

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

**Comments Of Major Mailers Association
In Response To Notice Of Inquiry No. 3**

On July 26, 2006, the Commission issued Notice Of Inquiry No. 3 (NOI No. 3).¹ NOI No. 3 requests interested parties to consider and comment on the Postal Service's proposal to "de-link" the design of single-piece mail and workshared mail within the First-Class Letters subclass.²

NOI No. 3 expresses several concerns, principally that the Postal Service's delinking proposal:

represents "a significant departure from the rationale used to justify First-Class Mail worksharing discounts since their inception" (NOI No. 3 at 2);

"implicitly treats single-piece mail and workshared mail as separate subclasses," a concept it rejected in Docket No. MC95-1 (id.); and

"implicitly downplays the importance of the price signals sent to mailers by the difference between the first-ounce single-piece rate and rates for comparable mail that is workshared" and "suggests a substantially different relationship between the markets for singlepiece and workshared First-Class Mail than that which underlies the historically accepted approach to rate design" (NOI No. 3 at 2-3).

Accordingly, in order to "thoroughly develop the record and facilitate consideration of alternatives" and "assure that a balanced record is available to inform the Commission's consideration,"³ the NOI encourages participants to address these issues through comments and testimony.

¹ *Postal Rate and Fee Changes*, Docket No. R2006-1, Notice Of Inquiry, issued July 26, 2006.

² On July 21, 2006, the Commission issued Notice Of Inquiry No. 2 (NOI No. 2) dealing with similar issues affecting the rate design for Standard Mail. MMA will limit its comments to First Class mail rate design issues.

³ NOI No. 3 at 1

MMA welcomes NOI No. 3 and appreciates the Commission's thoughtful efforts to identify and articulate the issues and factors it believes are central to a full and fair resolution of these important rate design issues. MMA already recognized and planned to address many of the principles highlighted in the NOI. Nevertheless, the Commission's discussion of these issues has served to focus MMA's thinking on matters that are crucial to the legitimate interest of workshared mailers in general, and large, bulk mailers like MMA members in particular.

MMA supports the Postal Service's delinking proposal in this rate and the specific First Class workshared discounts that result from that new analysis. The Postal Service should be applauded for seeking a rational, alternative approach to the "traditional" methods for setting First Class workshared letter rates. MMA recognizes, as the Postal Service has and the Commission should, that the basic assumptions and time-honored principles underlying the "historical" methods of setting First Class mail discounts no longer reflect significant, ongoing changes in the workshared mail market.

MMA's Operations And Interests In The Issues Addressed In NOI No. 3

MMA members are among the very largest mailers of bulk First Class workshared mail. In order to handle consistently high volume mailings, MMA members have made, and continue to make, significant investments in cutting edge software, including sophisticated address correction programs, computer systems and mail handling equipment. As a result, these mailers produce the highest quality, most accurate mail pieces in the industry. MMA members also work closely with the Postal Service to test and adopt new postal service programs such as PostalOne!, which is designed to reduce postal costs by streamlining the mail acceptance process and routing high volume mailings to the least cost transportation mode, all with the aid of advanced electronic communications that eliminate cumbersome, expensive paper-based processes. Finally, several MMA members have made very significant investments in time and money to have their facilities and personnel certified under the Postal Service's Mail Piece Total Quality Management (MPTQM) program and related

programs⁴ that assure their operations are as efficient as possible for the benefit of the Postal Service.

Many MMA members use First Class workshare mail primarily to send service bills and account statements to their own customers. For them, mailing is not their core business, but simply a tool they use to exchange information with, and receive payments from, their customers. Other MMA members perform mailing services where that function is outsourced by their clients. Although mailing traditionally was the core business of these firms, this is changing rapidly. To continue providing valuable services for their clients, these firms increasingly have evolved by designing and offering electronic delivery of account statements and online bill presentation and payment options for their clients.

All MMA members want the same basic things from the Postal Service:

efficient, reliable, and timely delivery of their mail;

postal rates that give them a “fair shake,” by which we mean rates that recognize and give them adequate credit for **all** the cost sparing attributes of their high quality mail pieces and the additional efforts and expense they incur that benefit the Postal Service and other First Class mailers; and

assurances that workshared mail rates are designed using rational, transparent and consistent principles of ratemaking so that they can plan and conduct their business affairs with a reasonable degree of certainty.

Unfortunately, ratemaking for workshared mail has become increasingly complicated, unnecessarily controversial, and unpredictable. MMA hopes that the full and open airing of the issues raised in NOI No. 3 will help to put workshared mail ratemaking on a more positive track.

⁴ MMA members are also very involved in the design of mail pieces that must meet very stringent requirements dictated by the Postal Service’s Mail piece Quality Control Program. Indeed, so knowledgeable are some MMA representatives that they instruct Postal Service personnel on the applicable mail piece design requirements.

