

**BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001**

ANNUAL COMPLIANCE REPORT, 2007

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Docket No. ACR2007

**COMMENTS OF
ALLIANCE OF NONPROFIT MAILERS AND
MAGAZINE PUBLISHERS OF AMERICA, INC.,**

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January 30, 2008

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Alliance of Nonprofit Mailers (“ANM”) and Magazine Publishers of America, Inc. (“MPA”) respectfully submit these comments in response to the Commission’s notice of and request for comments on the Postal Service’s Annual Compliance Report (“ACR”) for Fiscal Year 2007. See Docket No. ACR2007, *Annual Compliance Report*, Notice of Filing of Annual Compliance Report By The Postal Service And Solicitation of Public Comment (December 31, 2007), published at 73 Fed. Reg. 1234 (2008). The Commission has requested comments on “the degree to which the Postal Service’s operations and financial results comply with the policies of title 39.” *Id.* at 1234 (col. 3). The following comments address two issues involving Periodicals mail: (1) cost coverage; and (2) workshare discounts.

As a threshold matter, however, ANM and MPA agree with the Postal Service that the “applicable provisions” of Title 39 during FY 2007 were the Postal Reorganization Act, as amended (“PRA”), not the Postal Accountability and Enhancement Act (“PAEA”). ACR at 1 & n. 1. A transition provision of PAEA, codified at 39 U.S.C. § 3622(f), specifically provided that rate cases filed within one year after enactment of PAEA “shall be completed in accordance with subchapter II of chapter 36

of [Title 39] and implementing regulations, *as in effect before the date of enactment of this section*" (emphasis added).

The rates at issue here were implemented not through the streamlined procedures established by PAEA, 39 U.S.C. § 3622(e), but in Docket No. R2006-1, a full-blown on-the-record adversarial proceeding under the traditional ratemaking standards of the PRA. At the conclusion of the record in Docket No. R2006-1, the Commission found in its opinion and recommended decision that the rates it was recommending satisfied the PRA. See, e.g., Recommended Decision (issued February 26, 2007) at 1:

The rates of postage and fees for postal services set forth in Appendix One hereof are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.

For Periodicals Mail, the Commission specifically found that the recommended rates were projected to "exceed attributable costs by a small margin, and thus are consistent with the requirement that rates cover costs." R2006-1 Op. & Rec. Decis. (Feb. 26, 2007) ¶ 5776; *accord, id.*, Appendix G, Schedule 1. The Governors implemented as consistent with the Act all of the rate changes recommended by the Commission for Periodicals Mail. Decision of the Governors dated March 19, 2007. No party sought judicial review of the Governors' decisions before the expiration of the statutory period prescribed by former 39 U.S.C. § 3628.

Moreover, nothing in the PRA requires the Commission or the Governors to reconsider or reopen their R2006-1 findings in this proceeding. The Commission and the Governors satisfied the cost coverage requirement of former 39 U.S.C. § 3622(b)(3)

by recommending and implementing rates that were *projected* to generate revenues sufficient to cover attribute costs *during the test year*. See *UPS v. USPS*, 184 F.3d 827, 831-34 (D.C. Cir. 1999) (minimum cost coverages prescribed by PRA are satisfied by test year projections, which “may or may not come to pass”). The PRA did not require that rates be “continually updated to reflect the latest, most accurate data.” *Id.* at 836.

Accordingly, the Commission’s explicit findings (and the Governors’ implicit findings) that the rates established in Docket No. R2006-1 comply with “all applicable requirements of this title,” 39 U.S.C. §§ 3652(a)(1) and 3653(b)(1), are final and unreviewable. The remainder of these comments are not meant to relitigate the reasonableness of the rates established in R2006-1, but are offered solely to provide a perspective on issues that are likely to arise in future Commission proceedings.

