

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

ANNUAL COMPLIANCE REPORT, 2007

Docket No. ACR2007

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(February 13, 2008)

On December 28, 2007, the Postal Service filed its FY 2007 Annual Compliance Report, pursuant to section 3652 of title 39. On December 31, 2007, the Commission provided notice of this filing, and solicited public comment on the Report. The Commission set January 30, 2008, as the due date for initial comments on the Report, and February 13, 2008, as the due date for reply comments. Ten parties filed initial comments. Pursuant to the procedural schedule set forth by the Commission, the Postal Service hereby files its reply comments.

I. The Applicable Law

After receiving the section 3652 Report from the Postal Service, the Commission is tasked by section 3653 with determining, in part, whether the prices and fees charged by the Postal Service for its products during the fiscal year in question complied with the “applicable provisions of [chapter 36].” Similarly, section 3652 requires the Postal Service’s Report to analyze whether its products complied with “all applicable requirements” of title 39. The majority of the parties agree with the Postal Service that the provisions of the Postal Reorganization Act (PRA), rather than the Postal Accountability and Enhancement Act (PAEA), are the “applicable” legal provisions

relevant to the Postal Service's FY 2007 Report. Furthermore, they agree with the Postal Service's conclusion, as discussed in its Report at pages 6-7 (discussing market-dominant products) and 22-23 (discussing competitive products), that the FY 2007 prices and fees fully complied with the requirements of the PRA.¹

Valpak and the Public Representative, on the other hand, take the position that this Report should be analyzed under the provisions of the PAEA. Valpak asserts that the PAEA is "silent" as to whether the "PRA or PAEA is the appropriate touchstone for the evaluation of [the FY 2007] rates."² The Public Representative argues that "Section 3653(b) of the PAEA requires the Commission to conduct a review of, and make a determination of, the Postal Service's compliance with the ratemaking and service performance provisions of the PAEA."³

These parties seem to be under the mistaken impression that simply because the PAEA amended title 39 to include the Annual Compliance Review process of sections 3652 and 3653, the FY 2007 prices and fees should be judged based on the pricing provisions of the PAEA. This completely ignores, however, the transition provisions set forth by the PAEA. Section 3622(f) states, "For the 1-year period beginning on the date of enactment of this section [December 20, 2006], rates and classes for market-dominant products shall remain subject to modification in accordance with the provisions of [chapter 36] and section 407, as such provisions were last in effect before the date of enactment of this section."⁴ Section 3632(c), in turn, states, "Until regulations

¹ See DMA/PSA Comments at 2; MMA Comments at 8; ANPM/MPA Comments at 1-3; NPPC Comments at 3; Pitney Bowes Comments at 2; Time Warner Comments at 4.

² Valpak Comments at 9.

³ Public Representative Comments at 2.

⁴ Section 3622(f) goes on to say that any proceedings commenced during that one year period were to be completed "in accordance with subchapter II of chapter 36 of this title and implementing regulations, as in effect before the date of enactment of this section."

under section 3633 first take effect, rates and classes for competitive products shall remain subject to modification in accordance with the provisions of [chapter 36] and section 407, as such provisions were as last in effect before the date of enactment of this section.”

Because FY 2007 concluded prior to the running of the 1-year period from the date of enactment of the PAEA, and prior to the effective date of the new regulations concerning competitive products, the transition provisions clearly indicate that the governing law during FY 2007 were the provisions of chapter 36 “last in effect before the date of enactment” of the PAEA—namely, the provisions of the PRA. As such, the “applicable provisions of chapter 36” cited by section 3653(b)(1) are those of the PRA. Thus, contrary to Valpak’s claim, the law is not “silent” as to whether the compliance determination for FY 2007 should be based on the standards of the PRA or the PAEA. Nor is the Public Representative’s position that the section 3653(b) “requires” the Commission to determine whether the Postal Service complied with the “provisions of *the PAEA*” an accurate restatement of the law.⁵

