
ANNUAL COMPLIANCE REPORT

Docket No. ACR2008

**INITIAL COMMENTS OF VALASSIS DIRECT MAIL, INC. AND
THE SATURATION MAILERS COALITION CONCERNING
THE POSTAL SERVICE'S FY2008 ANNUAL COMPLIANCE REPORT**

(January 30, 2009)

Pursuant to the Commission's Notice issued on December 31, 2008, Valassis Direct Mail, Inc., a wholly owned subsidiary of Valassis Communications, Inc., and the Saturation Mailers Coalition hereby submits their initial comments concerning the Postal Service's second Annual Compliance Report (ACR) filed on December 28, 2008.

In general, we believe that the Postal Service has made good progress in improving its ACR compared to its initial FY2007 report. Several methodologies have been improved, which, in conjunction with more refined data collections, have led to costs that, on the whole, are more reliable and better attuned to product groupings than before. In addition, the Postal Service's workpapers and spreadsheets are, for the most part, better organized and easier to follow than before (except, of course, for the added difficulty generated by its decision to break the CRA and related workpapers into separate public and nonpublic files). While recognizing that further improvements can be made, we commend the Postal Service's efforts in this difficult task.

Our comments fall into three general categories. First, we address erroneous assumptions made by Valpak concerning volume data and costing of saturation detached address labels (DALs). Second, we comment on several technical issues relating to the Postal Service's costing. Third, we address the Commission's definitions

and treatment of what constitutes a “worksharing” discount under the Postal Accountability And Enhancement Act (the PAEA).

I. VALPAK’S CONCERN ABOUT DAL VOLUMES IS MISPLACED; THE CARRIER COST DATA SYSTEMS CORRECTLY REFLECT THE DRAMATIC SHIFT IN DELIVERY CHARACTERISTICS OF DALs DUE TO IMPLEMENTATION OF THE DAL SURCHARGE.

Valpak, and subsequently the Commission, have raised questions about the apparent disparity in Saturation DAL volumes as shown in the FY2008 Billing Determinants (BD) versus the City Carrier/Rural Carrier Cost Systems (CCCS and RCCS). The Billing Determinants show DAL volumes of 901.5 million, compared to 640.8 million in the CCCS/RCCS. This has led Valpak to presume that the CCCS/RCCS volumes must be understated, which it believes requires some adjustment to shift carrier costs from saturation letters to DALs and flats. To the contrary, however, this differential between CCCS/RCCS and BD volumes correctly reflects the fundamental change in DAL delivery characteristics caused by implementation of the DAL surcharge in Docket R2006-1.

Billing Determinant volumes represent the total number of DALs in the system, encompassing all types of postal delivery. But for purposes of allocating city and rural carrier costs, the relevant volume is the proportion of those total DALs actually delivered by city/rural carriers – excluding volumes delivered by other means such as Post Office Boxes, Highway Contract Carriers, and General Delivery. Thus, the CCCS/RCCS DAL volumes will always be less than the total BD volumes.

For Saturation/High Density letters and flats/parcels, the proportion of CCCS/RCCS volumes to total BD volumes is quite similar: 92.3% for letters versus 92.5% for flats/parcels – indicating that about 8% of both letters and flats are delivered

by means other than city and rural carriers.¹ This similarity is reasonable, since there is no marketplace reason to believe that Saturation/High Density letters and flats have a markedly different pattern of distribution.

For DALs, however, there has been a fundamental shift in distribution characteristics due to implementation of the DAL surcharge in the Docket R2006-1 rate case, which took effect in May of 2007. Prior to the surcharge, the distribution of DALs by delivery type was very close to that of Saturation flats as a whole. But after the surcharge became effective, virtually all of the larger saturation mailers operating in mid- and large-size metropolitan areas (where almost all deliveries are made by city or rural carriers, with virtually no post office box or highway contract deliveries) have discontinued DALs and shifted to on-piece addressing. By contrast, those mailers that have continued to use DALs tend to be smaller mailers operating in predominantly rural areas where post office box, general delivery, and highway contract deliveries can account for over 40 percent of the total deliveries.

Thus, Valpak's presupposition that the delivery characteristics for saturation mailers that have continued to use DALs are the same as for those that have converted from DALs to on-piece addressing is incorrect. The much-reduced current DAL volumes are now skewed toward a much higher proportion of non-city/non-rural carrier deliveries.²

¹ The CCCS/RCCS and BD/RPW volumes in this comparison are for letter-rated letters vs. flat/parcel-rated pieces, in USPS-FY08-32, CS06&7.xls and CS10.xls, shape-adjusted as specified in USPS-FY08-14, Shape Indicia MCS FY2008r ACRV col.xls.