Executive Summary

The First Class workshared mail market has evolved since the Commission first adopted a 1-cent discount in MC73-1 based on cost avoidance principles. For many years, spectacular growth in workshared mail volumes was a powerful financial engine that enabled the Postal Service to minimize rate increases for First Class single piece. Today the workshared mail market is fully mature. Volumes have peaked and may have begun a slow, inevitable decline.

The First Class workshared market looks **nothing** like it did when the first presort discount was implemented. Indeed, this market has changed dramatically over the past decade. Today, the First Class workshared market is characterized by a few very large bulk mailers and almost 90,000 small mailers. Due to economies of scale, the few very large bulk mailers produce the highest quality mail pieces and perform numerous additional workshared tasks that are not recognized by the historical cost avoidance principles that underlie the workshare discounts. These “Ultra High Volume (UHV) Mailers” get little or no credit for the valuable additional services they perform; instead, the additional cost savings they generate are spread out among all First Class workshared mailers. Accordingly, the Commission’s traditional cost avoidance approach is not sending appropriate price signals to mailers.

The Commission’s method of measuring workshared cost savings is unnecessarily complicated and controversial. Further it is based on outmoded assumptions regarding mailers’ choices. When presorted discounts were first offered, mailers had limited choices – qualify for a discount or send their mail at single piece rates. Today, mailers have more choices. Accordingly, basing discounts on the notion that cost savings can be measured from a “benchmark” mail piece representing the type of mail most likely to convert to the workshared category and the type of mail to which workshared mail would revert is no longer relevant in today’s dynamic market for workshared mail.

The Postal Service should be applauded for seeking a simpler, more predictable approach to setting rates for First Class workshared mail. The Service’s delinking proposal should provide mailers with greater certainty and predictability regarding the postage they will pay.

I. Evolution Of The First Class Workshare Market

Question 1 (a) in NOI No. 3 asks about the potential for single piece letters to **convert** to worksharing. Question 1 (b) asks about the potential for workshared letters to **revert** to single piece. Assumptions regarding the potential of single piece letters to migrate to worksharing and workshared letters to revert to single piece form the basis for the Commission's cost avoidance approach and its choice of a benchmark mail piece against which to measure cost savings.

When the Commission first adopted a 1-cent presort discount, there were approximately 1.8 billion qualifying pieces, representing less than 0.5% of all First Class letter mail. USPS-T-8 at 43 (Table 3, First Class Letters). As discounts grew over the next two decades, the volumes of First Class presorted mail grew dramatically. By FY 1995, when the Postal Service began the mail reclassification process in MC95-1, First Class workshared mail had reached 37.4 billion pieces, over 41% of all First Class letters. During this same time period, First Class single piece letter volumes grew from 49.9 billion to almost 56 billion pieces (1993), a growth rate that pales by comparison with the growth rate of the workshare letter market. See, USPS-T-7 at 43-44

As Table I shows, in the years that followed, First Class workshared mail volume continued to grow, even as the volumes of First Class single piece mail stalled and then declined rapidly, reaching 43.4 billion pieces in 2005. As a result, by FY 2005 First Class workshared letters made up over 53% of total First Class letters.

As Table I also shows, however, the First Class workshared market has undergone fundamental changes in recent years. First, the growth rate of workshared volumes plunged from 9.8% in 1995 to just 1.6% and 1.7% in FY 1996 and 1997, respectively. Then, following a recovery in 1998-2000, the growth rate plunged again and workshared letter volumes actually declined in 2003, ***apparently the first year-over-year decline in volumes since First Class workshare discounts were instituted.***

Table I
First-Class Volumes Since 1995
(Volumes in Millions)

Fiscal Year	Single Piece Volumes	Workshared Volumes	Workshared Portion %	Workshared Increase %
1995	53,527	37,388	41%	9.8%
1996	53,848	37,998	41%	1.6%
1997	54,504	38,648	41%	1.7%
1998	53,936	40,421	43%	4.6%
1999	53,413	42,685	44%	5.6%
2000	52,370	45,676	47%	7.0%
2001	50,946	47,075	48%	3.1%
2002	49,253	47,658	49%	1.2%
2003	46,558	47,288	50%	-0.8%
2004	45,162	47,334	51%	0.1%
2005	43,376	49,066	53%	3.7%

USPS witness Thress characterizes this recent downward trend for First Class workshared mail as “much less anticipated” than the steeper downward trend in First Class single piece letter volumes.⁵ As he concludes (USPS-T-7 at 46):

Certainly, one of the most significant factors affecting First-Class Mail volume in recent years is the increasing use of the Internet and electronic media as alternatives to the Postal Service. E-mail has emerged as a potent substitute for personal letters, bills can be paid online, and some consumers are beginning to receive bills and statements through the Internet rather than through the mail. Understanding the emergence of the Internet and its role vis-à-vis the mail is critical, therefore, in understanding First-Class Mail volume, both today and in the future.

