

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

**Annual Compliance Report**

**Docket No. ACR2007**

**Initial Comments  
Of  
Major Mailers Association**

In accordance with the procedures adopted in the Postal Regulatory Commission's (Commission or PRC) December 31, 2007 Notice in this proceeding,<sup>1</sup> Major Mailers Association (MMA) hereby submits its Initial Comments on issues relating to the Postal Service's December 28, 2007 Annual Compliance Report for Fiscal Year (FY) 2007 (ACR), as required by the Postal Accountability and Enhancement Act of 2006 (PAEA).<sup>2</sup> In addition to these Initial Comments, MMA is submitting analyses that contain materials relating to the derivation of First Class workshare cost savings. These analyses, which are identified as Attachment I, MMA-FY07 1 FCM Cost Savings and MMA-FY07-2 FCM Delivery Cost Savings, were prepared for MMA by its technical consultant, Mr. Richard E. Bentley.<sup>3</sup>

MMA's comments are focused specifically on the development of appropriate first class workshare cost savings. It is imperative that, in implementing PAEA, the Commission establish a sound theoretical and factual foundation for accurately measuring the full cost savings that the Postal Service enjoys as a result of the First Class workshare mailer program. Unfortunately, the workshare cost savings developed by the Postal Service in its 2007 ACR Report are inadequate to the task and flawed in at least two important respects.

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<sup>1</sup> *Annual Compliance Report*, Docket No. ACR2007, "Notice Of Filing Of Annual Compliance Report By The Postal Service And Solicitation Of Public Comment," issued December 31, 2007 (December 31 Notice).

<sup>2</sup> Pub. L. No. 109-435, 120 Stat. 3198 (December 20, 2006).

<sup>3</sup> Mr. Bentley has extensive experience in postal affairs. Since 1976, Mr. Bentley has testified as an expert witness in numerous omnibus rate proceedings, including most recently R2006-1, the final omnibus rate proceeding under the Postal Reorganization Act of 1970.

## **MMA's Operations And Interests In This Proceeding**

MMA members are among the very largest mailers of bulk First Class workshared mail. MMA members typically have invested hundreds of millions of dollars in facilities, equipment, and ongoing employee training to establish, maintain, and improve their high volume mailing operation. In order to prepare 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.<sup>4</sup> As a result, these mailers produce the highest quality, most accurate mail pieces in the industry, which are also the most efficient to process and deliver. 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 handling and transportation costs for the Postal Service by streamlining the mail acceptance process and routing high volume mailings to the USPS-assigned transportation mode. Other addressing and mail preparation requirements drive MMA members constantly to invest in the latest computer and postal equipment to assure their operations are as efficient as possible **for the benefit of the Postal Service**. Finally, several MMA member companies are participating with the Postal Service in Pilot Programs to test and refine the standards for the Intelligent Mail Barcode initiative.

MMA workshare mailers want a rate setting process that incorporates the following essential elements:

postal rates that recognize and give them full credit for all the cost sparing attributes of their high quality mail pieces and consistent, very high volume mailings, including costs avoided by the Postal Service from reduced handling and transportation expenses;

reasonable assurances that workshared mail rates are designed using rational, transparent and consistent ratemaking policies;

rate stability and predictability so that they can plan and conduct their business affairs with a reasonable degree of certainty.

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<sup>4</sup> 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.

Conceptually, it is easy to describe the methods and procedures that must be used to analyze the reasonableness of existing workshared discounts and any proposed changes in those discounts. First, the methodology for determining workshared discounts should be as simple and straightforward as possible. Second, workshare discounts should be based on readily available, verifiable actual data to the greatest extent possible. Third, if it is necessary to resort to theoretical mail flow models, all assumptions employed in the modeling process should be clearly spelled out, internally consistent, and produce reasonable results. Finally, to the extent that there are differences between the resulting conclusions of the theoretical models and actual cost data, the Commission needs to employ reasonable methods for reconciling theoretical results and conclusions to actual data.

Unfortunately, this methodology has been anything but straightforward. Derivation of workshared cost savings involves a complicated, interrelated set of numerous separate decisions that combine the results of actual data from the Postal Service's Cost and Revenue Analysis (CRA) system with theoretical constructs such as the Postal Service's mail flow models. Further, in several key areas the existing methodology either distorts or completely disregards significant actual data in favor of theoretical results produced by mail flow models that are demonstrably flawed. Finally, the results produced by this method defy logic and are internally inconsistent. As the Commission well knows, almost all of the elements of this rate setting procedure have been subject to significant controversy in one omnibus case after another under the Postal Reorganization Act of 1970 (PRA).

### **Comments**

In its first ACR Report, the Postal Service has calculated cost savings for workshare discounts that were in effect during the 2007 Postal Fiscal Year (PFY), as required by PAEA § 3652(b). The ACR Report includes the following workshare cost savings for First Class letters:

**Table 1**  
**Summary of USPS Derived Workshared Cost Savings**  
**(Cents)**

<b>First-Class Workshared Category</b>	<b>Mail Processing Cost Savings</b>	<b>Delivery Cost Savings</b>	<b>Total Workshared Cost Savings</b>
NonAuto Mach (All Presort Levels)	5.11	0.07	<b>5.19</b>
Auto Mixed AADC	5.20	-0.14	<b>5.06</b>
Auto AADC	6.81	0.09	<b>6.90</b>
Auto 3-Digit	7.24	0.13	<b>7.37</b>
Auto 5-Digit	9.22	0.28	<b>9.50</b>

Source: USPS-FY07-10 FCM Letters Cost, tab "NEW SUMMARY"

Table 2 compares the Postal Service's total derived 2007 PFY workshare cost savings (rounded to the nearest tenth of a cent) with the currently effective workshare discounts prescribed in R2006-1.