Conceivably, the Commission could conclude that the new pricing provisions of the PAEA are relevant even under the PRA due to former sections 3622(b)(9) and 3623(c)(6), which allowed the Commission to “consider such other factors as the Commission deems appropriate.” However, the Commission is certainly not “required” to consider the provisions of the PAEA when reviewing this Report for compliance with the PRA, since the phrase “such other factors as the Commission deems appropriate” clearly indicates that considering “such other factors” was within the Commission’s discretion. Moreover, retroactively applying the provisions of the PAEA to the FY 2007

⁵ Emphasis added.

prices in order to judge whether those prices complied with the PRA would be inappropriate, considering the prices were set under a completely different regulatory system. The only basis by which the Commission should predicate a “noncompliance” determination concerning the FY 2007 prices and fees is upon a finding that the Postal Service failed to comply with the clear standards of the PRA during FY 2007.

There is no basis to conclude that the FY 2007 prices failed to comply with the PRA, such that the Commission should in some way exercise its remedial authority under section 3653(c). Valpak points out that Periodicals did not cover its costs in FY 2007, and asks the Commission to either 1) order the Postal Service to raise Periodicals prices such that it is “ensured” that they cover attributable costs, or 2) to order the Postal Service “to focus the entirety of its [Periodicals] rate increases, to the maximum extent feasible, on those cost drivers (and on those publications) that do not cover attributable costs.”⁶

The fact that Periodicals failed to cover its attributable costs in FY 2007 does not mean, however, that the standards of the PRA have been violated, considering that the prices implemented in FY 2007 were implemented pursuant to Commission recommendation, with the intent to cover attributable costs in Test Year 2008. Thus, there is no basis for the Commission to issue a finding of “noncompliance,” or to invoke its remedial authority. Even more fundamentally, Valpak completely disregards the circumstances regarding Periodicals. Late in FY 2007, a significantly revamped price structure was implemented for Outside County Periodicals. Of course, during FY 2007

⁶ Valpak Comments at 48-51.

mailers had little opportunity to adjust to the new framework.⁷ Going forward, however, this price structure is expected to produce significant cost-savings benefits as mailers respond to the incentives it creates. As the Postal Service recently noted in its Notice initiating Docket No. R2008-1, a May increase this year, in conjunction with the increase of last July and with increased mailer response to the incentives created by the new structure, should help move Periodicals towards cost-compensatory status. Furthermore, the Postal Service is also working to further understand and reduce Periodicals costs, and has assembled a task force for that purpose, consistent with section 708 of the PAEA.

Thus, even assuming for the sake of argument that Periodicals can properly be found to have not “complied” with the PRA during FY 2007, the Commission should decline to order any remedial action.⁸ Section 3653 vests the Commission with the authority to take such action as “the Commission considers appropriate.” It is clearly appropriate for the Commission to stand back so as to allow mailers to continue to adjust to the new structure that was implemented only last July, and to allow the increases of last July and this May to have their effect. Declining to order unnecessary remedial action would also avoid the premature consideration of the proper parameters of the Commission’s authority under section 3653(c).

Like Valpak, the Public Representative points out that Periodicals (as well as Media Mail) did not cover its costs in FY 2007, and states that this “raises questions of

⁷ The cost coverage calculated for FY 2007 is therefore based primarily on the costs and revenues that resulted from the Docket No. R2005-1 prices.

⁸ This is also true if the Commission decided in this proceeding to apply PAEA law, which has reduced the legal importance of the “attributable cost” factor.

compliance with a number of policies and provisions of the PAEA.”⁹ He does not ask for any change to the existing prices, however; instead, he argues that the Postal Service has not “fulfilled its obligations under section 3652” because it has not explained how its FY 2007 prices and fees complied with the “policies of title 39.”¹⁰ He therefore asserts that the Postal Service “should provide a narrative explanation (similar to rate design and pricing testimony filed in rate cases under the PRA) describing how market-dominant products comply with the policies and provisions of the PAEA.”¹¹

The Public Representative bases this argument on current section 3622(c)(14), which he asserts makes the “policies of the PAEA” relevant to this proceeding.¹² This argument is founded, however, on the faulty premise that the PAEA, rather than the PRA, is the applicable law in this proceeding. Moreover, even if the Commission did consider section 3622(c)(14) relevant to this proceeding, the Public Representative still provides no convincing reason why the “narrative” he requests would in any way aid in the Commission’s determination of compliance.

