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

Annual Compliance Report **Docket No. ACR2007**

Reply 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,[1] Major Mailers Association (MMA) hereby submits the following brief Reply Comments on issues relating to the Postal Service's December 28, 2007 Annual Compliance Report for Fiscal Year (FY) 2007 (ACR):

1. MMA's Initial Comments (IC) discussed problems associated with the Postal Service's existing First Class mail flow models and the irrational mail processing costs produced when the model-derived costs were reconciled to actual CRA costs using only one, combined CRA Proportional Adjustment factor, rather than the two *separate* CRA Proportional Adjustment factors (one for non-prebarcoded NonAutomation letters and the other for prebarcoded Automation letters) and that the Commission had consistently used prior to the abrupt, unexplained policy switch buried in the technical library reference accompanying its R2006-1 Recommended Decision. *See* MMA IC at 11-15.[2]

A review of Time Warner's (TW) Initial Comments, which focused on Periodicals, demonstrates that problematic mail flow models and questionable

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[1] *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).

[2] As Table 6 (MMA IC at 12) shows, using only one, combined CRA Proportional 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). However, when two CRA Adjustment factors are used, BMM and NAMMA costs are virtually identical, as the Postal Service and Commission both recognize, they ***should*** be. MMA IC at 13. Using NAMMA delivery costs as a proxy for BMM delivery costs, as the Commission did in R2006-1, cannot be justified when the mail processing costs for each are so different. MMA IC at 10, fn 6.

methods for reconciling model-derived costs to actual CRA costs are not unique to First Class workshare mail cost savings. The specific issues and underlying facts do not appear to be the same for Periodicals and First Class workshare rate determination. Nevertheless, several important conclusions can be drawn from both situations. First, for both Periodicals and First Class workshare mail, the mail flow models understate actual CRA costs by a substantial margin. Therefore, it appears that both models contain inherently unrealistic assumptions about the manner and costs of processing the mail pieces.

Certainly, a significant portion of actual processing costs are not reflected in the simulated mail flows encompassed in the models. After much careful analysis, MMA is convinced that in First Class a large part of the problem lies in how the models understate the costs of processing non-prebarcoded letters that must have a barcode applied in the Remote Barcoding System (RBCS).[3]

Second, it appears that, at least for First Class, the extent to which model-derived costs diverge from actual CRA costs is getting ***much*** larger over time. In R2006-1, the Commission's CRA average unit cost for all First Class presorted letters (4.045 cents) was 30.1% higher than the comparable model-derived unit cost (3.110 cents).[4] According to the Postal Service's ACR filing, the CRA average unit cost for all presorted letters (4.280 cents) is now 61.6% higher than the comparable model-derived unit costs (2.648 cents).[5] Although the difference is now ***twice*** what it was in R2006-1, the Postal Service has not provided any explanation for this discrepancy. Accordingly, there is a pressing need for the

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[3] In Periodicals, a significant part of the problem appears to lie in the fact that the mail flow models have not been updated to reflect current operational realities of the AFSM 100. *See* TW IC at 14-15.

[4] *See* R2006-1 Library Reference PRC LR-12 MP Costs, worksheet FCM Letters Costs Final, tab "PRESORT LETTERS SUM."

[5] *See* USPS-FY07-10, tab "PRESORT LETTERS SUM."

Postal Service and the Commission first to acknowledge[6] then address forthrightly the flaws that are inherent to these models, and finally reform the models.

Finally, it is significant, but not entirely surprising, that MMA's and Time Warner's rate experts came to the same basic conclusion regarding the appropriate temporary solution to these problems – using two separate CRA Proportional Adjustment factors produces much more reasonable results than does using only one combined CRA Proportional Adjustment factor.

2. In the December 31 Notice (at 2, fn 3), the Commission expressed its hope that expediting public comments on the ACR filing would have an important additional benefit:

> If public comments on the Postal Service's annual report identify potential problem areas several weeks in advance of the Postal Service's rate filing, this may inform or influence the Postal Service's pricing decisions.