**Table 2**  
**Comparison of Current Discounts to USPS Derived Workshared Cost Savings**  
**(Cents)**

<b>First-Class Workshared Category</b>	<b>Current Discounts</b>	<b>USPS Cost Savings</b>	<b>% Passthrough</b>
NonAuto Mach (All Presort Levels)	3.7	5.2	71%
Auto Mixed AADC	5.0	5.1	99%
Auto AADC	6.9	6.9	100%
Auto 3-Digit	7.6	7.4	103%
Auto 5-Digit	9.8	9.5	103%

Source: MMA-FY07-1, page 2

As Table 2 shows, the current discounts for Auto 3-Digit and 5-Digit letters **appear** to pass through more than the corresponding PFY 2007 cost savings (albeit by a very modest 3%); the remaining discounts are equal to or lower than the 100% level. Based solely on this bare comparison, some might conclude that the current workshare discounts are not strictly consistent with the 100% passthrough limitation of PAEA. Such a conclusion would not be warranted for several reasons. Indeed, as discussed in Sections II A and B, *infra*, when two very obvious errors in application of the Commission's R2006-1 methodology are corrected, the total cost savings are higher than those derived by the Postal Service's rote application of R2006-1 workshare cost savings methodology. The corrected results are shown in Table 3.

**Table 3**  
**Comparison of USPS and Corrected Total Cost Savings**  
**(Cents)**

<b>First-Class Workshared Category</b>	<b>USPS</b>	<b>Corrected</b>	<b>Change</b>
NonAuto Mach (All Presort Levels)	5.19	0.35	-4.84
Auto Mixed AADC	5.06	5.94	0.88
Auto AADC	6.90	7.67	0.77
Auto 3-Digit	7.37	8.12	0.74
Auto 5-Digit	9.50	10.17	0.67

Source: MMA-FY07-1, page 1

Table 4 shows that the current level of discounts is significantly below the derived cost savings when the methodology is corrected for obvious errors.

**Table 4**  
**Comparison of Current Discounts to Corrected Workshared Cost Savings**  
**(Cents)**

<b>First-Class Workshared Category</b>	<b>Current Discounts</b>	<b>Corrected Cost Savings</b>	<b>% Passthrough</b>
NonAuto Mach (All Presort Levels)	3.7	0.3	1060%
Auto Mixed AADC	5.0	5.9	84%
Auto AADC	6.9	7.7	90%
Auto 3-Digit	7.6	8.1	94%
Auto 5-Digit	9.8	10.2	96%

Source: MMA-FY07-1, page 2

**I. General Considerations**

There are several reasons for questioning the validity and usefulness of the comparisons in Table 2. In the December 31 Notice, the Commission recognized that the context in which the Postal Service's 2007 ACR filing was made is unique. As the Commission stated (December 31 Notice at 2-3 (emphasis added)):

The context in which the Postal Service has filed its annual report for FY 2007 is unique in several respects. It is the first compliance report that the Postal Service has filed after passage of the Postal Accountability and Enhancement Act of 2006 (PAEA). Fiscal Year 2007 was a transition period during which the rate-setting criteria of the former Postal Reorganization Act (PRA) remained in force. The Postal Service suggests that FY 2007 rates and service should be analyzed for compliance with the rate-setting criteria of the PRA rather than the PAEA. *Id.* at 1. In its report, the Postal Service applies the rate-setting criteria of the PRA to the then-existing subclasses and concludes that FY 2007 rates and service fully complied with title 39. *Id.* at 6 and 22. ***Emphasizing the difficulty of developing a crosswalk between then-existing subclasses and the current list of products, the***

***Postal Service does not offer conclusions regarding the extent workshare discounts in effect in FY 2007 comply with the criteria of either the PRA or the PAEA. Id. at 19-22.***

MMA certainly agrees that the circumstances of this first ACR proceeding are unique. The time period covered by the ACR filing – Postal Fiscal Year (PFY) 2007 – is indeed a transition year. In R2006-1, which we now know was the last omnibus rate case filed under the PRA standards, the Base Year was PFY 2005 and the Test Year (TY) was PFY 2008. The R2006-1 rates, including First Class workshare discounts, were based upon projected revenues, costs and volumes for TY 2008. In contrast, the workshare cost savings derived in the ACR Report are based upon actual PFY 2007 data.

Furthermore, during PFY 2007 two different sets of rates were in effect. During the period October 1, 2006 through May 13, 2007, the settlement rates from R2005-1 were in effect. During the remainder of PFY 2007, the rates prescribed by the Commission in the litigated R2006-1 case were in effect. As a result, any comparison of the R2006-1 workshare discounts with cost savings derived from PFY 2007 data is, of necessity, an apples to oranges comparison.

The job of making any meaningful comparison between the R2006-1 workshare discounts and 2007 PFY cost savings is further complicated by changes that the Postal Service made in the model inputs and other factors that bear upon the derivation of workshare cost savings. The first three tabs of Attachment I catalog several material input value changes that MMA has been able to identify in the short time allotted to review of the ACR Report. There *may* be rational reasons for these changes but MMA has not been able to assess whether the changes are reasonable because the ACR Report does not provide *any* explanation for most of these changes.