⁵ USPS-T-7 at 45. As Mr. Thress also testifies, “the growth rate of First-Class workshared letters volume fell sharply, from 4.68 percent in 2002Q1 to 1.34 percent in 2002Q2 to 0.25 percent in 2002Q3. From there, First-Class workshared letters volume declined over the same period the previous year for four straight quarters from 2002Q4 through 2003Q3 and in six of eight quarters overall through 2004Q3.” Id. at 46. Regarding a 3.7% return to growth in GFY 2005, Mr. Thress states, “[w]hile positive, even this growth, which occurred in the absence of Postal rate increases and in the face of a fairly strong economy, was less than the growth which First-Class workshared letters experienced in the late 1990s.” Id.

USPS witness Bernstein elaborates on the reasons for the decline in First Class mail (USPS-T-8 at 3):

First-Class Mail volumes peaked at 103,526 million pieces in 2000 and remained essentially the same at 103,520 million pieces in 2001. In 2005, volume was 98,071 million pieces, a 5.3 percent decline from the level four years earlier. Since 1970, there had never before been a four-year period in which First-Class Mail volumes declined, until these past few years.

Several hypotheses have been put forward to account for this recent decline in First-Class Mail volumes, but the most reasonable explanation is that volumes have been adversely affected by a variety of technological changes that have created alternatives to the use of First-Class Mail. In fact, electronic diversion – as it is called -- has been going on for many years and it also explains why First-Class Mail volume growth slowed during the decade prior to this recent period of decline

A review of bill payment methods provides further insight into recent trends.

**Table II
Comparison Of Bill Payment Methods**

Year	By Mail	In Person	Auto Deduction	Online	Other Electronic
1990	84.00%	13.50%	2.10%	0.10%	0.30%
1991	84.80%	12.60%	2.20%	0.10%	0.40%
1992	84.30%	12.80%	2.40%	0.20%	0.40%
1993	84.50%	11.90%	3.10%	0.10%	0.40%
1994	85.00%	11.70%	2.90%	0.10%	0.40%
1995	85.50%	10.60%	3.20%	0.20%	0.50%
1996	84.40%	10.50%	4.00%	0.40%	0.70%
1997	84.80%	9.90%	4.00%	0.60%	0.70%
1998	85.10%	9.50%	4.30%	0.70%	0.60%
1999	84.40%	9.30%	4.60%	1.00%	0.60%
2000	79.40%	9.50%	7.30%	2.20%	1.60%
2001	78.40%	7.50%	7.00%	3.60%	3.50%
2002	75.00%	8.10%	8.40%	4.30%	4.30%
2003	73.50%	7.20%	8.90%	6.00%	4.30%
2004	69.30%	6.50%	9.60%	9.50%	5.10%
2005	66.60%	6.60%	10.40%	11.10%	5.20%

Source: Household Diary Study Recruitment Questionnaire

As Table II shows, sharp declines in the percentage of payments sent by mail and paid in person were matched by a phenomenal rise in payments using alternative electronic “delivery” methods.

These facts and analyses indicate that the First Class workshared market is now fully mature and that other powerful market forces, such as the rapid rise in online transactions, are eroding the preeminent position the Postal Service held for over three decades in the delivery of financial documents (account statements, bills and payment remittances).⁶ These facts respond directly to Question 1 (a) of NOI No. 3, which asks about the potential for single piece letters to convert to worksharing. The answer is that, today and for the foreseeable future, relatively few single piece letters have the potential to convert to worksharing.

From MMA’s experience, an additional reason for this phenomenon is that, especially in the last few years, workshared mailers have been able to upgrade a significant portion of their residual mail pieces that did not qualify for workshared rates. Reducing the volume of mail that has to be mailed at single piece rates has been possible due to improvements in software and procedures that are better able to resolve addresses that formerly did not meet applicable standards for workshared discounts. Ten years ago, this residual mail constituted 5% of their workshared mail; today it ranges from under 1% to 2%. In other words, MMA estimates that approximately 60-80% of these residual mail pieces have been converted from single piece to worksharing.⁷

⁶ Postmaster Potter commented on these developments in an April 3, 2006 speech before the general session of the National Postal Forum, stating “[f]inancial transactions continue to move to the Internet. Postal workload grows by 2 million addresses each year. But volume is not keeping pace. Pieces per delivery continue to fall. Single piece First-Class Mail — stamped mail — has dropped 11 billion pieces.” See, http://www.usps.com/communications/news/press/2006/pr06_pmg0403.htm

⁷ As discussed in Section V, the workshared mail market has undergone other dramatic changes since inception of workshared discounts, and especially in the last ten years. Whereas it might, at one time, been characterized by numerous workshared mailers that sent out mailings within a relatively narrow volume range, the industry has undergone fundamental changes and consolidation. Today, more than 50% of the total workshared letter volumes are sent out by a small number of very large mailers. These “UHV Mailers” produce mail pieces of the highest quality and accuracy and do *many* tasks that Postal Service employees must perform for the vast majority of low volume workshared mailings.