I. COST COVERAGE FOR PERIODICALS MAIL

In the library references to its ACR, the Postal Service reports that Periodicals Mail had a cost coverage of 83 percent in FY 2007. See USPS-LR-FY07-1, FY07CRA.xls, “CostStats.” The methodology used by the Postal Service to derive this figure, however, has understated the actual coverage ratio of Periodicals Mail in FY 2007 under the rates recommended by the Commission in Docket No. R2006-1. Moreover, even if the revenue actually received from Periodicals mail in some future fiscal year were to fall short of attributable costs, that circumstance would not render Periodicals rates unlawfully low. We discuss each point in turn.

A. The Postal Service's Calculations Have Understated The Coverage Ratio Of Periodicals Mail In FY 2007.

The FY 2007 Periodicals cost coverage reported in the Annual Compliance Report (ACR)—83 percent—significantly understates the cost coverage that actually resulted in FY 2007 from the current set of Periodicals rates during the portion of the year when the rates were in effect. The reported cost coverage also understates the coverage that will likely be achieved in FY 2008 and future years.

The current set of Periodicals rates, i.e., those recommended by the Postal Regulatory Commission in Docket No. R2006-1, did not take effect until July 15, 2007, more than 9 months into the fiscal year. Thus, the numerator of the FY 2007 cost coverage ratio reflects primarily the revenues generated by the rates recommended by the Commission in Docket No. R2005-1, not R2006-1. This fact significantly understates the cost coverage that will result from the current set of rates in two different ways.

First, in Docket No. R2006-1, the Commission recommended an 11.8 percent rate increase for Periodicals. Had these higher rates been in effect the entire fiscal year, the Periodicals cost coverage would have exceeded 90 percent—even assuming that the R2006-1 rates prompted no improvement in mail preparation at all.¹ Moreover, the Commission specifically found, as required by former 39 U.S.C. § 3622(b)(3), that the rates it was recommending would achieve a cost coverage of 100 percent in FY 2008, the actual test year used by the Postal Service and the Commission. R2006-1 Op. & Rec. Decis. (Feb. 26, 2007) ¶ 5776; *accord, id.*, Appendix G, Schedule 1.

¹ The Commission may verify the 90% value by multiplying the FY2007 cost coverage of 83% by the following ratio: $(1+11.8\%)/(1+(2.5\text{ months}/12\text{ months})\cdot 11.8\%)$.

Second, the changes in Periodicals rates implemented in Docket No. R2006-1 included significant changes in the rate design. Those changes were designed, among other objectives, to improve how Periodicals are prepared and help control Periodicals costs. As the Commission found in its initial Recommended Decision, “Periodicals mailers are extremely cost conscious, and the Commission expects that these rates will foster more efficient, less costly Periodicals mail.” R2006-1 Op. & Rec. Decis. at iv. Similarly, Chairman Blair later explained that “The five Commissioners were unanimous in their support for a refinement of Periodicals rates, which we believe will stem the tide of rising costs.”²

Because many of the new rate differentials established in Docket No. R2006-1 were designed to pass through less than 100 percent of cost differentials, R2006-1 Op. & Rec. Decis. at iv & ¶ 5765, the improvements in mail preparation expected to occur as a result of the rate changes should increase the FY 2008 Periodicals cost coverage further. Information made public since the end of R2006-1 confirm that the expected improvements are becoming a reality. For example:

- “Quebecor World initiated the Express Collation Mailing System in May 2005 in Bolingbrook, IL, near Chicago....Today, almost 900 titles participate in our ECMS program. As a result of the new rate structure and increased demand, we recently opened the program to publications printed elsewhere and already fifty publications printed by other companies participate in our program. We expect this number to increase significantly...”

² Testimony of the Honorable Dan G. Blair Before the U.S. House of Representatives Committee on Oversight and Government Reform Subcommittee on Federal Workforce, Postal Service, and the District of Columbia (October 30, 2007); accord, Dan G. Blair, Response to an editorial published in *The Boston Globe* on April 27, 2007 (April 30, 2007) (“Our decision also reflects the overall need to encourage efficient mailing practices that hold down costs to the Postal Service”).