Specifically, while the Public Representative asserts that section 3622(c)(14) refers to “policies of the PAEA,”¹³ that provision in fact refers to the “policies of this title [*i.e.*, title 39].”¹⁴ The PAEA did not, however, amend the general policy provisions of

⁹ Public Representative Comments at 5-6. As with Periodicals, the failure of Media Mail to cover its attributable costs does not mean that the PRA was violated in FY 2007. Furthermore, the Postal Service has recently noticed a price increase of 4.54 percent for Media Mail/Library Mail, expressly to improve its profitability. See Docket No. R2008-1, Notice of Market-Dominant Price Adjustment, at 19.

¹⁰ Public Representative Comments at 4.

¹¹ *Id.* at 6.

¹² *Id.* at 4.

¹³ *Id.*

¹⁴ See 39 U.S.C. § 3622(c)(14). The Public Representative also misstates the law when he seeks to claim equivalence between the “fair and equitable” provisions of the PRA, and the “just and reasonable” provision of the PAEA. Comments at 5 n.12. As the Postal Service discussed in Docket No. RM2007-1, this position is completely erroneous. See Docket No. RM2007-1, Reply Comments of the United States Postal Service on the First Advance Notice of Rulemaking, at 19-20. Certainly, it would be a surprise to

title 39. Therefore, the policies the Public Representative argues must be discussed by the Postal Service in its “narrative,” such as section 101(d), were considered by the Commission and the Governors when designing the prices and fees that were in effect during FY 2007, including the current prices.¹⁵ While the Public Representative might think it an interesting theoretical exercise for the Postal Service to opine on how the FY 2007 data provided in this Report implicates the Commission’s and Governors’ conclusions in Docket No. R2006-1, the Postal Service believes that any such “narrative” would be irrelevant to this proceeding.

II. Worksharing Cost Models

A. General Considerations

Several parties filed comments on the worksharing cost models submitted by the Postal Service. Time Warner and the Alliance of Nonprofit Mailers/Magazine Publishers of America (ANPM/MPA) propose revisions to the Periodicals cost model, while Major Mailers Association (MMA) proposes revisions to the First-Class Mail cost model. Pitney Bowes and the National Association of Presort Mailers (NAPM), meanwhile, express concern about what Pitney Bowes describes as “selective updates” to the cost models’ data inputs.¹⁶

It is important when considering the worksharing cost models to distinguish between methodology and data, and, in turn, to consider the broader nature of the Annual Compliance Report. The Postal Service believes that the Annual Compliance

those involved in the intense legislative deliberations regarding this issue to learn that there were in fact no material differences between the two standards.

¹⁵ In addition to section 101(d), the Public Representative cites section 404(b) as a policy provision that needs to be discussed in the Postal Service’s “narrative.” Comments at 4. While section 404 of title 39 was amended by the PAEA to include this language, the language of section 404(b) is a near-verbatim recitation of the first two sentences of former section 3621.

¹⁶ Pitney Bowes Comments at 6.

Report should take the best data available for the year that the Report covers, and apply that data to worksharing models that follow pre-approved Commission methodologies. The use of pre-approved Commission methodologies will help streamline the Annual Compliance Review process, and will help to focus the proceeding, not on arguments over how to measure what happened in the prior fiscal year, but on whether the Postal Service's prices and service performance complied with the provisions of chapter 36. This also will help prevent results-driven criticisms of Commission methodologies.

Proposals to change Commission methodology should instead largely be hashed out *prior* to the Postal Service's production of the Report. This will allow parties to have a full opportunity to comment upon methodological changes prior to their use, without the need to conform to the specified timeframe of section 3653. In this regard, the Postal Service generally agrees with the sentiments of MMA and Time Warner that the timeframes involved in the Annual Compliance Review process may not be completely conducive to the review of cost methodology changes.¹⁷ Instead, the Commission should largely direct the consideration of methodology changes to alternative processes. For example, the Commission could hold technical conferences outside of the Annual Compliance Report docket to consider proposed changes that it finds worthwhile to explore. It could convene these technical conferences soon after its Annual Determination of Compliance is issued.