In sum, First Class workshared mail is no longer the cash cow it once was for the Postal Service. Nevertheless, if managed carefully, this workshared mail can still provide substantial benefits in the form of a much higher institutional cost contribution (relative to its attributable costs) than First Class single piece or any other class of mail.

The Postal Service's delinking proposal does not change that relationship. If anything, it is designed to preserve the valuable contribution that First Class workshared mail makes to the viability of the postal system over the long term.

II. Changes In The Market For Workshared Mail Cast Serious Doubt On The Continuing Validity Of The Basic Assumptions Underpinning The Existing Ratemaking Formula Based On Cost Avoidance

Question 1 (b) in NOI No. 3, asks about the potential for workshared mail to revert to single piece mail. Between the 1970s and the early part of the 1990s, the answer to this question might have been yes. Since then, answering this question has become more complicated. Today, at least for the majority of First Class workshared mail, the answer is a resounding no.

When the workshared discount was initiated and for almost two decades thereafter, mailers choices were extremely limited. Essentially, the Postal Service was the only game in town for the vast majority of First Class workshared mailers.

The advent and amazingly rapid acceptance of the Internet and email represents a sea change. The Internet and email are perfectly suited for delivery of financial statements and for bill presentation and payment, the mainstays of First Class workshared letters for the Postal Service.⁸ Some recent projections show the number of U.S. households banking online to jump from 29.6 million in 2003 to 56 million by

⁸ In an effort to provide customers with additional choices, credit card companies have also created programs that automatically accept payments over the phone. In addition, banks, utilities and other service companies have, for many years, offered automatic deposit and payment options as a convenience for their customers and a way to reduce cumbersome and expensive paper-based transactions.

2008, and the percentage of those paying bills online to increase from 50% in 2003 to 85% in 2008.⁹

MMA is not predicting the immediate demise of First Class workshared mail. Indeed, MMA members expect to continue and build upon the mutually beneficial partnerships they have forged with the Postal Service for over three decades. Use of First Class mail for delivery of financial account statements and bill presentation and payment will continue to be an important component of workshared mail because MMA members and many other workshared mailers are involved directly or indirectly in service businesses where customer choice is key.

While MMA does not expect use of First Class workshared mail to decline precipitously in the near future, the Postal Service and the Commission both have it in their power to hasten conversion of transactions now involving workshared mail to Internet, email, and other electronic-based processes. Controlling costs is an imperative for MMA members and, we believe, almost all First Class workshared mailers. Postage is just one of the costs of doing business. Mailers are not interested in why postage costs have increased generally¹⁰ or the intricacies of postal ratemaking in particular. They are concerned about what increased postage costs mean for their bottom lines. An even more important consideration is mailers' perceptions about where postage costs are likely to go. Even the perception that postage costs cannot be controlled will drive mailers' decisions to seek out, **and promote vigorously,**

⁹ See, e.g. http://www.microsoft.com/smallbusiness/resources/technology/business_software/online_bankings_best_lure_online_bill_paying.mspx. According to Pew Internet & American Life Project surveys, (1) 73% of American adults – about 147 million people – use the Internet and (2) as of March 2006, 42 % of American adults -- 84 million people -- now have fast Internet connections (broadband) at home, an increase of 40% year-over-year and twice the rate of increase between 2004-2005. http://www.pewinternet.org/trends/Internet_Activities_7.19.06.htm and <http://pewresearch.org/datatrends/?NumberID=23>. Greater acceptance of the Internet and email and build out of broadband access increases the use of online alternatives to the mail.

¹⁰ In his speech before the National Postal Forum, Postmaster General Potter stated: “this year we had to raise rates to pay for the Escrow Account of \$3.1 billion as required by law. While we had all hoped for legislative relief from the payment, it simply didn't happen.”

This is **exactly** the type of thing that workshare mailers fear – imposition of additional costs that not even the Postal Service is able to control. Such lamentable developments only serve to discourage mailers about the viability of workshare mail and encourage them to look for alternative delivery technologies that have more stable costs.

alternatives such as the Internet and email, which offer them greater control over costs. If such decisions are made, very likely they will be permanent.

Accordingly, unlike decades past, simplistic assumptions about the potential for workshared mail to revert to single piece simply are not relevant to informed ratemaking in the electronic age. If the Commission were to reduce or eliminate discounts, First Class workshared letters would revert to single piece, **but only temporarily**. Mailers, particularly UHV mailers would redouble their efforts to move these types of transactions from the Postal Service to the Internet and other less expensive alternatives. Such an unwise policy would wreak havoc on the postal system.¹¹

III. The Existing Method Of Setting First Class Workshared Rates Is Unduly Complicated and Controversial

According to the Postal Service, important benefits of its proposal to delink the rates of single piece and workshared mail include a simpler approach to ratemaking and a reduction in the controversy surrounding the existing rate setting methodology for workshared mail. USPS-T-32 at 12-13, 15. MMA applauds the Postal Service for seeking a new way to set First Class workshared rates.

Reducing controversy over competing rate design methods is not, by itself, a reason to embrace the Postal Service's delinking proposal in this case. However, the degree of controversy that the current methodology continues to generate in case after case for nearly a decade is clearly excessive.