“Quebecor World Logistics recently announced plans to significantly expand our comailing operations to meet the increased demand for these services and to bring optimized solution sets to our customers. To better service the non-Quebecor World print marketplace, we are moving into a new and larger consolidation facility and co-mail center in the Northeast by early 2008. This expansion will allow us to serve a broader spectrum of publications. Unlike some previous co-mailers, the new generation of equipment that we will begin deploying in early 2008 can process polywrapped and tabloid-sized magazines. The first two machines will be deployed into this new facility and we have agreements in place to purchase an additional 4 machines. This added capacity in the Northeast will allow us to serve additional customers and plants in this region as well as more publications that are printed elsewhere.”³

- “In 2006, [Quad Graphics has seen its] total comail volume between periodicals and catalogs was about 1 billion copies. With about 890 million copies comailed to date in 2007, we have almost reached that volume through August of this year.”⁴
- Last summer, ALG Worldwide Logistics, a third-party provider, began offering comailing and co-palletization services. In September, it announced plans to expand its offerings significantly.⁵

In addition to these developments, the Postal Service is on the verge of deploying its much-anticipated Flats Sequencing Systems (“FSS”). As explained in the Postal Service’s recent Transformation Plan (2007 Update), this deployment is a key

³ Testimony of Anita Pursley Before the U.S. House of Representatives Committee on Oversight and Government Reform Subcommittee on Federal Workforce, Postal Service, and the District of Columbia. October 30, 2007.

⁴ Testimony of Joseph Schick Before the U.S. House of Representatives Committee on Oversight and Government Reform Subcommittee on Federal Workforce, Postal Service, and the District of Columbia. October 30, 2007.

⁵ *ALG Connect* newsletter (June 1, 2007), (downloaded from www.algworldwide.com/boilerplate/newsletters/connect_2007/issues/06_01_07_letter); ALG Worldwide Press Release. “ALG to Deliver More Innovative Logistics Solutions with New Expansion” (September 27, 2007).

component of USPS efficiency improvement efforts.⁶ Rollout of the FSS will significantly decrease the cost of processing flats (the mailpiece shape of essentially all Periodicals class mail) by replacing the manual casing of flats to delivery point sequence (“DPS”) with automated sorting:

The remaining two-thirds of planned [2008] savings will come from process improvements. Most letter operations have been successfully automated; however, 40 percent of flat mail is still processed manually. Deployment of the Flats Sequencing System (FSS), starting in 2008, promises to bring efficiency gains to flat mail similar to those achieved by sequencing letters. Increased standardization will support the capture of savings from FSS and from multiple other initiatives.

* * *

The FSS will sort flats into delivery sequence at high speeds and at a much higher productivity than today’s manual process. Prior to roll-out of the production systems, a pre-production FSS has been installed. This integrated end-to-end system consists of several major components. Combined, these various components can sequence flat mail at 16,500 pieces per hour. The FSS is equipped with a self-contained staging and material handling system. At the end of pass-one sorting an automatic sweep occurs and all trays are returned to the feed area in correct order for immediate pass-two sequencing. At the end of the run, mail is automatically swept, placed into street trays, and discharged onto mail transport equipment that will be dispatched to the dock, and ultimately loaded onto trucks destined for delivery units.⁷

Further, the Commission estimated in R2006-1 that several USPS cost reduction initiatives would reduce FY 2008 Periodicals costs by \$45 million. R2006-1, PRC-LR-3, fy07ar_prcfinal_auxCR.xls, “Seg24”. In addition, management efforts taken in response

⁶ “The Flats Sequencing System, which begins deployment this year, is also a key focus.” Transformation Plan (2007 Update), Letter From Postmaster General/CEO Potter and Board of Governors Chairman Miller.

⁷ Transformation Plan (2007 Update) at 15 & 21.

to a recent audit report of the Postal Service Office of Inspector General (“OIG”) regarding enhancements to the AFSM 100 Automated Induction (“AI”)/Automated Tray Handling System (“ATHS”) will allow the Postal Service to capture savings in FY 2008 than were not previously captured. USPS OIG Report DA-AR-07-005, *Automated Flat Sorting Machine 100 Enhancements* (September 10, 2007). Specifically, in response to OIG concerns that increased mail preparation costs have offset some of the savings from AFSM 100 enhancements, the Postal Service committed to corrective actions to resolve the issue. *Id.* at 18.