There may be exceptions, however, which a rule of reason can govern. That is, while the general expectation should be that the Postal Service will follow pre-existing Commission methodology when it produces its Report, there should not be a rigid rule

¹⁷ See MMA Comments at 7; Time Warner Comments 9, 24-25, 30.

against the Postal Service's introduction of new methodology changes when such changes are demonstrably necessary, such as in the instance when the pre-approved models are not able to utilize more contemporary data. In addition, while the general expectation should be that the Commission will not promulgate methodology changes during the Annual Compliance Report, it should not completely foreclose the possibility that a methodology change proposed during this process will be a clearly superior way in which to understand what happened in the fiscal year covered by the Report. Both circumstances, however, should be clearly seen as the exception rather than the rule.

Consistent with this approach, the Postal Service in the worksharing cost models endeavored to use the Commission's methodologies from Docket No. R2006-1, with the notable (and what will almost certainly be the out-of-the-ordinary) exception of the Periodicals cost model that is very much a "work in progress" due to Periodicals' new, revamped price structure. Even with respect to the Periodicals cost model, however, the Postal Service tried to faithfully reproduce and update the model approved by the Commission in Docket No. R2006-1, and only modified that model when obvious errors, omissions, or inconsistencies with operational realities were discovered. In particular, the Postal Service attempted to adhere to the model even when the Postal Service felt that the methodology employed was not the most appropriate way to represent a complex reality. The Postal Service did this based on its belief that modifications to the pre-existing methodology should generally not be aired for the first time in the Annual Compliance Report.

In addition, the Commission should generally treat criticisms of its pre-existing methodologies as being prospective in effect; that is, as suggestions on how to improve

the cost models for future Reports. The Postal Service's response to specific mailer proposals to modify the models used in this proceeding is set forth in Section B below.

In terms of data inputs to the models, both NAPM and Pitney Bowes criticize what they view as "selective updates" to the data, citing in particular the new read and accept rates used by the Postal Service.¹⁸ In particular, NAPM argues that updating one set of inputs without updating others can "potentially downgrade[]" the accuracy of the cost avoidance estimates, and that mailers need the opportunity to review and comment upon updated data.¹⁹ Furthermore, NAPM argues that the Commission should "require all relevant data to be, to the maximum extent possible, collected at or about the same time," and "should adopt rules to ensure that interested parties are afforded the opportunity for meaningful, advanced review of any significant data input changes to the workshare cost calculations."²⁰ Pitney Bowes also suggests that the Commission "adopt rules regarding data updates to mitigate unintended distortions caused by selective data updates."²¹

The Postal Service does not agree that a rule should be imposed that disfavors or even forbids the partial updating of the data used in the cost models. The acquisition of new data inputs is necessarily constrained by time and resource limitations. As a practical matter, it is not realistic to expect that "all relevant data" can be collected "at or about the same time."²² As new and more accurate data inputs become available for the year covered by the Report, the Postal Service should be allowed to use them in the models, like it has always done. Preventing such updates on the grounds that there

¹⁸ NAPM Comments at 3-4; Pitney Bowes Comments at 6-7.

¹⁹ NAPM Comments at 3.

²⁰ *Id.* at 3-4.

²¹ Pitney Bowes Comments at 7.

²² NAPM Comments 4.

may be other inputs that have not been as recently updated would make the perfect the enemy of the good.

In addition, the desire to review updated data in advance ignores the fact that there are a vast number of inputs to the cost models. Updated data are inevitable due to the fact that the Postal Service is a constantly evolving operation with new employees, processes, equipment, and costs. Effectively requiring a review of each updated input, some of which do not become available until right before the Annual Compliance Report is issued, would be wholly impractical.