In principle, the Commission's traditional cost avoidance methodology sounds simple and straight forward: compare the unit costs of different categories of workshared mail against the cost of a "benchmark" mail piece from single piece mail and then compute the difference. As usual, however, the devil is in the details.

There are numerous flaws in the current rate setting methodology. Chief among them are the fact that the Postal Service and, to some extent, the Commission, keep changing the playing field and moving the goal posts. Among other things, the current methodology (1) employs mail flow models of doubtful validity because they do not

¹¹ Initially, reversion of significant volumes to single piece would cause the Postal Service to increase its mail processing capacity. However, once these volumes are diverted **permanently** to less costly alternatives, such as the Internet, the Postal Service will be left with excess capacity.

accurately reflect actual costs, (2) uses a theoretical benchmark mail piece (Bulk Metered Mail or BMM) that, in practice, requires reference to the costs of other real mail pieces, such as single piece Metered Mail, because the Postal Service does not collect actual costs for BMM, and (3) involves interminable speculation and wrangling about the classification of mail processing cost pools and how they are impacted by worksharing.¹²

To these controversial issues, which cause substantial uncertainty for affected workshared mailers, must be added the Postal Service's rather bizarre approach to the setting of workshared letter rates and the Commission's willingness to indulge the Postal Service, thankfully not in all instances. In recent omnibus cases, the Postal Service has followed the unhelpful practice of creating cost studies that understate or ignore almost entirely cost savings resulting from worksharing. Then, in what apparently is intended to appear as a magnanimous gesture to workshared mailers, Postal Service rate witnesses offer up independent, largely judgmental reasons why discounts should be higher than the apparent cost savings.¹³ The Postal Service should not engage in such shenanigans. MMA and other First Class workshared mailers want a fair shake, not a handout, from the Postal Service.

Attached hereto as Appendix A, is a description of how ratemaking for First Class workshared letters has deteriorated over time. This description illustrates how ever more complicated and convoluted the ratemaking process has become, especially during the last decade. As Appendix A demonstrates, the history of workshared mail ratemaking in the last decade does not show a steadfast commitment to a core set of principles. Instead, both the Postal Service and the Commission have waffled on the specifics of their ratemaking approaches and reversed course on several crucial issues. The only consistent theme or pattern in this rate setting history is that, certainly after MC95-1, there has been a concerted effort to restrict the definition of worksharing and remove legitimate cost savings from the analyses.

¹² This litany does not include the impact of the Postal Service's proposed attributable cost methodology that the Commission has rejected on no less than four occasions.

¹³ For example, in R2001-1, the Postal Service's proposed First Class discounts produced percent passthroughs that **appeared** to range from 115% to 122% for the various non-carrier route, automation presort levels. In R2000-1, the range was from 117% to 123%.

For these reasons, efforts to invest the existing cost savings methodology with the virtues of “tradition” and “history” are misleading. As Appendix A demonstrates, there has been no consistency in the way First Class workshare rates have been designed. Accordingly, there is no foundation for the Commission’s concerns that the Postal Service’s delinking proposal will send inappropriate price signals to workshare mailers or disrupt the existing relationship between the rates for First Class workshared mail and single piece. As discussed in the next section, delinking is more likely to make those rate relationships *more* consistent over time and send accurate price signals to workshare mailers.

III. The Postal Service’s Delinking Proposal Represents a Constructive Step Forward Towards Setting First Class Workshare Rates Based On Sound Principles And Easy To Understand Data

MMA applauds the Postal Service for seizing the initiative and seeking a new, innovative and more rational method for setting rates. MMA supports, and urges the Commission to recommend, the specific First Class workshared rates proposed by the Postal Service in this case. MMA also generally supports the basic principles of the Service’s new delinking methodology by which those rates were derived.

USPS witness Altaf Taufique has explained in detail his proposal to de-link First Class workshared rates and discounts from the rates for single piece. The Postal Service’s delinking proposal consists of two parts. First, workshared discounts are determined by market-based factors as well as derived relative cost differences among the various presort levels. Second, the Service proposes to establish as a ratemaking goal setting single piece and workshared mail rates so that, in the aggregate, both categories make equal unit contributions to institutional costs.

There can be no doubt that delinking First Class workshared mail discounts from the “traditional” but problematic and unnecessarily complex method of deriving cost savings simplifies greatly the workshared rate/discount analysis. This beneficial change will provide First Class workshared mailers with a more transparent view of the rate setting process.

Delinking of workshared discounts from derived cost savings also eliminates the inherent problems and bias associated with mail flow models that attempt to compare unit costs on an absolute basis. The models used by the Postal Service are seriously

flawed because, since R2000-1, the models for Automation letters have consistently **overstated** unit costs compared to CRA-derived costs and, just as consistently, the models for BMM (the Commission's preferred the benchmark mail piece) have **understated** costs compared to the CRA-derived benchmark.¹⁴ Due to the anomalous results produced by the Postal Service's mail flow models, an additional step in the existing rate setting process requires application of "CRA adjustment factors" to true up the model derived costs.

