for letter tray sorting operations that use mechanical tray sorters and robotics total 0.169 cents for First-Class Mail automation presort letters.<sup>7</sup> *See* USPS LR-K-110; Appendix 2. These operations perform a similar function as the opening units in separating letter trays. Originating letters in mixed AADC trays could incur mechanical tray sorting and robotics costs at an origin plant and at the destinating AADC. Originating letters in 5-digit trays could incur mechanical tray sorting and robotics costs only at the origin plant as the Postal Service bypasses the destinating AADC by transporting the mail directly to the P&DF responsible for destinating processing. Further, letters in 5-digit trays on pallet separations could bypass the tray sorting costs at the origin plant. *See* Tr. 5/1650-75. Accordingly, these costs vary with presort level and should be classified as proportional.

*Dispatch Operations:* Dispatch operations include, among other activities, the separation, staging, and movement of processed mail for subsequent distribution or outbound transportation and strap and sleeve trays. *See* Tr. 4/1060-61; Tr. 5/1309-10. Dispatch operations unit costs total 0.069 cents for First-Class Mail automation presort letters. *See* USPS LR-K-110; Appendix 2. Dispatch costs relate to the number of times mail is processed and the number of times processed mail is prepared for outbound transportation. Originating letters in mixed AADC trays can be processed in four sort schemes and require two or three strapping and/or sleeving activities. Originating letters in 5-digit trays can be processed in only one sort scheme

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<sup>7</sup> We include mechanical and manual sack sorting operations in this discussion because they can sort First-Class Mail letter trays. *See* Response to P.O. Information Request No. 4, Question 11(a)(Tr. 4/1078-1105).

and require at most one sleeving activity. *See* Tr. 5/1650-75. Hence, mixed AADC letters incur greater dispatch costs than 5-digit letters. Accordingly, these costs vary with presort level and should be classified as proportional.

*Opening Unit Manual Transport Operations:* Opening unit manual transport operations include, among other activities, the transportation of containers of mail between work areas. *See* Tr. 4/1060-61; Tr. 5/1312-13. Their unit costs total 0.030 cents for First-Class Mail automation presort letters. *See* USPS LR-K-110; Appendix 2. These costs directly relate to the number of work areas that mail is processed or handled in. The Postal Service processes and handles originating letters in mixed AADC trays in more opening unit/bullpen operations, piece distribution operations, and dispatch operations than originating letters in 5-digit trays. *See* Tr. 5/1650-75. Hence, mixed AADC letters incur greater opening unit manual transport costs than 5-digit letters. Accordingly, these costs vary with presort level and should be classified as proportional.

*Scanning Mail Operations:* Scanning mail operations include, among other activities, the loading, scanning, labeling, unloading, sleeving, and strapping of letter trays. *See* Tr. 4/1060-61; Tr. 5/1678-79. Their unit costs total 0.032 cents for First-Class Mail automation presort letters. *See* USPS LR-K-110; Appendix 2. Originating letters in mixed AADC trays incur the costs for scanning mail operations at an origin plant and sometimes at a destinating AADC that dispatches the letters, after managed mail program distribution, to another facility for incoming primary and secondary distribution. Originating letters in 5-digit trays scanned and labeled using PostalOne! generally do not incur any costs for scanning and labeling mail operations at an origin plant<sup>8</sup> and

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<sup>8</sup> Even if the Postal Service loads, scans, and unloads the 5-digit letter tray at an origin plant, it avoids some incremental costs such as labeling, manual sleeving, and manual strapping costs. Further, destinating letters in 5-digit trays do not incur any scanning costs at all. It is not likely that all letters in mixed AADC trays destinate within

at the destinating facility. Accordingly, these costs vary with presort level and should be classified as proportional.