Finally, it is important when considering the worksharing cost models to recognize the fundamental change in the nature of the regulatory system. Under the PRA, cost models were only reviewed in rate cases that sometimes were years apart. Under the PAEA, however, cost models will be reviewed each year, and the Postal Service will have the ability to price on a yearly, incremental basis. This means that the cost avoidances measured by the cost models in any one year will play a less critical role than the models that were used to set prices in any one omnibus case under the PRA. The short time period between cost model reviews also means that parties may exaggerate the possibility, and consequences, of distortions. It is thus appropriate to consider the refinement and improvement of the cost models as a long-term process, over a series of years.

B. Comments by the Parties on the Worksharing Models

1) MMA

Initially, it may be useful to highlight a point that might not be obvious from MMA's comments. Early in those comments, when MMA is presenting tables to

compare the FY 2007 cost avoidance estimates presented by the Postal Service with what MMA claims are “corrected” estimates, MMA refers to correction of “two very obvious errors in *application of the Commission’s R2006-1 methodology.*”²³ To read this, one might suppose that MMA was taking issue, not with the Commission’s methodology, but rather with the Postal Service’s *application of that methodology*. In fact, however, the two features of the models which MMA characterizes as “very obvious errors” are features which were quite explicitly present in the Commission’s Docket No. R2006-1 methodology. Thus, contrary to what the above quotation from MMA’s comments might suggest, it is the Commission’s methodology itself which MMA is challenging, not the Postal Service’s application of that methodology. And, to be fair to MMA, the true target of its criticisms is made clearer in subsequent portions of its comments.²⁴ Nonetheless, readers should not be misled by this early portion of MMA’s comments into thinking that the Postal Service has misapplied the Commission’s methodology.

Moving to the substance of those alleged “errors,” MMA criticizes the First-Class Mail worksharing cost model’s use of a single CRA adjustment factor, and its use of modeled delivery point sequencing (DPS) figures.²⁵ In terms of the CRA adjustment factor, MMA rehashes the arguments it made in Docket No. R2006-1 concerning the need for two CRA proportional adjustment factors, one for automation presort and the other one for non-automation presort. The Postal Service addressed this issue in its

²³ MMA Comments at 4 (emphasis added).

²⁴ See, e.g., *id.* at 10.

²⁵ MMA questions the use of Nonautomation Machinable Mixed AADC (NAMMA) as the delivery proxy for BMM. The Commission addressed this issue in its Opinion and Recommended Decision in R2006-1, accepting the use of NAMMA letters as the delivery cost proxy. See ¶ 5157.

Reply Brief in Docket No. R2006-1, and the Commission rejected MMA's position, as evidenced by ¶ 5159 of its Opinion and Recommended Decision and by PRC-LR-12.²⁶

On page 12 of its initial comments, MMA further attempts to compare NAMMA and BMM costs. However, MMA appears to ignore the fact that the single piece metered letter proxy that is used for BMM letters contains costs for both machinable letters and nonmachinable letters. BMM, in contrast, is generally regarded to be machinable. The proxy costs also contain cancellation and meter prep costs. That is why the BMM proxy cost (13.073 cents, in tab CRA-Bulk Metered Letters of USPS-FY07-10) and the NAMMA cost (4.498 cents in tab MACH-MAADC-AADC of USPS-FY07-10) are so different. MMA is likewise off the mark in its attempt to compare MAADC cost and Nonautomation costs.²⁷ Nonautomation letters sometimes are presorted to the three- and five-digit levels, compared to automation MAADC letters, which never are presorted to those levels. The mail pieces are not processed through the exact same operations and, as a result, they are not expected to have identical costs.

MMA's DPS argument on pages 15-17 of its Comments, meanwhile, seems to be largely a results-driven criticism of the cost model that is inconsistent with past Commission practice in the last four omnibus rate cases. That criticism should not be used to alter the cost avoidances calculated by the Postal Service in its Compliance Report.

²⁶ The Commission states in the Opinion and Recommended Decision: "The Commission accepts the use of a single CRA cost estimate that combines the costs of non-automation and automation presort." This certainly belies MMA's claim that "the only evidence of what the Commission did was buried" in a Library Reference. MMA Comments at 11.

²⁷ *Id.* at 14-15.