Based on MMA's analyses, it appears that adoption of the Postal Service's delinking proposal, especially the feature that would implement rates based upon equal unit contributions to institutional costs for single piece and workshared mail, in the aggregate, will produce stable rates for the foreseeable future. In this regard, the record already shows that the unit contributions to institutional costs of First Class single piece and Presort have remained remarkably stable since at least R2000-1. See, responses of USPS witness Taufique to Interrogatories MMA/USPS-T32-2 (USPS attributable cost method) and 7 (PRC attributable cost method).¹⁵

Rate stability is very important to mailers, like MMA members, who must make multimillion dollar decisions regarding investments in new or upgraded mail facilities, computer systems, software, and mail handling equipment.¹⁶ No mailer can, or expects to, predict with 100% accuracy what postage rates will be in 5, 10 years or more, the life expectancy of many such investments. Nevertheless, the more uncertainty associated with postal ratemaking and the greater certainty associated with alternative tools such as the Internet and email, which have proven to be viable and reliable alternatives to mail with known costs and benefits, the more likely it will be that mailers opt to invest in alternative technologies and solutions.

¹⁴ Particularly troubling is the failure of the Postal Service's BMM model to accurately reflect the costs associated with the Remote Bar Code System (RBCS). The assumptions relied upon, and results calculated by, the Postal Service make no sense. See, e.g. R2001-1, Surrebuttal Testimony Of Richard E. Bentley On Behalf Of KeySpan, KE-ST-1 at 7-17.

¹⁵ See also institutional response to Interrogatory MMA/USPS-T32-7 (B).

¹⁶ For example, MMA members have invested in rapid laser printers that can accommodate high volume print jobs with a high degree of accuracy and reliability. The cost of just one printer is approximately \$ 13 million.

Finally, MMA has anticipated the Commission's concerns with delinking. Accordingly, MMA's testimony will show that, in any event, the specific rate discounts proposed in this case are significantly less than the cost savings derived by traditional methods.

IV. The Rapidly Changing Nature Of Worksharing Requires Fundamental Reform Of The Current Workshared Mail Rate Structure

In NOI No. 3, the Commission urged parties to identify and discuss "attendant issues not highlighted in the Notices of Inquiry. NOI No. 3 at 1. MMA submits that the consolidation of workshared mail volumes and the rise of "Ultra High Volume (UHV) Mailers" is the elephant in the rate setting parlor that can no longer be ignored. This is an important issue that clearly has not been addressed by the Commission. It is also an issue that is not adequately addressed by the Postal Service's delinking proposal.

The Postal Service and the Commission have focused narrowly on cost savings that result solely from specific mail preparation activities -- presorting and prebarcoding. Moreover, discounts are based on the minimum mailing size, currently 500 pieces. Workshare mailers receive **exactly** the same discounts regardless of whether their mailings consist of one **thousand** pieces or one **million** pieces. In other words, the current system of workshare discounts gives absolutely no specific recognition to increased savings realized by the Postal Service when originating mail is specially prepared and consistently presented in high volumes from one very large mailer's facility.¹⁷

Existing discounts do not reflect recent, fundamental changes in the workshared letter market. There are over 90,000 First-Class workshare mailers. R2005-1 Tr 8D/4578. In FY 2005, just **35** of all Ultra High Volume mailers accounted for **25.3 billion** First Class workshare letters.¹⁸ In other words, these 35 Ultra High Volume

¹⁷ More specifically, the current system of workshare discounts has failed to change in response to significant changes in mailing technologies and innovative mailing practices implemented in recent years. Such changes include implementation of the Merlin System, PostalOne!, tray and pallet sortations and adoption of plant loading arrangements for high volume workshare mailers. There can be no doubt that consistent high volume mailings and the consolidation of mail volumes at a few main locations are both significant cost drivers.

¹⁸ USPS Institutional response to Interrogatory MMA/USPS-2.

Mailers, who constitute only about **0.04%** of total workshare mailers account for more than **53%** of all First Class workshared letter mail.

These facts demonstrate that the workshare market is increasingly comprised of relatively few very large mailers who account for the vast bulk of the workshare mail being entered on one end of the spectrum and a very large number of small workshared mailers who send out very low volume mailings on the other end of the spectrum.¹⁹

Consistent high volume mailings matter for several reasons. First, sending out high volumes of mail requires mailers to invest in the latest, most efficient (**but very expensive**) mail preparation equipment such as advanced computers, improved software programs, printers, mail inserters, automatic scales, banding equipment, and mail moving equipment such as conveyors, fork lifts, and shrinkwrapping machinery. Using new, high tech equipment and systems leads to better quality mail pieces that are more uniform, reliable, and readable than mail pieces prepared by small volume mailers with older equipment and systems.