*Platform Operations:* Platform operations include the work of expeditors and, among other activities, loading and unloading trucks, cross docking containers of mail, and sorting mail during the vehicle unloading process. *See* Tr. 7/2620-21; Tr. 4/1060-61. Their unit costs total 0.308 cents for First-Class Mail automation presort letters. *See* USPS LR-K-110; Appendix 2. In Docket No. R2000-1, the Commission found that platform costs are affected by worksharing activities and classified them as worksharing-related fixed for First-Class Mail. *See* PRC Op. Docket No. R2000-1, para. 5091. However, platform costs not only vary between workshared and non-workshared letters, but vary within presorted letters. For example, originating letters in mixed AADC trays could incur inbound and outbound platform costs at a destinating AADC prior to dispatch to a downstream facility for incoming primary and secondary distribution. Originating letters in 5-digit trays could bypass the platform at the destinating AADC altogether. *See* n.6, *supra*. Further, the cost of expediting the distribution and dispatch of processed mail is affected by the number of times mail is processed in piece distribution operations. And the Postal Service processes originating letters in mixed AADC trays in more piece distribution operations than originating letters in 5-digit trays. *See* Tr. 5/1650-75. Finally, originating letters in 5-digit trays on pallet separations would bypass the inbound and outbound platform costs at the origin plant. *See* Tr. 5/1644-45. Thus, more platform costs are incurred for mixed AADC letters than for 5-digit letters. Accordingly, these costs vary with presort level and should be classified as proportional.

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the service area of the entry Postal Service facility, so the average scanning cost for letters in mixed AADC trays will always be non-zero.

*Allied Labor Operations:* Allied labor operations have “two principal functions – to prepare mail for distribution operations in the plant, and to process other mail that may not require handling in piece sorting operations.”<sup>9</sup> See USPS-LR-K-1 page 3-7. Their unit costs in non-MODS facilities total 0.243 cents for First-Class Mail automation presort letters. See USPS LR-K-110; Appendix 2. Although allied labor overlaps some of the other non-modeled activities, it can be thought of as a catch-all category that encompasses all mail processing activities “allied” to direct piece sortation activities. Intuitively, some allied labor activities, like moving mail to/from sorting operations, have a direct relationship to distribution operations: the greater the amount of distribution operations, the greater the amount of allied labor operations. We have discussed specific allied labor costs, like opening units and dispatch, above. Thus, the costs of allied labor activities vary to some degree with presort level and should be classified as proportional.

*Miscellaneous Mail Processing and Support Operations:* Miscellaneous mail processing and support operations include the “numerous additional activities” that clerks and mailhandlers perform in addition to sorting and allied operations. See USPS-LR-K-1 page 3-9. Their unit costs total 0.176 cents for First-Class Mail automation presort letters. See USPS LR-K-110; Appendix 2. These operations are simply “general mail processing support operations.” See USPS-LR-K-1 page 3-9. The Postal Service concedes that miscellaneous mail processing costs are “obviously worksharing related.” See Response to P.O. Information Request No. 4, question 11(a)(Tr. 4/1078-1105). Further, it is intuitive that miscellaneous and support operations are proportional to distribution operations: the greater the amount of distribution operations, the

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<sup>9</sup> Allied labor includes “[p]latform and collection activities, moving mail to/from other operations, separating/breaking down mail, [and] other allied labor activities.” USPS-LR-K-1 at 3-11. Further, witness Smith acknowledged that allied labor in non-MODS facilities includes mail preparation, canceling, facing, banding, culling, and separating mail activities. See Tr. 7/2629-32.

greater the amount of support operations. Accordingly, these costs vary with presort level and should be classified as proportional.

The unit costs in these allied labor, general support, and tray sorting pools are aggregated in Table 4 below. The aggregated data shows that these 16 pools account for 1.2 cents in unit costs for First-Class Mail automation letters and comprise 77 percent of the total of all costs that the Postal Service classifies as not proportional.<sup>10</sup> As indicated above, the on-the-record analysis of these non-modeled activities establishes that these costs vary with the degree of worksharing. Accordingly, these costs should be classified as proportional.