The final tab of Attachment I is an analysis that calculates the full net effect of the Postal Service's numerous input changes and compares it with the results of using the inputs that the Commission used in R2006-1. Table 5 summarizes the results of that analysis.

**Table 5**  
**Comparison of First-Class Workshare Cost Savings With**  
**And Without Updated Input Variables**  
**(Cents)**

First Class Letter Category	Derived Workshare Cost Savings		
	USPS	R2006-1 PRC With FY07 Wages	Change
BMM (Benchmark)			
NonAutomation	5.19	5.58	-0.40
Auto MAADC	5.06	4.96	0.11
Auto AADC	6.90	6.85	0.05
Auto 3-Digit	7.37	7.55	-0.17
Auto 5-Digit	9.50	9.70	-0.20
CRA Proportional Adj Factor	1.616	1.383	0.233

Source: Attachment I

Some of the changes that the Postal Service made in the ACR Report reduce workshare cost savings; other changes have the opposite effect. However, as Table 5 shows, the net effect of these changes is a material reduction in workshare cost savings for 3-Digit and 5-Digit, the two categories that make up almost 90% of total Automation letter volumes. Put another way, if the Postal Service had not made any changes, the derived cost savings would have been higher.

For MMA, and we hope the Commission, this first ACR Report brings several important considerations into sharper focus. First, the extremely tight timeframe allowed for completion of an ACR proceeding does not give affected mailers or the Commission an adequate opportunity to review numerous proposed changes in depth, consider and test the reasons for the change, reach a decision whether each change is reasonable, and make a case for or against the changes.. The task before mailers and the Commission is doubly hard where, as here, the Postal Service has provided no explanation, much less a thorough explanation and sufficient supporting information.

To be sure, the Postal Service *and mailers* should be afforded an opportunity to propose changes in the methodology for measuring workshare cost savings. But annual ACR and CPI-U rate increase proceedings are not appropriate forums for this purpose.

Second, whenever the Postal Service makes changes like the ones proposed here, it must be required to provide a reasonable explanation for each change and provide supporting documentation for review by the Commission and affected mailers. In addition, procedural and substantive due process requires that interested parties must be given an adequate opportunity to test the proposed changes and present their views for consideration by the Commission. Obviously, specific procedures will depend upon the nature, extent and potential impact on mailers and the postal system.

In view of these facts, MMA generally agrees with the Postal Service that the Commission should apply applicable PRA criteria in this first ACR proceeding. For MMA, it is clear that the existing discounts comply with PRA. The Commission's Recommended Decision in R2006-1 prescribed the current discounts in accordance with applicable PRA criteria and the Board Of Governors accepted this aspect of that Recommended Decision without reservation. Those discounts continued to apply throughout the balance of PFY 2007. The current discounts remain presumptively lawful and, by definition, cannot be reduced based on an analysis of actual PFY 2007 data because they were, quite properly, based on projected 2008 PFY data.

Even if PAEA criteria were to be applied to the existing workshare discounts in this case, the comparison in Table 2 above would not require any change in the existing workshare discounts. First, PAEA has recognized that worksharing includes handling and transportation, factors not considered by the Commission in R2006-1 or addressed in the Postal Service's ACR Report.

Further, PAEA generally requires that, with certain exceptions, over time workshare discounts not exceed the cost that the Postal Service avoids as the result of mailers' worksharing activities. See, PAEA § 3622 (e) (2). The unique context in which this first ACR has been made and the uncertainties inherent in making meaningful comparisons discussed above should, without more, refute any claim that the current discounts are not in compliance with the criteria of PAEA.

In any event, PAEA does not require that discounts in excess of avoided costs be summarily reduced. Such discounts may remain in effect if reducing them would lead to a loss of volume in the affected category of mail and reduce the aggregate contribution to institutional costs from the category below what it otherwise would have been if the

discount had not been reduced. PAEA § 3622 (e) (3)(A). Similarly, such discounts may remain in effect if necessary to mitigate rate shock and the excess over the applicable cost savings will be phased out. PAEA § 3622 (e) (2) (B). Finally, workshare discounts need not be reduced if reduction of the discount would impede the efficient operation of the Postal Service. PAEA § 3622 (e) (2) (D).

In recent years, First Class workshare mailers have played an increasingly important role in ensuring the continued financial viability of the Postal Service and achievement of other Postal Service's goals. While First Class single piece mail volumes have declined precipitously (a trend the Postal Service seems powerless to reverse) growth in First Class workshare mail volumes has served to mitigate or offset the revenue losses. In R2006-1, the Commission's TY 2008 projections for single piece and workshare mail volumes were 37.5 billion pieces and 47.8 billion pieces, respectively. As the Postal Service's 2007 ACR Report shows, at 40.1 billion pieces First Class single piece volumes are on track to reach the predicted decline. In contrast, at almost 50 billion pieces workshare mail volumes have already exceeded by a substantial amount the volumes projected for TY 2008. Growth in workshare volumes is very important to the financial health of the Postal Service. According to USPS-FY07 1 CRA, the unit contribution of First Class workshare mail (21.1 cents) is almost 20% higher than that of Single Piece mail (17.7 cents). At a minimum, this disparity in the relative contributions of these two products indicates that workshare mailers already are bearing a disproportionate share of the revenue responsibility apportioned to First Class.