Second, when UHV Mailers routinely send out mail in very high volumes, the Postal Service has greater control over the mail and the mailers. Using fewer resources, the Postal Service can much more effectively enforce very complex mail design and address quality requirements with high volume mailers than it can with the multitude of low volume workshared mailers. Third, Postal Service acceptance procedures are much more efficient and less expensive when individual mailings have high volumes.²⁰

Finally, when mail is presented in very high volumes, the Postal Service can avoid several time consuming and expensive operations that Postal Service employees must perform when much smaller mailings are tendered by low volume workshared

¹⁹ In R2005-1, the Postal Service confirmed that 39% of all workshared mailings contain 1,500 or fewer pieces and account for just 2% of all volumes. Similarly, about 90% of all mailings representing just 23% of all volumes contain fewer than 25,000 pieces. R2005-1 Tr 8D/4585.

²⁰ Obviously, it is much more efficient to have one mailer tender one mailing containing 100,000 pieces than it is to have 100 small mailers tender one mailing each containing 1,000 pieces. Yet, under the current rate structure, the rates for all of these letters will be identical if the degree of presort is the same.

mailers. These operations are set forth in Appendix B.²¹ In sum, Ultra High Volume mailers are also ultra high efficiency mailers.

Unfortunately, the existing rate structure has not changed to reflect the rapid evolution in the workshared mail market. There are several inequities built into the current, outdated First-Class workshared mail rate structure. First, because the current methodology for measuring workshared cost savings are narrowly focused just on savings due to presortation and prebarcoding, high volume workshared mailers get no credit whatsoever for additional cost savings that their extra worksharing activities make possible.²² Second, the one size fits all workshared discount structure gives high volume workshared mailers no credit for the additional cost savings that result from economies of scale. Indeed, to the extent that the existing cost savings methodology does capture such additional savings, the rate structure discriminates against high volume mailers because the additional savings they generate for the Postal Service are spread over all workshared mail volumes. The rate structure simply has not kept up with the changing technologies that define worksharing operations in today's market.

NOI No. 3, suggests that the price signals sent by the existing cost savings methodology is superior because it gives workshared mailers a clear picture of the value of the worksharing they perform. Nothing could be further from the truth. Because the existing cost savings methodology improperly disregards high volume driven cost savings, small volume workshared mailers and High Volume, High Efficiency workshared mailers both receive erroneous price signals. Small volume mailers receive a signal that the worksharing they perform is worth more than it really is. Likewise, UHV Mailers and other large bulk mailers get a clear signal that the numerous additional worksharing tasks they perform provide **no** value to the Postal Service.

²¹ See, e.g. R2005-1 Tr 8D/4571, 4572-73. UHV mailers and other High Volume First-Class mailers can and do perform all of these operations. For the vast majority of smaller First-Class mailers, Postal Service employees must perform almost all of these operations. Yet **all** First-Class mailers pay the exact same rates.

²² In R2005-1, USPS witness Abdirahman admitted that his workshare cost savings analysis excludes savings that result from the enumerated activities that high volume workshare mailers routinely perform but low volume mailers do not perform. R2005-1 Tr 4/973-74, 979-83.

This is not the first time that the Commission has faced a situation where determining rates based on outmoded cost analyses produced inequitable results. In R2000-1, after much controversy,²³ the Postal Service proposed and the Commission recommended establishment of a separate fee category for High Volume QBRM, to recognize economies associated with the counting and rating of QBRM **received** in high volumes. *Postal Rate And Fee Changes*, Docket No. R2000-1, Opinion And Recommended Decision, issued November 13, 2000 at 543-44, 550. The Commission's conclusions in that case provide useful guidance for restructuring of workshared rates where mail is **sent out** in consistently high volumes:

The recommended new fee categories for QBRM will allow fees that are aligned more closely with costs than existing fee, and therefore more fair and equitable to QBRM mailers. The Commission notes that BRM volume has decreased substantially over time. This may have occurred in part because firms that would otherwise use BRM have been deterred by a non-cost based fee structure for QBRM that made its use uneconomical. Adopting a more cost-based QBRM fee structure may spur volume. Because such mail pieces are often related to bill paying, greater usage may aid the Service in staving off electronic diversion. Improvements in QBRM pricing and costing are therefore quite important, and the new structure is desirable from the point of view of both users and the Postal Service.

The Commission's observations regarding the importance of cost based rates in staving off electronic diversion are particularly relevant to the issue presented here. MMA submits that the circumstances surrounding establishment of a separate rate category for High Volume QBRM can serve as a model for re-examining the 30-year old concept of one-rate-fits-all for First-Class workshared discounts.

For these reasons, the Commission should direct the Postal Service to study all aspects of the cost sparing effects that consistently high volumes have on postal costs and propose appropriate de-averaged workshared rates for First Class workshared mail.

²³ In R87-1, the Commission faulted the Postal Service for continuing to rely upon an outdated special study of Business Reply Mail ("BRM") per piece fee costs where new, automated methods of counting and rating BRM reduced such costs. *Postal Rate And Fee Changes, 1987*, Docket No. R87-1, Opinion And Recommended Decision, issued March 4, 1988 at 791-92, 794-95.