<b>Table 4. First-Class Mail BMM and Automation Letters Unit Mail Processing Costs by Select Mail Flow Operations (cents)</b>			
<b>Operations</b>	<b>Number of Cost Pools</b>	<b>BMM Letters</b>	<b>Automation Letters</b>
		<b>Unit Cost</b>	<b>Unit Cost</b>
Allied Labor*	8	2.673	0.876
General Support	6	0.703	0.176
Tray Sorting	2	0.230	0.149
Total	16	3.605	1.200
* Includes the allied cost pool in non-MODS facilities and all LDC 17 cost pools except cancellation, metered mail preparation, flats preparation, pouching, and presort.			
Source: USPS LR-K-110 and Appendix 2.			

It bears noting that the Postal Service’s treatment of these costs has been discussed in prior cases. In Docket No. MC95-1, Postal Service witness Smith acknowledged that some of the same non-modeled activities (e.g., moving mail between operations, platform handlings, and unbanding and unsleeving trays) depend primarily on or are partly influenced by presort level of the mail. See PRC Op. MC95-1, para. 4279. In view of the deficiencies in the classifications and modeling, witness Smith stated,

<sup>10</sup> Note that there is overlap between these pools and those that the attribution and distribution theory shows should be classified as proportional.

it would be better to be able to model the non-modeled activities in order to accurately relate these costs to categories. Such an effort would be a considerable undertaking and represents a goal to which the Postal Service will strive.

PRC Op. MC95-1, para 4277 citing USPS-T-10 at 5. Perhaps because of the expedited nature of this case, the Postal Service has not been able to meet this goal in presenting the cost classifications in the instant case. While it is not necessary to do so to support an across-the-board request, particularly because the Settlement Agreement does not bind the parties in future cases, the Commission should recognize that more accurate and refined costing methods are available.

- iii. Costs in “anomalous” mail processing cost pools vary with the amount of worksharing performed.

Among the mail processing costs that are classified as non-worksharing-related fixed are those in cost pools in which First-Class Mail letters are unexpected. Mail processing costs in these pools may be unexpected because of the shape, the type of facility, or the class of mail that the pool relates to. For example, while it would seem anomalous that First-Class letter mail processing costs would appear in manual parcel sorting operations, in BMCs, or in express mail pools, IOCS actually records such tallies and the Postal Service does use these tallies to distribute mail processing costs to mail subclasses and special services.

The phenomenon of unexpected cost pools was also an issue in Docket No. R2000-1. In that docket, USPS witness Eggleston offered the following explanation of these costs,

IOCS handling tallies record the mail actually being handled by the employees recorded as working a given mail processing operation (cost pool), rather than the mail expected to be handled in a given operation.

Docket No. R2000-1, Tr. 13/5128-29.

From an operational perspective, these tallies generally result from two different circumstances: (1) when the Postal Service does infrequently handle letter-shaped mail in non-

letter operations; and (2) when clerks and mailhandlers do infrequently work in operations that are different from the operation into which they are clocked. *See* Tr. 5/1685-87.

For example, a First-Class Mail letter tally in a manual flat sorting operation generally would result from one of two possibilities. The tallied clerk was working in a letter sorting operation (e.g., manual sorting), but had not clocked out of the flat sorting operation and into the letter sorting operation. Alternatively, the tallied clerk was, in fact, sorting that letter in the manual flat sorting operation. In either case, these costs are for sorting the letter and, therefore, vary with the amount of worksharing performed.

This argument applies to more than just piece-distribution operations. As discussed in previous sections of this brief, the costs for many activities – e.g., allied, general support, container-handling activities – vary with the amount of worksharing performed. Thus, if, for example, the clerk was clocked into the manual flat sorting operation, but was bringing letters to a piece-distribution operation, it would still be appropriate to classify that cost as worksharing-related proportional. The Commission, therefore, should recognize that all of these cost pools would more properly be classified as worksharing-related proportional costs.