While most of MMA's concerns about the worksharing cost models are directed to the Commission's methodology, the one exception is its assertion that the Postal Service used a methodology that was rejected by the Commission in Docket No. R2006-1 for measuring QBRM cost savings.²⁸ MMA, however, distorts the outcome of that case. While it is true that the Commission criticized the Postal Service's QBRM cost model, it also criticized the alternative methodologies proposed by MMA and Time Warner."²⁹ The Commission did not, however, provide an alternate methodology in its QBRM cost analyses for the Postal Service to replicate in this Report. Lacking a clear direction from the Commission, the Postal Service therefore produced a QBRM cost savings analysis that is consistent with past Commission proceedings, as shown in the Postal Service's Brief and Reply Brief in Docket No. R2006-1.

2) Time Warner

As noted above, the Periodicals cost model (presented in USPS-FY07-11) is a product of circumstances created when the Commission completely revamped the Periodicals price structure in Docket No. R2006-1. In its comments, Time Warner makes several suggestions to improve the Periodicals model. The Postal Service agrees that the model, as it stands, may not provide an accurate estimate of the relative

²⁸ *Id.* at 10 n.5.

²⁹ More fully, the Commission stated:

None of the cost estimates presented on this record reflect this reality. By ending its analysis after the first barcoded sort, the Postal Service's model fails to capture the costs generated by those pieces that require additional sorts to isolate. *Conversely, the cost avoidance estimates proposed by Time Warner and MMA overstate the true savings by assuming that every QBRM piece must be processed through the incoming secondary.*

PRC Op., R2006-1, at p. 166 (emphasis added). MMA chose to share the first half of the quote, but omit the second half.

cost differences among pieces, bundles, and containers at different levels of presort and entry. The Postal Service would welcome the opportunity to review and research each element of the model, make appropriate methodological changes, and update parameters, so that it can provide the Commission with what it believes to be more accurate measurement of the costs of pieces, bundles, and containers. The Postal Service suggests that the Commission consider that there may be shortcomings in the model's methodology and with some of the model's parameters, and start a process in which the Postal Service could collaborate with the Commission and other interested parties to make further corrections and improvements in advance of next year's Report.

Time Warner (as well as ANPM/MPA) has specific concerns regarding the AFSM 100 cost pool, operation 140 costs, and the CRA cost adjustments. The Postal Service agrees that the cost model, as it currently stands, does not provide the best cost estimates because of the inclusion of OP 140 flats prep costs in the AFSM 100 pool. There are dozens of short-term solutions that could be applied, and all would be imprecise. At this time, the Postal Service has not evaluated the merits of each possible solution. The long-term solution will require more investigation to find the best possible method to address flats prep costs in the model.³⁰

³⁰ The Postal Service must take exception to one Time Warner line of comments on this topic. Time Warner claims:

Unfortunately, the IOCS tallies filed in FY07 LR-27 are of no help in determining how the MODS 140 workhours were used by different types of mail or different sort schemes. That is because not a single tally indicates MODS number 140, even though IOCS clerks are supposed to record the MODS number a sampled employee is clocked into.

Time Warner Comments at 21 n. 6. Similar claims are made on pages 20 and 26. In fact, however, there are 3435 tallies in the IOCS dataset submitted in USPS-FY07-27 where a MODS code of 140 has been recorded for a clerk or mailhandler. Full data on activities of and mail handled by these employees are available for analysis.

Time Warner also provides a discussion of how bundle breakage is incorporated into the model. While its comments may have merit, they are also incomplete. Bundle breakage is considerably more complicated than what is reflected in the model, in the Docket No. R2006-1 testimony of witness Stralberg, or in Time Warner's Comments in this docket. Bundles can and do break at every stage of processing; some sources of breakage have been thoroughly discussed in previous testimony, others have not. Bundles break inside sacks as sacks are processed; during transit as pallets rub against each other; when pallets are loaded, unloaded, or cross-docked (either from the friction of the fork-lift or accidental collisions with staged pallets); and when bundles are dumped onto belts (either belts at the SPBS, APPS, or belts feeding manual bundle sort operations). Bundles break when they fall into hampers at the SPBS or APPS runouts; when they are manually thrown into hampers in manual bundle sort operations; and when bundles land upon them. At each and every possible stage that breakage can occur, the incidence of breakage is likely to differ. For example, bundles sorted from pallets manually may incur less breakage *prior to sortation* than on the APPS or SPBS because SPBS and APPS sortation will involve the stresses of dumping and the friction of the belts, as noted by Time Warner. However, manually sorted bundles incur greater incidence of breakage *during and after sortation* because the bundles are pitched greater distances into hampers than is required on APPS or SPBS machines, which Time Warner does not acknowledge.