The facts show that First Class workshare mail is a vital resource for the Postal Service. The Commission should husband this vital resource and take all reasonable measures to help the Postal Service increase this business, if possible. Above all else, the Commission should not take any action that would send a signal to workshare mailers that their contributions are not valued. Reducing discounts at this juncture would do just that.

## **II. Specific Problems With The Postal Service's Workshare Cost Savings Analysis**

It is incumbent upon the Commission to derive accurate workshare cost savings so that workshare discounts will neither short change workshare mailers by giving them

discounts that are less than the cost avoided by the Postal Service, nor prejudice other mailers by giving workshare mailers discounts that are higher than avoided cost. This will ensure that the resulting rates fairly apportion revenue responsibility between First-Class Single Piece and workshare mailers, and send the appropriate economic signals to the mailing market.

In the ACR Report, the Postal Service claims that it updated workshare cost savings using actual data for the 2007 PFY and the methodologies employed by the Commission in R2006-1.<sup>5</sup> Unfortunately, there are at least<sup>6</sup> two significant problems with the Commission's existing methodology for determining workshared cost savings that can and must be corrected to make the comparison of current workshare discount levels with cost savings reasonable:

1. In R2006-1, the Commission broke with its consistent past practice of using two CRA proportional adjustment factors to reconcile the theoretical cost results produced by the Postal Service's mail flow models with actual costs reported in the CRA and, without providing any explanation, simply accepted the use of one CRA adjustment factor. This unfortunate break with prior practice has produced nonsensical results and arbitrarily reduced mail processing cost savings due to worksharing.
2. In R2006-1, the Commission improperly ignored actual data regarding Delivery Point Sequencing (DPS %) - the percentages of workshared letters that are successfully processed on automation. The result of turning a blind eye to actual data was a wholly artificial reduction in delivery cost savings due

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<sup>5</sup> This claim is not true for QBRM. The ACR Report shows cost savings of 2.3 cents, much lower than the existing 3.0 cent discount. See USPS-FY07-21\_QBRM\_WORKWHARING\_SAVINGS, tab "QBRM COST AVOIDANCE SUMMARY". However, a further review shows that the QBRM cost savings is based upon a Postal Service methodology that the Commission specifically rejected in R2006-1. See R2006-1, Opinion and Recommended Decision, issued February 26, 2007 at 166: "By ending its analysis after the first barcode sort, the Postal Service's model fails to capture the costs generated by those pieces that require additional sorts to isolate." ***The Postal Service must not be allowed to reduce QBRM cost savings by resurrecting a flawed method the Commission explicitly rejected less than one year ago.***

<sup>6</sup> In MMA's view, there are several errors other than those addressed in these comments. For example, on principle it makes no sense to use NAMMA, itself a workshare mail category, as the proxy for BMM in measuring delivery cost savings. After all, it seems inappropriate and fundamentally unfair to isolate and measure workshare cost savings between two letter categories when both categories are workshared to begin with. In essence, it is akin to handicapping one runner in a foot race by requiring him to run the race while carrying a 30-pound rock. In addition, using NAMMA delivery costs as the proxy for BMM is inconsistent with the Commission's use of single piece metered mail (MML) letter costs as the proxy for BMM when measuring mail processing cost savings. MML delivery costs are readily available as shown by the record in R2006-1. Nevertheless, despite these principled objections to using NAMMA, MMA is willing to use NAMMA if the most obvious problem – failure to reconcile model-derived Delivery Point Sequencing percentages (DPS %) to actual DPS %s – is corrected.

to worksharing. Failure to give proper regard to actual data also resulted in nonsensical results.

#### **A. Problems With The Determination Of Mail Processing Cost Savings**

The Postal Service first began using mail flow models to derive workshared cost savings in R97-1. From their inception, the results of the mail flow model did not square with actual costs as reported in the Postal Service's Cost and Revenue Analysis (CRA). Therefore, it was necessary to reconcile the model-derived costs with CRA costs. The practice of using two separate CRA Proportional Adjustment factors, one for NonAutomation letters and one for Automation letters, also began with the R97-1 case. Two separate CRA Adjustment factors were used because the Postal Service's models consistently understated the costs of processing non-prebarcoded letters (such as NonAutomation letters) and consistently overstated the costs of processing prebarcoded letters (such as Automation letters). The practice of using two separate CRA Proportional Adjustment factors was not controversial because it generally produced reasonable results.

In R2005-1 it was discovered that the CRA costs reported separately for NonAutomation and Automation letters were problematic. It seemed that some of this mail could not be properly identified by the Postal Service's In-Office System, resulting in possible bias. As of result, the Postal Service proposed in R2006-1 to combine the CRA costs for NonAutomation and Automation costs and "de-average" the total costs on the basis of the weighted average unit costs derived from the mail flow models.

In R2006-1, rather than continue its consistent past practice of using two separate CRA Proportional Adjustment factors for NonAutomation and Automation letters respectively, the Postal Service broke with tradition and proposed use of one combined CRA Adjustment factor. Despite the fact that this proposal was very controversial,<sup>7</sup> the Commission's Recommended Decision provided no explanation how or why it resolved the controversy the way it did. Indeed, the only evidence of what the Commission did is buried in Library Reference PRC-12 at tab "PRESORT LETTERS SUM."