Table 5 below aggregates the 24 cost pools with non-zero letter mail processing costs that are not First-Class Mail letter pools and their associated mail processing unit costs under the PRC method for mail processing variability into three different categories: unexpected facility, unexpected shape, and unexpected class. As the table shows, while unit costs in these pools tend to be small, there are many of them and in aggregate they comprise 0.283 cents of unit mail processing costs for BMM letters and 0.059 cents for automation presort letters. All of these costs should be classified as proportional.

<b>Table 5. Anomalous Cost Pools and Associated CRA BMM Letter and Auto Letter Unit Mail Processing Costs (cents)</b>			
<b>Operations</b>	<b>Number of Cost Pools</b>	<b>BMM Letters</b>	<b>Automation Letters</b>
		<b>Unit Cost</b>	<b>Unit Cost</b>
Unexpected Facility	8	0.026	0.004
Unexpected Shape	12	0.241	0.044
Unexpected Class	4	0.015	0.011
Total	24	0.283	0.059
Source: USPS LR-K-110 and Appendix 3.			

c. *Analysis of unit costs from CRA systems corroborate that most costs vary with the level of worksharing.*

Analysis of the IOCS unit cost data bolsters the arguments and record evidence set forth above that the vast majority of costs classified as non-worksharing-related fixed and worksharing-related fixed mail processing costs vary with respect to: (1) whether a piece is workshared, and (2) the amount of worksharing performed.<sup>11</sup>

Table 6, below, classifies non-worksharing-related fixed cost pools by their ratio of First-Class Mail BMM letters unit cost to First-Class Mail automation letters unit cost using the PRC method for mail processing variability. *See* USPS-LR-K-110.

As the table shows, 35 cost pools with non-zero mail processing costs are classified as non-worksharing-related fixed. In 33 of these, the unit cost for BMM letters exceeds the unit cost for automation letters. In 25 of these pools, the unit cost for BMM letters is greater than twice the unit cost for automation letters, and in 10 of these pools, the unit cost of BMM letter is

<sup>11</sup> On a related issue, the proportional Cost and Revenue Analysis (“CRA”) adjustment factor for First-Class Mail automation letters is substantially less than one for both the USPS version of the letter cost model (0.707 from USPS LR-K-48) and the PRC version of the model (0.734 from USPS LR-K-110). This means that the Postal Service’s modeled cost of activities that vary with presort is significantly higher than the “proportional” costs from the CRA and that application of the proportional CRA adjustment reduces the modeled costs avoided by presortation by 25-30 percent. This result is counterintuitive since, as the Postal Rate Commission noted in its Docket No. MC95-1 Opinion and Recommended Decision, *see* PRC Op. MC95-1, para. 4220, it is generally accepted that engineering models tend to be under inclusive, not over inclusive. It also suggests that the Postal Service’s qualitative assessment of which cost pools vary with respect to presort could be incorrect, biasing the actual CRA cost estimates downward.

greater than five times greater. In total, the BMM letters unit costs in the non-worksharing-related fixed cost pools is over three times the automation letter unit costs in these pools.

<b>Table 6. Number of Non-Worksharing-Related Fixed Cost Pools (and Associated Unit Costs) by Specified Ratios of BMM Letters Unit Cost to Automation Letters Unit Cost</b>			
<b>Ratio Range</b>	<b>Number of Pools with Specified Ratio of BMM Letters to Auto Letters Unit Cost</b>	<b>Unit Costs (cents)</b>	
		<b>BMM Letters</b>	<b>Auto Letters</b>
Less than 1	2	0.007	0.010
Between 1 and 2	8	0.236	0.152
Between 2 and 5	15	1.071	0.326
Over 5	10	0.228	0.021
Total Pools	35	1.541	0.509

Although there may be differences between BMM and automation letters with respect to cost causing characteristics like weight, shape, and local / non-local mix, the most obvious difference is that BMM letters are not workshared and automation letters are. No other characteristic can explain such large and striking unit cost differences in pools that the USPS classifies as non-worksharing-related fixed.<sup>12</sup>

4. Improvements To The USPS Cost Models Demonstrate That First-Class Workshared Mail Discounts Are Close To And Sometimes Below Efficient Component Pricing Discounts.