Incorporation of differential incidences of breakage by sortation technology and by processing point (prior to sortation, during sortation, or after sortation) will greatly increase the complexity of the model. In addition, accurate measurement of the

differential breakage is both difficult and expensive. As modeled in the Annual Compliance Report, the additional cost due to broken bundles is less than 1.4 percent of total Outside County Periodicals CRA mail processing costs. Although bundle breakage costs are relatively small, selective adjustments to the way breakage is modeled, as proposed by Time Warner, would distort the relative costs associated with pieces of different presort levels.

3) ANPM/MPA

In large measure, the comments of ANPM/MPA regarding the Periodicals cost model are similar to those of Time Warner, and thus the above comments regarding Time Warner are generally applicable to ANPM/MPA as well. An additional issue raised by ANPM/MPA (which is raised by Time Warner as well) is that of piece costs relating to allied operations. ANPM/MPA believe that such “allied piece costs” should be included when measuring avoided costs, and cite as one reason the need for “internal consistency.”³¹ Yet what is not addressed is the potential lack of internal consistency if the costs of allied operations are included in per-piece costs, but not in per-bundle costs. The Postal Service submits that this entire line of discussion merely underscores the need, in the context of the still relatively new Periodicals price structure, for a comprehensive re-evaluation that seeks both a sound theoretical construct for the concept of “cost avoidance,” and the identification of practical means to provide the best available empirical estimates of the parameters necessary to implement the appropriate theoretical framework.

³¹ See ANPM/MPA Comments at 15.

4) Valpak

As it has done in the last several omnibus rate cases, Valpak points to what it continues to call “anomalous costs” for ECR mail.³² Yet Valpak’s protests that these cost results are “unexplained” ring just as hollow in this proceeding as they did in the last rate case. As noted in the Postal Service’s Reply Brief (pages 126-27) in Docket No. R2006-1, the reality is not that certain results are unexplained (or unexplainable), but rather that Valpak would prefer to ignore the explanations proffered. In any event, the Postal Service has applied the established methodology, and nothing in Valpak’s comments justifies any departure from the FY 2007 results which that methodology produces.

Beyond that, Valpak introduces a major red herring into the mix when it focuses on the volume reported for Detached Address Labels (DALs) within the annual billing determinant data in USPS-FY07-4. Valpak raises a number of questions about that billing determinant data, and then surprisingly inquires “what volume was used to distribute city and rural carrier costs for the year, and ... from whence was that volume derived?”³³ Valpak should be well aware, however, that to understand carrier cost distribution questions, it makes sense first to examine the relevant carrier costing materials, not billing determinant data. As explained plainly on page 2 of the Preface to USPS-FY07-19 regarding delivery costs, DALs were identified and recorded separately in FY 2007 as part of the two Carrier Cost Systems (City and Rural). The respective city and rural estimates for DALs in FY 2007 were 2,278,393,126 and 866,182,586 (USPS-FY07-19, UDCInputs071211, worksheet DALs cells D15 and D21). Once again,

³² Valpak Comments at 37-39.

³³ Valpak Comments at 41-42.

despite the claims of Valpak that questions it wishes to raise are “unanswered,” the answers are, in fact, exactly where one would expect to find them.³⁴

III. Worksharing Discount Passthroughs

Several parties raise issues about the calculation of the passthroughs in USPS-FY07-3. These comments are discussed below.