In response to the OIG’s recommendation that the Vice President, Network Operations, emphasize “use of established methods for effective machine operation and staffing to plant managers,” the Postal Service offered the following management response (*id.*):

Management Response: We agree with the emphasis of using established methods for effective machine operations and staffing and will continue to reinforce established methods and staffing requirements with the plant managers. We currently have a standardization guide for Ai/ATHS operations and a certification process in place that requires use of the proper methods and staffing in order to meet the certification criteria. These documents have been disseminated to the field.

We also message to the field every month the actual operational performance (throughput, machine utilization and mail prep work hours) of every Ai/ATHS plant in the network and publish those sites that have complied with the standardized requirements and met all the certification criteria.

Likewise, in response to the OIG's recommendation that the Postal Service establish "plans to reduce mail preparation by an average of 19.3 work hours per machine, per day," the Postal Service offered the following management response (*id.*):

Management Response: We agree with this recommendation as well and believe the efforts described in our response to the first recommendation will effectively address the objectives summarized in this second recommendation. We are also preparing a service talk for all AFSM 100 Supervisors, Distribution Operations (SDOs) as well as Managers, Distribution Operations (MDOs) on how best to manage the Ai mail prep operation. A site cannot become certified without limiting mail prep work hours to not exceed 70 hours per day, while maintaining a machine utilization of 200,000 pieces fed per day.

For all of these reasons, the actual cost coverage of Periodicals class mail since the implementation of the R2006-1 rate changes, and the cost coverage going forward, are likely to be well above 83 percent.

B. Even A Cost Coverage Below 100 Percent Would Not Warrant A Finding That Periodicals Class Rates Violate The Act.

Periodicals rates would not be unlawfully low under PAEA even if the revenue actually received from Periodicals class mail in some future year failed to cover attributable costs. PAEA does not allow the Commission to impose rate increases that exceed the CPI-based adjustment index established by 39 U.S.C. § 3622(d) merely because Periodicals rates would otherwise fail to cover attributable costs. As previously explained by MPA and other parties in Docket No. RM2007-1, the language, legislative

history, and economic policies of Section 3622(d) preclude the Commission from allowing the attributable cost floor to trump the rate cap for individual classes of mail.⁸

To be sure, it would be reasonable for the Commission to require that a class of mail which fails to recover attributable cost take the full amount of the CPI-based and banked increase authority. As ANM and MPA noted in their April 6, 2007, comments in Docket No. RM2007-1, the Postal Service (or, under procedures authorized by the Act, the Commission) may continue to increase the rates for a class that fails to cover attributable costs by the full amount of the CPI until full coverage of attribute costs is attained. This interpretation of the statute harmonizes the rate cap provisions of § 3622(d)(1) and the attributable cost factor of § 3622(c)(2) by giving effect to both, and without frustrating the intent of Congress.

II. THE PASS-THROUGH OF COST SAVINGS UNDERLYING CARRIER ROUTE DISCOUNTS FOR PERIODICALS MAIL.

In its initial ACR filing (which attempts to follow strictly the PRC's R2006-1 methodology), the Postal Service estimates that the pass-through of cost savings underlying the Carrier Route discounts for Periodicals Mail was nearly 140 percent in FY 2007. See USPS-FY07-LR-3, Worksharing Discount Table – Final – 1227.xls, “Periodicals Outside County”, cell G12. Even if the Postal Service obtained similar results in future fiscal years, however, a narrowing of the discounts would be unwarranted. The 140 percent pass-through ratio is an artifact of unrealistically low cost

⁸ Docket No. RM2007-1, ANM-MPA comments (April 6, 2007) at 2-10; *id.*, ANM-MPA comments (May 7, 2007) at 2-3; *accord, id.*, ABM comments (April 6, 2007) at 3-4; *id.*, NNA comments (April 6, 2007) at 3-10; USPS comments (April 6, 2007) at 22-23.

avoidance estimates. Substituting more accurate cost avoidance estimates demonstrates that the pass-through is well below 100 percent.⁹

This section of our comments explains two adjustments that should be made to the cost avoidance estimates originally presented by the Postal Service in the ACR. The first adjustment relates to the proxy used for estimating the delivery costs avoided by Carrier Route Basic Periodicals and the second relates to the treatment of allied piece costs. When these two adjustments are made – to produce a more accurate estimate of avoided costs – the Carrier Route Basic pass-through is below 100 percent.