To evaluate how close USPS proposed discounts are to ECPR discounts, the USPS cost models must be adjusted to correct for the obvious flaws in the cost pool classifications previously discussed. In the absence of fully modeling the behavior of costs to presort level, a more elegant solution is simply to classify those cost pools shown above to vary with workshare level as proportional and use the PB-LR-1 to calculate costs and cost avoidances. The

<sup>12</sup> This suggests that, after properly controlling for piece weight, shape, local / non-local mix, and other identifiable and measurable cost causing characteristics not related to worksharing, a statistical analysis would still show significant mail processing cost differences between BMM and automation letters. These mail processing cost differences must then be explained by worksharing.

manipulation of the classification is premised on the assumption that actual costs vary with respect to presort level in exactly the same way as the modeled costs do, an assumption which is demonstrably superior to assuming they do not vary at all. Further, making a logical assumption of this sort is not without precedent in mail processing costing. For example, current cost methodology for mail processing assumes that non-handling costs vary with volume and are generally distributed to subclass in the same way as are the handling costs

Moreover, classifying cost pools as fixed when their costs clearly vary with presort level is completely incorrect from a methodological perspective. If costs are classified in one of the two fixed categories, these costs would make no contribution to the cost differences between presort levels, yet the record evidence demonstrates that there are, in fact, cost differences in these pools between the presort levels. Thus, an evaluation of discounts with respect to ECPR that properly classifies these pools as proportional to increase the accuracy of the Postal Service cost models is illustrative. *See Appendix 4 for classifications.*

By correcting the USPS models and calculated passthroughs using the library reference tool in PB-LR-1, and setting all costs pools to proportional as discussed above and as shown in Appendix 4, most passthroughs under either the cumulative or incremental methods are closer to or less than 100 percent.<sup>13</sup> For example, under the corrected model with PRC variability, Automation 5-Digit has a cumulative passthrough of 94 percent and an incremental passthrough of 77 percent, as compared to 108 percent cumulative and 113 percent incremental passthroughs calculated with the original USPS model with PRC variability. And Automation AADC has a cumulative passthrough of 94 percent and an incremental passthrough of 56 percent in the

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<sup>13</sup> Cost pools that were not discussed above were left classified as worksharing-related fixed or not worksharing-related fixed.

corrected version as compared to 101 percent and 82 percent in the original model. Thus, discounts with a corrected model more closely approximate ECPR discounts.

As suggested by witness Smith in Docket No. MC95-1, in the future, the Postal Service should attempt to model the non-modeled activities in order to accurately relate these costs to categories. Although modeling the non-modeled activities would require some effort, the resulting cost avoidance estimates would improve consistency with how nonworkshared and workshared mail are actually processed throughout the Postal Service network. Both Postal Service operations and industry mail preparation have changed in fundamental ways since the early worksharing models analyzed the piece and package handling costs. Because accurate estimates of cost avoidance are necessary for ECPR, the Postal Service should fully analyze mail entry, pallet separations, PostalOne!, mail processing total quality management (“MPTQM”), container handling activities, tray sorting and handling activities, allied labor activities, mail processing support activities, and other network-related mail processing activities for relevance to the worksharing required to receive a discount.

Pitney Bowes respectfully submits that the mail flows provided by the Postal Service in response to the written interrogatories of Pitney Bowes and others in this case, *see e.g.*, Tr. 7/1650-75, would provide a valuable starting point for this extended modeling.