A. APWU

The American Postal Workers Union (APWU) expresses “concern” about the Postal Service’s analysis of worksharing cost differences within products, and not between products.³⁵ In particular, APWU questions the fact that the Postal Service did not examine, in USPS-FY07-3, the passthroughs between BMM and presort First-Class Mail. It claims that this decision is not consistent with Commission’s decision in R2006-1 that rejected the Postal Service’s proposal to “de-link” presort First-Class Mail from single-piece First-Class Mail.³⁶

It should be noted that the Postal Service, consistent with its approach of using pre-existing Commission methodology when presenting its cost models, followed Commission methodology in USPS-FY07-10; the Postal Service therefore provided a mail processing cost estimate for BMM, and applied that estimate to the presort categories to calculate cost differences. The Postal Service did not, however, use BMM as a benchmark for Presort First-Class Mail for purposes of complying with section 3652(b). As the Postal Service discussed in the Report, the language of section

³⁴ With respect to the question Valpak raises (Comments at 43) regarding DALs and parcels, the Postal Service has already provided an explanation in response to Question 14 of Commission Information Request No. 2.

³⁵ APWU Comments at 2.

³⁶ *Id.*

3652(b), which directs the Postal Service to provide the specified workshare data “*with respect to each market-dominant product for which a workshare discount was in effect,*” suggests that the proper analysis is to measure worksharing differences on an intra-product, rather than inter-product, basis.³⁷

Other parties agree with the Postal Service’s approach.³⁸ For its part, APWU also clearly recognized the implications of the Postal Service’s proposal in Docket No. RM2007-1 to separate single-piece and presort First-Class Mail into separate “products” in the new Mail Classification Schedule, since it argued against such an outcome, noting that was “functionally equivalent to the Postal Service’s proposal, rejected by the Commission last year, to de-link single piece and workshare rates.”³⁹ The Commission, however, accepted the Postal Service’s proposal (after noting APWU’s concerns), and placed Single-Piece Letters and Presort Letters into separate products.⁴⁰ Thus, the Postal Service has acted in a manner consistent with regulatory developments since Docket No. R2006-1, and consistent with the PAEA.

B. NAPM

NAPM criticizes the Postal Service for measuring its passthroughs at the margin between rates.⁴¹ The Postal Service recognizes that presort discounts and passthroughs can be calculated in several ways. Nevertheless, the Postal Service believes that the approach it has taken is consistent with the Commission’s rules and past practice regarding the identification of discounts and passthroughs. The Postal

³⁷ See Annual Compliance Report at 20-22.

³⁸ See NPPC Comments at 6; DMA/PSA Comments at 2.

³⁹ See Docket No. RM2007-1, Comments of the American Postal Workers Union, AFL-CIO on United States Postal Service Mail Classification Schedule, at 2 (October 9, 2007).

⁴⁰ See Order No. 43 at 103.

⁴¹ NAPM Comments at 2. DMA and PSA, however, agree with the Postal Service’s approach. DMA/PSA Comments at 2.

Service's approach also allows the consideration of factors, such as those raised by NAPM, when choosing the level of costs that are passed through as discounts. When developing discounts and passthroughs, the Postal Service attempts to take all relevant factors into consideration, whatever method is used to report discounts and passthroughs.

C. DMA/PSA

The Direct Marketing Association and the Parcel Shippers Association (DMA/PSA) argue that the Postal Service inappropriately calculated the passthroughs in USPS-FY07-3 because it compared the current discount, which was only in effect for part of FY 2007, to the avoided cost figure that measures the entirety of FY 2007.⁴² DMA/PSA argue that both the discount and cost avoided figure must cover the same time period, and suggests a means of deriving a volume-weighted discount figure for the entire fiscal year.

In the Postal Service's view, however, section 3652(b) does not require an exact temporal alignment between a discount and avoided costs. Instead, that section is intended to call attention to discounts that are (or are getting) way out of line with avoided costs, and to then see whether such discounts are justified. This accords with the language of section 3622(e), which, when read in its entirety, establishes not a rigid pricing rule but a general principle that allows for the consideration of context over time.⁴³

Respectfully submitted,

UNITED STATES POSTAL SERVICE

⁴² *Id.* at 2-3.

⁴³ See Docket No. RM2007-1, Reply Comments of the United States Postal Service on the Second Advance Notice of Rulemaking, at 9-11 (July 3, 2007).

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