In addition, this section discusses and approximates the impact that excluding costs associated with mail preparation for the AFSM 100 ATHS/AI, i.e., Code 140 costs, has on the Carrier Route Basic cost avoidance. ANM and MPA strongly recommend that the Postal Service include these costs in future revisions of its cost avoidance model.

A. Changes That Should Be Made Immediately To The Periodicals Cost Model.

Below, ANM and MPA explain two adjustments that should be made to the FY 2007 Periodicals cost model filed in the ACR. Making these two adjustments increases the Carrier Route Basic cost avoidance to 11.4 cents¹⁰ and reduces the associated

⁹ For future compliance review proceedings, it should be noted that 39 U.S.C. § 3622(e)(2)(C) specifically exempts mail “consisting exclusively of mail matter of educational, cultural, scientific, or informational value” from the statutory limits imposed by § 3622(e) on worksharing discounts. See R2000-1 PRC Op. & Rec. Decis. ¶ 5573 (noting that ECSI value is a defining attribute of Periodicals mail).

¹⁰ The 11.4 cents is comprised of an 8.56-cent direct and allied piece cost avoidance between machinable/nonbarcoded 5-Digit and machinable/nonbarcoded Carrier Route flats (USPS-LR-FY07-11, PER OC flats 07ACRv011608 errata.xls, “Summary”, E14

pass-through to 93 percent. Including Code 140 costs in the cost model (as discussed further below) will further increase the Carrier Route Basic cost avoidance and reduce the pass-through.

1. Use of a Standard Mail proxy to estimate unit delivery costs.

Ideally, the delivery costs avoided by Periodicals Carrier Route Basic flats relative to non-Carrier Route flats would be estimated using Periodicals delivery cost data by presort level. However, for the reasons discussed at the technical conference held at the Commission on January 23, 2008, such data are not available. Thus, the delivery cost avoided by Carrier Route Basic flats must be estimated using a proxy.

The traditional approach adopted in Docket No. R97-1, R2000-1, and R2001-1 was to use the delivery cost difference between Standard Mail Regular and Standard Mail Enhanced Carrier Route (“ECR”) Basic as a proxy.¹¹ This approach should be used for the ACR because the approach properly isolates the costs avoided by presorting to Carrier Route by comparing mail pieces among which the primary difference is whether they were presorted to Carrier Route.

minus E15) and a 2.886-cent delivery cost difference estimated by comparing the costs of Standard Mail Regular and Standard Mail ECR Basic flats (USPS-LR-FY07-19, UDCmodel071211.xls, “1. Table 1,” C72 minus G77).

¹¹ See January 20, 2008 comments of Robert W. Mitchell on Carrier Cost Differences Suited to be Part of the Basis for the Carrier-Route Discount in Periodicals, With Particular Reference to the Annual Compliance Review. Please note that Docket No. R2005-1 was settled, and the settling parties stipulated that their consent to the R2005-1 rates would not bar them in future cases from challenging the costing assumptions underlying those rates. Docket No. R2005-1, Stipulation and Agreement filed July 22, 2005, at ¶¶ 12-13.