CONCLUSIONS

1. The markets for First Class workshared mail and single piece mail are very different today than when worksharing discounts were first implemented or even a decade ago. Accordingly, simplistic notions that one type of mail is a substitute for the other because there is a potential for significant volumes of single piece mail to convert to workshared mail and that workshared mail has the potential to revert to single piece mail are no longer true or relevant to postal ratemaking in the age of viable, reliable and less expensive alternative electronic substitutes for delivery of paper statements, bills, and checks.
2. The Commission's concerns about delinking are not well founded. Delinking is likely to maintain the existing stable relationships between the price of First Class workshared mail and single piece mail, thereby giving mailers greater confidence in postal ratemaking than they have today under "traditional" complex and ever changing cost savings principles. Moreover, the record in this case will show that the specific rate discounts the Postal Service proposes using its delinking analysis are **significantly** less than the cost savings derived by traditional cost savings methods.
3. Neither the Commission's "historical" cost savings method nor delinking will cure a glaring flaw in the existing rate structure. Basing rates on cost attributes of the lowest common denominator mailings sends inaccurate price signals to First Class workshare mailers. The Commission has a duty to rectify the inequities caused by the existing rate structure.

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Examples of How the Commission's Cost Savings Methodology For First Class Workshared Letters Has Changed Over Time

Early on, the Postal Service attempted to measure workshared cost savings based on a top-down reversion method. This analysis focused on the additional costs incurred (assuming no capacity problems) if all presorted letters reverted back to single piece. The Commission repeatedly rejected this approach.

In R84-1, the Commission used the average for all ***single piece letters as the benchmark*** from which to measure workshared cost savings. The relevant costs included operational mail processing costs, including incoming secondary costs, but excluding mail preparation costs.

In R87-1, the Commission eliminated incoming secondary costs but added back in mail preparation costs.

In MC95-1 the Postal Service proposed to price workshared letters as a separate subclass. It adopted the Commission's bottoms-up approach and included all mail processing costs, including incoming secondary, all delivery costs, transportation and all other costs. All costs were reconciled to the CRA. Although the Commission rejected the subclass proposal it did consider all mail processing and delivery costs for deriving presort cost savings. It suggested that the Postal Service use BMM as the benchmark from which to measure cost savings, thereby limiting savings that result from mail preparation.

In R97-1, the Postal Service introduced a new concept for attributing costs that, among other things, reduced derived cost savings. The Postal Service continued to propose this cost attribution methodology in every case since. The Commission has rejected this approach in every case.

In R97-1, the Postal Service also proposed to classify cost pools as either proportional or fixed, a concept that the Commission accepted.

In R2000-1, the Postal Service began eliminating cost pools from consideration claiming that they were unaffected by worksharing. This concept reduced derived cost savings. The Commission accepted some of these classifications but rejected others, such as platform and mail preparation costs, that it found clearly were affected by worksharing.

In R2000-1, the Postal Service took the position that BMM incurs *zero* mail preparation costs. The Commission rejected this proposal but adjusted downward the BMM cost associated with mail preparation.

In R2001-1 and R2005-1, the Postal Service reversed course and included all mail preparation costs for BMM. The Commission did not rule on this issue because both cases were settled.

In R97-1 and again in R2000-1, the Postal Service proposed to use nonautomation letters as the benchmark from which to measure workshared delivery cost savings. The Commission accepted this proposal in both cases. Then, in R2001-1 and again in R2005-1, the Postal Service changed direction, proposing to use nonautomation machinable mixed AADC letters as the benchmark from which to measure delivery cost savings. ***This proposal eliminated almost 2 full cents from the derivation of workshared cost savings.*** The Commission made no decision on this proposal because both cases were settled.

Tasks Bulk Workshare Mailers Routinely Perform For The Postal Service But Tasks Postal Service Personnel Must Perform For Small Volume Mailers

Traying letters

- Removing old tray labels and printing and inserting new labels;
- Sleeving the trays;
- Banding the trays;
- Preparing and applying Destination and Routing (D&R) labels, including the use of PostalOne!;
- Weighing the trays;
- Postage verification, including on-site MERLIN systems;
- Electronic transmission of weight and volume data to Postal data centers, including the use of PostalOne!;
- Electronic transmissions of all postal paperwork, including the use of PostalOne!; and
- Presorting the trays of mail prior to placing them onto pallets or other containers.

Palletizing the trays

- Stacking trays onto pallets;
- Shrinkwrapping full pallets to secure trays during transport by the USPS;
- Labeling pallets; and
- Separating and presorting pallets prior to the point at which they are loaded onto trucks.

Loading mail onto trucks

- Moving full labeled pallets to the workshare mailer's loading dock;
- Loading pallets onto USPS trucks;
- Meeting USPS scheduling requirements; and
- Presorting trucks with presorted pallets.