**C. There Is Insufficient Record Evidence To Deviate From An Across-The-Board Increase For Non-Automation Presort First-Class Letter Mail.**

In addition to the policy reasons for applying the across-the-board increase to all rates, the record does not support any adjustment to the proposed non-automation presort discount.

First and most important, this form of worksharing continues to provide value to the Postal Service. As the Postal Service's rate design witness pointed out,

there is reason to believe that value remains in the mailer sortation of items that are not presented in a manner that facilitates their processing through postal automation. In essence, the Postal Service may still be benefited by mailers presorting mail that does not readily go through postal automation, and thereby avoiding potentially relatively expensive processing costs as a result of the presorting.

Response of witness Taufique to P.O. Information Request No. 1 Question 1(b).

In addition to the cost savings from mailer presortation, other requirements (e.g., Move Update) imposed on all workshared First-Class Mail letters including non-automation presort letters continue to reduce Postal Service costs. *See* Tr. 4/1066.

Second, the Postal Service's cost avoidance model, which shows that the unit cost of machinable non-automation presort letters is greater than the cost of BMM, is flawed and has been undermined by its sponsoring witness. Witness Abdirahman stated in response to P.O. Information Request No. 1, Question 1(a), that the USPS cost avoidance model suffers from a data problem that creates erroneous estimates showing that machinable non-automation presort letters cost more than BMM. *See* Tr. 4/1075-77. Specifically, IOCS tallies mistakenly identify costs for all First-Class Mail presort letters that do not bear 11-digit barcodes as non-automation presort letter costs. Because some of these pieces qualified for and were accepted at automation letter rates, IOCS improperly overstates non-automation costs.

This improper identification of costs overstates non-automation presort letter costs.

Given that there are more than twenty times as many automation presort letters as non-automation presort letters in First-Class Mail, it is no surprise that this misclassification results in “non-automation presort letters unit costs increas[ing] dramatically, while the automation presort letters unit costs decreas[ing] slightly.”<sup>14</sup> Response to P.O. Information Request No. 1 Question 1(a)(Tr. 4/1075-77). Therefore the use of overstated costs for non-automation presort letters in the Postal Service’s cost avoidance models significantly understates the value of this form of worksharing to the Postal Service.

Moreover, given that the record contains no reliable estimate of the cost avoided by non-automation presort letters, there is no basis to change the proposed discount. Rather, in view of the recognized deficiencies in the Postal Service’s data collection methodology for estimating the cost of non-automation presort letters, the results should be completely discounted in this case. As discussed by witness Taufique, the Postal Service should review its method for determining the cost avoided by non-automation presort letters before the next rate case. *See* Response to P.O. Information Request No. 1, Question 1(b).

#### **IV. CONCLUSION**

The evidence in the record, and the representations of the signatory parties, provide an adequate basis for the Commission to conclude that the rate and classification proposals set forth in the Settlement Agreement are supported by the record, are consistent with the applicable statutory requirements and, therefore, should be recommended. Moreover, for the reasons stated above, Pitney Bowes respectfully submits that the Commission can satisfy itself that the rates

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<sup>14</sup> Note also that the overstatement of costs for non-automation presort letters suggests that the cost differences between presort levels for automation letters are understated. If the overstated non-automation costs were switched back to automation letters and switched to any of the proportional pools, the CRA adjustment for automation letters would be closer to one and cost differences between the presort levels would be expanded rather than reduced.

associated with First-Class Mail automation and non-automation discounts should also be accepted without modification. Accordingly, Pitney Bowes respectfully requests that the Commission recommend to the Governors the adoption of the rates and fees set forth in the Settlement Agreement.

Respectfully submitted,

\_\_\_\_\_/s/\_\_\_\_\_  
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DATED: September 26, 2005

# Appendix 1

Appendix 1. First-Class Mail Bulk Metered Mail and Automation Letters Unit Mail Processing Costs By Cost Pool (cents)  
(USPS Cost Pool Classifications)

Source: LR-K-110.