In contrast, the Postal Service estimated these avoided costs in its initial ACR report by relying on the delivery cost difference between all Periodicals flats and Standard Mail ECR Basic flats as the cost proxy.¹² Use of this proxy, however, does not properly isolate the costs avoided by presorting to Carrier Route. See USPS-LR-FY07-4, 07 Periodicals BD 1-22-08.xls. Approximately half of all Periodicals are presorted to Carrier Route. A category of mail in which half the pieces have been presort to the carrier route level obviously understates the costs of flat-shaped mail which has received no carrier route presorting at all.¹³

2. Inclusion of all piece-related cost avoidances (both direct and allied)

As discussed during the January 11 and 23 technical conferences, the Postal Service excluded allied piece costs when calculating the costs avoided by presorting in USPS-LR-FY07-3. These allied piece costs omitted by this assumption involve the costs of operations such as moving pieces between piece-sorting operations and loading containers of pieces onto trucks for transportation after the pieces have been

¹² At the January 23 technical conference, the Postal Service stated that it used this proxy to be consistent with the Commission's Docket No. R2006-1 methodology. The Postal Service expressed support, however, for using the delivery cost difference between Standard Mail Regular and Standard Mail ECR Basic as the proxy for the Periodicals Carrier Route Basic delivery cost avoidance. The Postal Service confirmed its preference for the "traditional" approach in its January 28 "Notice of Filing Additional Materials Requested at the January 23, 2008 Technical Conference on Periodicals Costs."

¹³ Further, comparing costs for Periodicals flats to those for Standard Mail flats is not an apples-to-apples comparison. For example, service standards and average weight per piece differ between Periodicals and Standard Mail flats.

sorted by the Postal Service.¹⁴ Excluding these costs is inappropriate when estimating the costs avoided by presorting.

First, excluding allied costs is inconsistent with the general cost avoidance approach used by the Commission in Docket No. R2006-1 to estimate presort and prebarcoding cost avoidances. Specifically, in Docket No. R2006-1, the Commission included allied costs in First-Class Mail and Standard Mail worksharing cost avoidances by treating allied cost pools as piggyback cost pools in the CRA adjustment, i.e., worksharing-related proportional to the same extent as all direct cost pools. See R2006-1, PRC-LR-12, FCM Letters Costs Final.xls, “CRA-Presort Letters” and FCM Flats Cost Final.xls, “CRA Presort Flats”; PRC-LR-15, PRC StdReg Letters Costs.xls, “CRA – Prescott Letters” and PRC StdReg Flats Costs.xls, “CRA Flats”.¹⁵

While the approach for incorporating allied costs into worksharing cost avoidances is different for Periodicals – involving explicit models rather than piggybacking – the Commission’s logic for including allied cost avoidances in the First-Class Mail and Standard Mail applies equally to Periodicals:

In the letter mail processing cost model, the Commission assigns the letter sorting cost pools as proportional, consistent with the Postal Service and intervenors. The pools that witness Buc assigns as fixed are assigned as either worksharing-related fixed or non-worksharing related, as appropriate. The remaining costs, which are largely allied and support

¹⁴ All of the allied piece operations can be seen in the cost models on worksheets “MADC”, “ADC”, “3D”, and “5D” in USPS-LR-FY07-11, PER OC flats 07ACRv011608 errata.xls.

¹⁵ As discussed at the January 11 and 23 technical conferences, no CRA adjustment was used for Periodicals piece costs in Docket No. R2006-1, an omission due primarily to the complexities of the cost model. Thus, there was no opportunity to include allied costs through a CRA adjustment to Periodicals piece costs.

costs, are distributed to the three groups in the same proportions as the directly assigned pools. The allied and support pools support all mail processing operations, and so it is reasonable to assume that they are affected by worksharing to the same extent as the proportional and fixed operations they support.

R2006-1 Op. & Rec. Decis. ¶ 5161 (footnotes omitted.)

The second reason for including allied piece-related costs is to ensure that the Periodicals cost model is internally consistent. Without this change, the same activity (e.g., unloading a container of Periodicals at the delivery unit) will be included in the model for some mail preparations, but not others. This, of course, would be inappropriate.

An example of how the model incorporates the cost for unloading containers at the destination delivery unit (DDU) may help illustrate why excluding allied piece-related costs leads to internal inconsistencies.