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<sup>7</sup> MMA proposal to retain the longstanding practice of using two separate CRA Proportional Adjustment factors was discussed at length in R2006-1 Exhibit MMA-T-1, pp 12-14 and explained further in MMA witness Bentley in Exhibit MMA-T-1, Appendix I, pp. 10-17.

Because the Commission apparently did not recognize how controversial this change was, it failed to see that using one CRA adjustment factor produced anomalous results. Table 6 shows the worksharing related costs for the relevant First Class mail categories. On the left are the costs derived using one CRA Adjustment factor for all presorted letters (USPS); on the right are the costs derived using the traditional two CRA Adjustment factors (Corrected).

**Table 6**  
**Comparison of USPS and Corrected Workshared-Related Unit Costs**  
**For First-Class NAMMA and BMM Letters**  
**(Cents)**

First-Class Letter Category	USPS			Corrected		
	Model-Derived WR Unit Cost	CRA Prop Adj Factor	Adjusted WR Unit Cost	Model-Derived WR Unit Cost	CRA Prop Adj Fact	Adjusted WR Unit Cost
NAMMA	4.498	1.617	7.271	4.498	2.394	10.766
BMM	4.490	2.394	10.747	4.490	2.394	10.747
Difference	0.008		-3.475	0.008		0.019

Source: MMA-FY07-1, p. 3

As Table 6 shows, using only one combined CRA Adjustment factor leads to the counterintuitive conclusion that it costs far less to process NonAutomation Machinable Mixed AADC-AADC letters (NAMMA) (7.27 cents) than it costs to process Bulk Metered Mail (BMM) (10.75 cents). By contrast, when two CRA Adjustment factors are used, BMM and NAMMA costs are virtually identical.

It is beyond cavil that the costs for processing BMM and NAMMA are very similar. MMA starts with the proposition that BMM and NAMMA processing costs should be almost identical because the mail flow models for BMM and NAMMA are *identical*. In fact, the *only* difference between the two mail categories concerns a minimal difference in the premium pay adjustment factors – 1.015 for BMM versus 1.012 for NAMMA<sup>8</sup> – that are used as part of the model simulation to derive unit costs. See USPS-FY07-10, tab “WAGE RATES - PIGGYBACK FACTORS.” This explains the miniscule **0.008** cent model-derived unit cost difference highlighted in yellow in Table 6. Under the Postal Service’s flawed one CRA Proportional Adjustment factor

<sup>8</sup> See USPS-FY07-10, tabs “BMM COSTS” and “MACH MAADC-AADC-COSTS.”

reconciliation methodology, the unit cost difference balloons to a whopping **3.475** cents while under the traditional 2 CRA Proportional Adjustment factor methodology difference is only **0.019** cents.. There is no logical or factual reason why BMM letters should cost **48%** more to process than NAMMA letters, especially when, as the Postal Service readily stipulated in response to the following MMA R2006-1 interrogatory, BMM and NAMMA exhibit the same cost characteristics and should have very similar costs:<sup>9</sup>

**MMA/USPS-T22-35**

Please refer to Library Reference USPS-LR-L-141, which was filed in response to POIR No. 5. Please refer to pages 2 and 3 for BMM costs and pages 21 and 22 for Nonautomation machineable mixed AADC/AADC (NAMMA) letter costs.

- A. Please confirm that the mail flow model and resulting unit cost for NAMMA letters is **identical** to that provided for BMM letters. If you cannot confirm, please explain.
- A. **Confirmed.**
- B. If the BMM model-derived unit cost is 2.915 cents lower than the CRA-derived unit cost, is it reasonable to conclude the model-derived unit cost for NAMMA letters is similarly understated? Please explain your answer.
- B. Partially confirmed. It cannot be confirmed that actual NAMMA are over or understated since actual costs are not known. However, ***it can be confirmed that NAMMA and BMM exhibit similar physical characteristics and would be expected to have similar cost characteristics.*** Please refer to the response to POIR 1 (a) in Docket No. R2005-1.

Using only one CRA Proportional Adjustment factor actually exacerbates the effects of a fundamental flaw in the Postal Service's mail flow models that has existed from their inception.<sup>10</sup> The mail flow models contain a significant internal inconsistency – if a non-prebarcoded category such as NAMMA is assumed to be prebarcoded,<sup>11</sup> processing costs **should** go down. Instead, contrary to all expectations, processing costs increase in the Postal Service's models. Table 7 illustrates this phenomenon. It also shows on the left column marked USPS that using one CRA Proportional Adjustment factor does nothing to mitigate this counterintuitive result; in fact it magnifies the error. As shown on the right hand column marked Corrected, using two separate CRA Proportional Adjustment factors substantially solves the problem. Mathematically,

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<sup>9</sup> The interrogatory was redirected to the Postal Service for an institutional by USPS witness Abdirahman. Tr. 18C/6281 (emphasis added).

<sup>10</sup> MMA discovered this flaw early on and, starting in R2001-1, has tried, unsuccessfully, to bring the problem to the attention of the Commission and Postal Service. See R2006-1 Exhibit MMA-T-1, Appendix 1 at 12.

<sup>11</sup> Assuming NAMMA letters are prebarcoded, they would enter the mailstream at the "Out Prim Auto" operation rather than the "ISS" operation.

the problem can be corrected if, *and only if*, two separate CRA Proportional Adjustment factors are applied separately depending upon whether or not the letters are prebarcoded.