MMA shared the Commission's optimism on this score. Accordingly, MMA worked hard to identify several areas of concern raised by the Postal Service's derivation of First Class workshare cost savings in the ACR filing. MMA also specifically quantified the impact that various flaws had on workshare cost savings. Several other parties worked diligently to identify problem areas for consideration by the Postal Service.[7]

On Monday, the Postal Service filed its notice of price adjustments for Market Dominant products.[8] Unfortunately, it appears that the Commission's hope that expediting comments would provide valuable input to inform the Postal

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[6] MMA brought problems associated with the First Class mail flow models generally and with the RBCS simulation in particular to the Commission's attention beginning in R2000-1, the omnibus case immediately following introduction of the First Class mail flow models, and has raised the issue in every subsequent omnibus rate proceeding. MMA's concerns have gone unheeded by the Commission and the Postal Service. Contrary to most fundamental precepts of worksharing and commonsense, the Postal Service's models still indicate that it costs more to process prebarcoded letters than it costs to process identical letters that are not prebarcoded. With such internal inconsistencies, it is no wonder that the models produce unreliable results.

[7] See Initial Comments filed by Direct Marketing Association, Inc. and Parcel Shippers Association, Inc, Pitney Bowes, Inc., National Association of Presort Mailers and National Postal Policy Council.

[8] *Notice Of Price Adjustment*, Docket No. R2008-1, United States Postal Service Notice Of Market-Dominant Price Adjustment, dated February 11, 2008 (Price Cap Filing).

Service's pricing decisions in R2008-1 was not realized. Instead, the Postal Service apparently disregarded the parties' legitimate concerns and proceeded with the Price Cap Filing as if the flawed ACR workshare cost savings were gospel.

Perhaps the most glaring and egregious example of the Postal Service's overreaching is its 23% proposed reduction in the QBRM discount, from 3.0 to 2.3 cents. As MMA pointed out (IC at 10, fn 5), the 2.3 QBRM cost savings derived by the Postal Service in the ACR filing, was based upon a methodology that the Commission specifically rejected in R2006-1. Such a drastic reduction in the QBRM discount fails to take into account and balance properly the minimal additional revenues for the Postal Service[9] against the adverse rate shock for QBRM mailers who count upon the current 3.0 cent discount to make their continued use of QBRM financially feasible.

MMA's cursory review of the Price Cap Filing also shows that First Class workshare mailers will be required to shoulder an excessive 3.5% rate increase to make up the shortfall in revenues that result from the much below average 2.4% increase that Single Piece mailers will pay, mainly because of the integer constraint. In general, the Postal Service proposes to reduce workshare discounts to the level of the unit cost savings reflected in the ACR.[10] The problem with this approach is that the ACR cost savings are fundamentally flawed, as MMA and other parties have demonstrated. MMA IC at 5 (Table 4), 6-7 (Attachment I), 9-17. Therefore, reducing workshare discounts will send erroneous price signals to mailers who invest heavily to participate in the

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[9] The drastic, unsupported reduction in the QBRM discount nets the Postal Service just over $2 million.

[10] The Postal Service apparently recognized that the methodology the Commission used in R2006-1 to set the discount for NonAutomation Machinable letters was seriously flawed. It proposes to "correct" those errors by reducing the discount from 3.7 to 2.6 cents. Unfortunately, the Postal Service has come up with a brand new methodology to measure the "extra costs" associated with processing NonAutomation letters compared to Automation letters. The resulting 2.5-cent "surcharge" relies on results produced by the Postal Service's flawed mail flow model. This new "analysis" shows that it costs more to add a barcode to, and process, NonAutomation letters, which by definition are machine printed and presorted, than it costs to add a barcode to, and process, hand-addressed letters. That relationship makes absolutely no sense. Price Cap Filing, Appendix A, p. 2. The Postal Service also limited the reduction in the discount for 5-digit Automation letters to 0.2 cent.

workshare program, will be at odds with the principles of Efficient Component Pricing, and result in an inefficient use of society's valuable resources.

CONCLUSION

For the foregoing reasons and those set forth in MMA's Initial Comments, the Commission should find that the current First Class workshare discounts are fully consistent with the requirements of both the PRA and PAEA. In fact, the current workshare discounts should be increased, not reduced as the Postal Service is proposing in its Price Cap Filing.

Respectfully submitted,

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