- For a piece in a Carrier Route bundle on a 5-Digit pallet, the Periodicals cost model includes the cost for unloading the 5-Digit pallet at the DDU as part of the cost of the 5-Digit pallet, which forms the basis of the container charge for a 5-Digit pallet.¹⁶
- For a piece in a 5-Digit bundle, the Periodicals cost model includes the cost of unloading the Postal Service container (into which this piece was sorted at the destination plant) is included in the model as an allied piece cost.¹⁷

¹⁶ USPS-LR-FY07-11, PER OC flats 07ACRv011608 errata.xls, "Pallet Costs", cell X30.

¹⁷ See, e.g., USPS-LR-FY07-11, PER OC flats 07ACRv011608 errata.xls, "5D", row 180.

Thus, excluding allied piece cost avoidances from consideration when setting discounts would result in these unloading costs to be considered for one mail preparation (in this case, 5-Digit pallets), but ignoring them for all other mail preparations. In this example, this inappropriately understates the cost avoided by entering mail on 5-Digit pallets.¹⁸

Finally, the impact of excluding allied piece-related costs is significant. As Table 2 below shows, the effect of the exclusion is to understate the mail processing cost avoidance for three presort levels by at least two cents.

**Table 1.
Allied Piece Costs and Cost Avoidances by Presort Level
for Nonbarcoded, Machinable Pieces**

Presort Level	Allied Piece Cost	Allied Cost Avoidance
	[1]	[2]
Mixed ADC	\$0.081	n/a
ADC	\$0.060	\$0.021
3-Digit	\$0.049	\$0.010
5-Digit	\$0.021	\$0.029
Carrier Route	\$0.001	\$0.020

[1] USPS-LR-FY07-11, PER OC flats 07ACRv011608 errata.xls, "Summary", cells E40 through E44

[2] Calculated by subtracting Allied Piece cost [1] for presort level from that for previous presort level

B. In Future Compliance Reports, AFSM 100 ATHS/AI Mail Preparation Costs Should Be Incorporated In The Cost Avoidance Model

As discussed in the preliminary comments of Halstein Stralberg,¹⁹ Postal Service employees spent approximately 8.5 million work hours clocked into the AFSM 100

¹⁸ For more detail on this example, see the January 20 Further Comments of Halstein Stralberg on the USPS Filing of FY2007 Annual Compliance Review Data.

¹⁹ See Preliminary Comments Made Available at January 11 Technical Conference.

ATHS/AI Mail Preparation MODS Operation (MODS Operation Code 140). The time spent in this operation is close to the 9.8 million hours that were spent in direct AFSM 100 operations.²⁰

Despite the large number of work hours in operation 140, the Periodicals cost model completely ignores them for purposes of determining cost avoidances: the Code 140 work hours are neither included in the calculation of AFSM 100 productivities²¹ nor are the Code 140 costs distributed to rate category in the same manner as Code “035” Flats Preparation costs.²² The Postal Service should study how these costs are incurred and incorporate them into the next revision of the Periodicals cost model.

In the interim, excluding these costs from the Periodicals cost model clearly understates presort cost avoidances in general and the Carrier Route Basic cost avoidance in particular. ANM and MPA have estimated upper and lower bounds on the effect of excluding these work hours from the Periodicals cost model on the Carrier Route Basic cost avoidance by analyzing two scenarios.

²⁰ These work hour figures can be found in USPS-LR-FY07-7, USPS-FY07-7.Part1.xls, “I-2B. CPool Hrs by Ops&LDC-MODS”, cells D198 and D389

²¹ This can be seen by comparing the AFSM 100 work hour data in USPS-LR-FY07-23, Yrscrub2007.xls, cells H29 through H52 to the direct AFSM 100 work hours in USPS-LR-FY07-7, USPS-FY07-7.Part1.xls, “I-2B. CPool Hrs by Ops&LDC-MODS”, cell D198. The sum of all AFSM 100 work hour data – 9.3 million work hours in Yrscrub2007.xls -- is slightly less than the direct AFSM 100 work hours in USPS-LR-FY07-7. The slight discrepancy between the data sets is due to a small amount of data was scrubbed from the MODS data set used to calculate productivities.