**Table 7**  
**Comparison of USPS and Corrected Unit Processing Costs for NAMA Letters and NAMA Letters, if Pre-Barcoded (Cents)**

First-Class Letter Category	(1)	(2)	(3)	(4)	(5)	(6)
	USPS			Corrected		
	Model-Derived WR Unit Cost	CRA Prop Adj Factor	Adjusted WR Unit Cost (1) x (2)	Model-Derived WR Unit Cost	CRA Prop Adj Factor	Adjusted WR Unit Cost (4) x (5)
NAMMA	4.498	1.617	7.271	4.498	2.394	10.766
NAMMA if Prebarcoded	4.620	1.617	7.469	4.620	1.573	7.267
Difference	-0.122		(0.198)	-0.122		3.499

Source: MMA-FY07-1, p. 3

Despite a decade of experience, the Postal Service’s mail flow models continue to indicate that prebarcoded letters cost more to process than non-prebarcoded letters. The Postal Service and the Commission have failed to come to grips with this nonsensical result, much less reform the mail flow models. This problem continues to plague efforts to develop accurate and representative workshare cost savings.

Table 8 compares and contrasts the resulting processing cost savings due to worksharing under the USPS methodology and as corrected.

**Table 8**  
**Comparison of USPS and Corrected Mail Processing Cost Savings (Cents)**

First-Class Workshared Category	USPS	Corrected	Change
NonAuto Mach (All Presort Levels)	5.11	0.30	-4.81
Auto Mixed AADC	5.20	5.43	0.23
Auto AADC	6.81	7.00	0.19
Auto 3-Digit	7.24	7.42	0.18
Auto 5-Digit	9.22	9.35	0.12

As Table 8 also shows, using two CRA Adjustment factors “fixes” another anomalous result produced by using only one CRA Adjustment factor. In R2006-1, the processing cost savings for NonAuto Machinable letters *appeared* to jump considerably as compared to previous cases. But those are phantom cost savings. It simply defies

credulity to assert that mail that is only presorted but not prebarcoded saves over 5 cents per piece while adding a barcode produces very minimal savings.

For these reasons, the Commission should calculate processing cost savings due to worksharing using two CRA adjustment factors, as had been its consistent practice prior to R2006-1.

**B. Problems With The Determination Of Delivery Cost Savings**

There are several problems with the manner in which delivery cost savings are determined. Nonetheless, MMA will only address one obvious shortcoming – the use of theoretical model-derived DPS %s that cannot be squared with readily available actual DPS % information.

As discussed above, when model-derived mail processing costs cannot be squared with actual costs reported in the CRA, the Commission uses a procedure to reconcile the theoretical model results with actual costs. Prior to R2006-1, delivery costs were developed using theoretical model-derived DPS %s because the Postal Service apparently did not have any actual DPS % data available. However, in R2006-1, the Postal Service provided actual DPS % data for the first time.<sup>12</sup> MMA used that actual DPS % data to reconcile the theoretical DPS % information produced by the Postal Service’s mail flow models.

Table 9, which compares actual DPS % data with model-derived DPS % data, shows that the mail flow models significantly overstate the successful DPS rate for NonAutomation Letters while the extent of the overstatement for Automation Letters is much more modest.

**Table 9  
Comparison of Theoretical and Actual DPS %s**

<b>First-Class Letter Category</b>	<b>DPS %s From Models</b>	<b>Actual R2006-1 DPS %s</b>	<b>DPS % Change</b>
NonAutomation Total	86.93%	77.22%	9.71%
Automation Total	89.05%	85.24%	3.81%

<sup>12</sup> In R2006-1, USPS witness Kelley indicated in response to Interrogatory MMA/USPS-T30-5A that actual DPS %s “could have been calculated” in R2005-1 but apparently were not. See Tr. 12/3350. In R2005-1 USPS witness Kelley testified in response to Interrogatory MMA/USPS-T16-4-F that he did not use any actual data to independently evaluate whether the theoretical model-derived DPS %s were reasonable or accurate.

It is not clear whether the Commission appreciated the material differences between the model DPS %s and actual DPS %s or the implications of the actual DPS %s for delivery cost savings. In this regard, the Commission did not even acknowledge the fact that MMA had used recently available actual data or that there was any controversy regarding this aspect of determining delivery cost savings. Once again, it was not possible to determine from the Recommended Decision how the Commission ruled or why. Only an in depth review of Library Reference LR PRC-12 reveals that the Commission used theoretical DPS %s without reconciling them to the actual DPS %s in the record.

As a matter of fact, MMA witness Bentley made the existence of actual DPS % data and his reliance upon such data a prominent part of his analysis of Delivery Cost Savings. Mr. Bentley testified that one of the improvements he instituted in order to derive more accurate unit delivery costs was to reconcile the theoretical DPS %s to actual DPS %s provided by USPS witness Kelley in R2006-1 Library Reference USPS-LR-L-67. See R2006-1, Exhibit MMA-T-1 at 13. He also explained in detail how this was accomplished. See R2006-1, Exhibit MMA-T-1, Appendix I at 21-22. The actual analysis was provided in Library Reference MMA-LR-1, page 2.