Worksharing-Related Processing Cost Pools	Cost Pool	Bulk Metered Mail			Automation Letters			Crosswalk of Reclassification Categories			Classification in Corrected Model			
		WRP	WRF	NWRF	WRP	WRF	NWRF	Attribution & Distribution	Mail Flow	CRA Cost Comparison	WRP	WRF	NWRF	
MODS 11 BCS/	BCS - Other than CBSCS/DBCS	7.766	0.278		2.327	0.112								
MODS 11 BCS/DBCS	CBSCS / DBCS	2.368			1.158									
MODS 11 OCR/	OCR	0.885			0.088									
MODS 14 MANL	Manual Letters	1.603			0.215									
MODS 15 LDT15	LDC 15 - RBCS	0.575			0.085									
MODS 41 LD41	LDC 41 - Unit Distribution - Automated	0.082			0.030									
MODS 42 LD42	LDC 42 - Unit Distribution - Mechanized	0.000			0.000									
MODS 43 LD43	LDC 43 - Unit Distribution - Manual	0.424			0.107									
MODS 44 LD44	LDC 44 - Post-Office Box Distribution	0.205			0.090									
NON MODS AUTOMIEC	Automated/Mechanized	0.376			0.184									
NON MODS MANL	Manual Letters	0.985			0.241									

LEGEND  
USPS COST POOL CLASSIFICATION

- WRP worksharing-related proportional
- WRF worksharing-related fixed
- NWRF not worksharing-related fixed

# Appendix 2



# Appendix 3

Appendix 3. First-Class Mail Bulk Metered Mail and Automation Letters Unit Mail Processing Costs by Cost Pool (cents)  
(USPS Cost Pool Classifications)

Source: LR-K-110.

Cost Pool	Bulk Metered Mail			Automation Letters			Crosswalk of Reclassification Categories		Classification In Corrected Model
	WRP	WRF	NWRF	WRP	WRF	NWRF	Attribution & Distribution	Mail Flow	
Unpackaged Facility			0.028			0.000			✓
BACMS NMO			0.000			0.000			✓
BACMS OTHR			0.001			0.001			✓
BACMS PLA			0.000			0.000			✓
BACMS PSM			0.000			0.000			✓
BACMS SPB			0.000			0.000			✓
BACMS SSM			0.000			0.000			✓
BACMS 19 INTL ISC			0.018			0.001			✓
BACMS 19 PMPFCS			0.006			0.002			✓
Unpackaged Shape			0.245			0.044			✓
BACMS 12 FSM 100			0.037			0.003			✓
BACMS 12 FSM/			0.000			0.000			✓
BACMS 12 FSM/1000			0.034			0.005			✓
BACMS 13 MEGPARC			0.000			0.000			✓
BACMS 13 SPBS OTH			0.032			0.002			✓
BACMS 13 SPBS/PRIO			0.002			0.001			✓
BACMS 14 MANP			0.024			0.002			✓
BACMS 14 MANP			0.017			0.005			✓
BACMS 17 FLAT/PRP			0.055			0.015			✓
BACMS 18 REWRAP			0.014			0.001			✓
NON BACMS MANP			0.019			0.005			✓
NON BACMS MANP			0.007			0.003			✓
Unpackaged Class			0.018			0.011			✓
BACMS 14 PRIORITY			0.007			0.003			✓
BACMS 18 EXPRESS			0.008			0.001			✓
BACMS 48 LD48 EXP			0.001			0.000			✓
NON BACMS EXPRESS			0.000			0.000			✓

**LEGEND**  
 WRP working-related proportional  
 WRF working-related fixed  
 NWRF not working-related fixed

**USPS COST POOL CLASSIFICATION**  
 working-related proportional  
 working-related fixed  
 not working-related fixed

# Appendix 4