²² USPS-LR-FY07-7, Preface.Part.2.USPS-FY07-7.Tables.xls makes clear that Code 140 costs are included in the AFSM 100, rather than the Flats Preparation, cost pool in the Cost and Revenue Analysis. Thus, these costs are not distributed in the Periodicals Cost Model like other “035” Flats Preparation costs.

The first scenario treats the Code 140 work hours as direct AFSM 100 work hours for determining the AFSM 100 productivity. Including these work hours in the productivity calculations lowers the average AFSM 100 productivity to approximately 1,650 total pieces fed (“TFP”) per hour.²³ To analyze the impact of this scenario on cost avoidances, we adjusted the average AFSM 100 productivities in the model to 1,650 TFP per hour.

The second scenario treats these work hours as Flats Preparation costs. To analyze this scenario, we first determined the unit Code 140 costs. To do this, we split the 2.23-cent unit cost in the AFSM 100 cost pool²⁴ into direct AFSM 100 cost pool and Code 140 costs based upon the percentage of work hours in the two operations. Using this method resulted in a unit Code 140 cost of approximately one cent per piece.²⁵ To analyze the impact of this scenario, ANM and MPA transferred the Code 140 costs from the AFSM 100 cost pool to the Flats Preparation cost pool, thus treating Code 140 costs in the same manner as Flats Preparation costs.

As Table 2 below shows, both of these “bounding” approaches for incorporating the Code 140 significantly increase the Carrier Route Basic cost avoidance, suggesting that the pass-through underlying the Carrier Route Basic discounts is significantly less than 100 percent:

²³ This was calculated by dividing the AFSM 100 TPF (29.4 billion) from USPS-LR-FY07-23, Yrscrub2007 by the sum of AFSM 100 direct (9.3 million from Yrscrub2007.xls) and Code 140 (8.5 million from USPS-LR-FY07-07) workhours. This approach may slightly understate productivity because Code 140 work hours have not been scrubbed while the other two figures have been.

²⁴ USPS-LR-FY07-11, PER OC flats 07ACRv011608 errata.xls, “CRA Flats”, cell F15.

²⁵ $2.23 \text{ cents} * 8.5 \text{ million Code 140 work hours} / (8.5 \text{ million Code 140 workhours} + 9.8 \text{ million direct AFSM 100 workhours})$

**Table 2.
Carrier Route Basic Cost Avoidance, Discount, and
Pass-through by Scenario**

Scenario		Mail Processing²⁶	Delivery	Total	FY 2007 Discount	Pass-through
Baseline	[1]	\$0.086	\$0.029	\$0.114	\$0.107	93%
Scenario 1	[2]	\$0.094	\$0.029	\$0.122	\$0.107	87%
Scenario 2	[3]	\$0.104	\$0.029	\$0.133	\$0.107	80%

[1] MP cost avoidance includes Allied and Direct Piece Costs; delivery costs calculated using "traditional" approach.

[2] Same as [1] except average AFSM 100 productivity reduced to 1,650.

[3] Same as [1] except one-cent transferred from AFSM 100 cost pool to Flats Preparation cost pool.

²⁶ All mail processing cost avoidances in Table 2 were calculated by subtracting the unit cost in cell E15 in USPS-LR-FY07-11, PER OC flats 07ACRv011608.xls, "Summary" from the unit cost in cell E14 of the same worksheet.

CONCLUSION

For the foregoing reasons, ANM and MPA respectfully requests that the Commission: (1) find that the Periodicals rates established in R2006-1 were and are in compliance with “all applicable requirements” of Title 39 in Fiscal Year 2007; and (2) consider the other points raised by ANM and MPA in future compliance review cases or other proceedings.

Respectfully submitted,

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January 30, 2008

DECLARATION OF SANDER GLICK

My name is Sander Glick. I am Vice-President and co-founder of SLS Consulting, Inc., a consulting firm in Washington, D.C., that specializes in postal economics. I have testified before the Commission in several previous rate cases, including Docket No. R2006-1.

The revenue and cost analyses in the above Comments were prepared by me.

I declare under penalties of perjury that the foregoing is true and correct.

/s/

Sander A. Glick

January 30, 2008