In view of the fact that actual DPS %s are readily available from the Postal Service, there is no logical, factual or policy reason to ignore such actual data and continue reliance upon purely theoretical model-derived DPS% data, especially where it is evident that the model derived information is not representative. The importance of utilizing accurate DPS %s as the distribution key for in-office delivery cost cannot be understated. Since manual processing is so much more expensive than DPS processing, very small changes in the DPS % can have a very significant impact on the distribution of costs. In fact, use of actual DPS % data also has a material effect on the level of delivery cost savings, as Table 10 shows.<sup>13</sup>

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<sup>13</sup> The Postal Service's computed delivery cost savings as reproduced here should be corrected. The DPS %s listed in UDCInputs071211, tab "DPS%" in the Postal Service's ACR Report uses an incorrect DPS % for Automation 5-digit CSCBCS/Manual sites. The figure used in the cost savings analysis is 52.98%, yet the model-derived figure is 54.43%, as shown in USPS-FY07-10 FCM Letters Costs, tab "Auto 5-Digit CSCBCS -Man Cost".

**Table 10**  
**Comparison of Delivery Cost Savings**  
**(Cents)**

<b>First-Class Workshared Category</b>	<b>USPS</b>	<b>Corrected</b>	<b>Change</b>
NonAuto Mach (All Presort Levels)	0.07	0.05	-0.03
Auto Mixed AADC	-0.14	0.51	0.65
Auto AADC	0.09	0.67	0.58
Auto 3-Digit	0.13	0.70	0.57
Auto 5-Digit	0.28	0.83	0.55

Source: MMA-FY07-1, page 1

In preparing Table 10, the only change MMA made to the Postal Service's derivation of delivery cost savings was substitution of theoretical DPS %s that are reconciled to actual DPS % for the purely theoretical DPS% employed by the Postal Service.<sup>14</sup>

**B. Correcting the Postal Service's Workshare Cost Savings**

After correcting the Postal Service's mail processing cost savings for its failure to properly reconcile costs to the CRA, and correcting its delivery cost savings by reconciling the DPS %s to actual data, the total derived cost savings increase. As Table 4, *supra* p.5, shows, with the exception of NonAutomation Machinable Letters, the current discounts passthrough well below 100% of the corresponding cost savings. Accordingly, the current workshare discounts easily comply with the applicable criteria of **both** the PRA and PAEA.

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<sup>14</sup> MMA used the most recently available information on actual DPS %s - from R2006-1. Understandably, the Postal Service did not include updated actual DPS % data in its ACR Report because the Commission did not rely upon such data in R2006-1. MMA expects that there have not been any material changes in actual DPS %s during PFY 2007. Nevertheless, the Commission can request updated actual DPS %s data if it has any lingering concerns on that score.

## CONCLUSION

For all the foregoing reasons, the Commission should find that the current workshare discounts are fully consistent with the requirements of both the PRA and PAEA.

Respectfully submitted,

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## Attachment I - Comparison of Model Inputs Between USPS (FY2007) and PRC (TY2008)

Table 1 - Inputs for a Typical Mail Flow Cost Model (BMM) With Significant Variations Highlighted

	TPH			Pieces Per Hour			Piggyback Factor			Weighted Cents Per Piece		
	USPS	PRC	Change	USPS	PRC	Change	USPS	PRC	Change	USPS	PRC	Change
<b>Outgoing RBCS</b>												
ISS	10,073	10,073	0	6,285	6,856	-571	1.712	2.064	-0.353	0.992	1.095	-0.103
RCR	1,331	1,331	0	--	--	--	--	--	--	0.018	0.013	0.005
REC	288	288	0	773	787	-14	1.365	1.370	-0.005	0.109	0.108	0.002
OSS	1,350	1,350	0	9,452	9,370	82	1.786	1.751	0.036	0.092	0.091	0.001
LMLM	27	27	0	2,142	3,111	-969	3.118	2.902	0.215	0.014	0.009	0.005
<b>Outgoing Primary</b>												
Automation	307	307	0	8,547	8,461	85	1.787	1.739	0.047	0.023	0.023	0.000
Manual	88	92	-3	474	408	67	1.313	1.278	0.036	0.089	0.104	-0.015
<b>Outgoing Secondary</b>												
Automation	2,798	2,798	0	9,216	9,157	59	1.786	1.749	0.037	0.196	0.193	0.003
Manual	73	121	-48	643	650	-7	1.313	1.278	0.036	0.054	0.087	-0.032
<b>Incoming RBCS</b>												
ISS	0	0	0	4,094	4,441	-347	1.712	2.064	-0.353	0.000	0.000	0.000
RCR	0	0	0	--	--	--	--	--	--	0.000	0.000	0.000
REC	0	0	0	773	787	-14	1.365	1.370	-0.005	0.000	0.000	0.000
OSS	0	0	0	6,926	8,510	-1,584	1.779	1.801	-0.022	0.000	0.000	0.000
LMLM	0	0	0	2,142	3,111	-969	3.118	2.902	0.215	0.000	0.000	0.000
<b>Incoming MMP</b>												
Automation AADC	1,837	1,814	24	6,667	6,879	-212	1.786	1.752	0.034	0.178	0.167	0.011
Manual ADC	110	199	-89	581	583	-2	1.313	1.309	0.004	0.090	0.162	-0.072
<b>Incoming SCF/Primary</b>												
Automation	5,544	5,506	38	6,610	7,085	-475	1.784	1.766	0.018	0.541	0.496	0.045
Manual	127	236	-109	629	627	3	1.313	1.278	0.036	0.096	0.175	-0.078
<b>Incoming Secondaries</b>												
Auto Carrier Route	1,823	2,007	-184	7,561	7,560	1	1.784	1.769	0.015	0.156	0.170	-0.014
Auto 3-Pass DPS	3,039	3,140	-100	16,646	14,830	1,816	1.797	1.718	0.079	0.119	0.131	-0.013
Auto 2-Pass DPS	15,767	14,895	872	9,496	9,401	95	1.787	1.737	0.050	1.073	0.995	0.078
Man Inc Sec Final At Plant	321	646	-324	437	575	-138	1.313	1.278	0.036	0.350	0.520	-0.170
Man Inc Sec Final At DU	114	229	-115	926	928	-2	1.313	1.278	0.036	0.059	0.114	-0.056
Box Section Sort, DPS	783	736	47	1,976	2,015	-39	1.313	1.309	0.004	0.189	0.173	0.015
Box Section Sort, Other	107	154	-47	988	1,007	-20	1.313	1.309	0.004	0.052	0.073	-0.021

Table 2 - Piggyback Factors With Significant Variations Highlighted

Equipment	Piggyback Factors		
	USPS	PRC	Change
MLOCR	1.712	2.064	-0.353
REC	1.365	1.370	-0.005
LMLM	3.118	2.902	0.215
MPBCS	1.773	1.865	-0.092
DBCS	1.787	1.737	0.050
CSBCS	1.797	1.718	0.079
Manual	1.313	1.278	0.036
Manual P.O. Box	1.313	1.309	0.004
Tray Opening Unit Bundle Sortir	1.351	1.320	0.031

Table 3 - Acceptance Rates With Significant Variations Highlighted

Operation	Acceptance Rates		
	USPS	PRC	Change
Out Prim Auto	96.83%	95.76%	1.07%
Out Sec Auto	97.92%	96.16%	1.75%
Inc MMP Auto	98.40%	95.98%	2.42%
Inc SCF/Prim Auto	98.42%	96.60%	1.83%
Inc Sec 1 Pass Auto	98.40%	96.10%	2.30%
Inc Sec 2 Pass Auto - Pass 1	99.18%	97.61%	1.57%
Inc Sec 2 Pass Auto - Pass 2	99.27%	98.56%	0.71%
Inc Sec 3 Pass Auto - Pass 1	99.18%	97.61%	1.57%
Inc Sec 3 Pass Auto - Passes 2	99.27%	98.56%	0.71%

Table 4 - Marginal Productivities With Significant Variations Highlighted

Operation	Marginal Productivities		
	USPS	PRC	Change
Outgoing ISS	6,285	6,856	(571)
Incoming ISS	4,094	4,441	(347)
REC	773	787	(14)
LMLM	2,142	3,111	(969)
Outgoing OSS	9,452	9,370	82
Incoming OSS	6,926	8,510	(1,584)
Outgoing BCS Primary	8,547	8,461	85
Outgoing BCS Secondary	9,216	9,157	59
Incoming BCS MMP	6,667	6,879	(212)
Incoming BCS SCF/Primary	6,610	7,085	(475)
Incoming BCS Secondary Carrier Route(1 Pass)	7,561	7,560	1
Incoming BCS Secondary DPS (2 Pass)	9,496	9,401	95
Incoming CSBCS Secondary DPS (3 Pass)	16,646	14,830	1,816
Manual Outgoing Primary	474	408	67
Manual Outgoing Secondary	643	650	(7)
Manual ADC(in MMP)	581	583	(2)
Manual Incoming SCF/Primary	629	627	3
Manual Incoming Secondary, MODS Site	437	575	(138)
Manual Incoming Secondary Non MODS Sites	926	928	(2)
P.O. Box Sort DPS	1,976	2,015	(39)
P.O. Box Sort Other	988	1,007	(20)
Tray Opening Unit Bundle Sorting	121	120	0

Table 5 - RCR Cost Per Image With Significant Variations Highlighted

	RCR Cost Per Image		
	USPS	PRC	Change
RCR Cost Per Image	0.135	0.094	0.041

Comparison of PRC Cost Savings and PRC Cost Savings using FY 2007 Wage Rates from ACR2007

First Class Letter Category	(1)	(2)	(3)	(4)	(5)	(6)
	Model-Derived Unit Costs			Derived Workshare Cost Savings		
	USPS ACR	PRC With FY07 Wages	Changes	USPS ACR	PRC With FY07 Wages	Changes
BMM (Benchmark)	4.490	4.899	-0.409			
NonAutomation	4.332	4.689	-0.357	5.19	5.58	-0.40
Auto MAADC	4.279	4.884	-0.605	5.06	4.96	0.11
Auto AADC	3.281	3.692	-0.411	6.90	6.85	0.05
Auto 3-Digit	3.014	3.270	-0.256	7.37	7.55	-0.17
Auto 5-Digit	1.789	1.917	-0.128	9.50	9.70	-0.20
CRA Proportional Adj Factor				1.616	1.383	0.233

(1) USPS-FY07-10, tab "PRESORT LETTERS SUM"

(2) PRC-LR-12 but with FY2007 wage rates, tab "PRESORT LETTERS SUM"

(3) (1) - (2)

(4) USPS-FY07-10, tab "SUMMARY"

(5) PRC-LR-12 but with FY2007 wage rates, tab "PRESORT LETTERS SUM"

(6) (4) - (5)

USPS ACR = USPS results as filed in ACR2007

PRC With FY07 Wages = PRC Opinion model but with the FY2007 wage rates taken from USPS ACR