² In R2005-1, the Commission estimated the total volume of Saturation DALs at 4.314 billion (PRC Opinion at 136, citing witness Crowder). For FY08, as a result of the
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Although there are no USPS data systems that can directly quantify this difference by delivery type, there are data from Docket R2005-1 that illustrate this disparity among mailers by size and geographic market. At the request of Valpak, Advo provided volume information, including delivery type, for DAL mailings of Advo, its subsidiary Mail Marketing Systems, Inc. (MMSI), and 14 independent mailers who form a joint selling network known as the Advo National Network Extension program (ANNE). The following table, taken from Advo's response to VP/ADVO-1-4 in R2005-1, shows the proportion of non-city/non-rural delivery of DALs in calendar year 2004, prior to the DAL surcharge:

TABLE 1
CY 2004 PROPORTIONS OF DALs BY DELIVERY TYPE

	<u>CY 2004 Total DALs</u>	<u>P.O. Box, Highway Contract & General Delivery DALs</u>	<u>% PO, HC & Gen. Del. DALs</u>
Advo	3,145,472,576	156,672,844	4.98%
MMSI	53,581,776	9,409,000	17.56%
ANNE	383,785,000	53,879,000	14.04%
Total	3,582,839,352	219,960,844	6.14%

Not coincidentally, MMSI and the ANNE mailers tend to operate in smaller towns and rural markets not covered in Advo's mail programs, and therefore have a higher

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surcharge, DAL volume has plummeted to only 0.901 billion -- a greater-than-80 percent reduction since 2004 even without adjustment for Saturation mail growth over that period. The vast majority of that conversion to on-piece addressing has come from mailers serving mid-to-large-size metropolitan markets.

proportion of non-city/non-rural carrier delivery.³ But even within ANNE, there are wide variations in type of delivery by mailer, with non-city/non-rural carrier deliveries ranging from roughly 8 percent for mailers operating in mid-size cities to 40 percent for smaller mailers serving small towns and rural areas. It is this latter category of smaller mailers that have been least able to convert to on-piece addressing, and that continue to use DALs.

Given these fundamental shifts in DAL usage patterns caused by the surcharge, it is likely that both the CCCS/RCCS and the RPW/BD volume figures for DALs are correct, the difference reflecting the far more rural makeup of mailings that continue to use DALs. Accordingly, there is no basis to make any adjustment that would shift city and rural carrier costs from Saturation letters to DALs.

We would note that a shift of costs from Saturation letters to DALs, as contemplated by Valpak, would not have any adverse impact on Valassis because it has converted all of its shared mailings to on-piece addressing. However, it would adversely affect DAL costs for many smaller saturation mailers that are still using DALs. Indeed, this concern about the impact of the DAL surcharge on smaller mailers in more rural markets is what prompted the Saturation Mailers Coalition (SMC) in Docket R2006-1 to urge the Postal Service to offer a “simplified addressing” alternative to the DAL. As SMC witness Pete Gorman testified:

³ The more rural character of the ANNE mailings compared to Advo is also reflected in the breakout between city versus rural carrier delivery. For Advo, 72% of its DAL mailings in 2004 were delivered by city carriers, compared to only 23% rural carriers. For ANNE, only 44% were delivered by city carriers, nearly equal to the 42% delivered by rural carriers. *Compare* VP/ADVO-1 and 4, Docket R2005-1.

“For many DAL mailers, however, conversion to ‘city-style’ on-piece addressing is impractical and would greatly disrupt their business models and operations, particularly for those DAL mailers that do not do their own production but use outside printers or mail houses. Our members have different business reasons for the way they do business, and face differing challenges in adapting to the Postal Service’s proposal. For many, conversion to ‘city-style’ on-piece addressing is not cost-effective or workable. Proposing solutions that give mailers choices and work for the industry, and the Postal Service, is the key reason why the SMC has been pressing for a ‘simplified but certified’ addressing alternative on city routes.” SMC-T-1 at 12, Docket R2006-1.

Until the Postal Service allows simplified addressing, these smaller mailers who are unable to convert to on-piece addressing will continue to be forced to use DALs and pay the surcharge. Their only alternatives today are to switch to private delivery where addressing is unnecessary (as some have done and others are considering), or to go out of business.

Adverse impact on small mailers, of course, is not a justification for failing to correct erroneous cost data. It is, however, good cause to ensure that the data are, indeed, incorrect before making costing shifts that may harm those small DAL mailers. Here, there is absolutely no evidence that the DAL volumes collected in the CCCS and RCCS data systems are incorrect. To the contrary, the evidence that does exist clearly demonstrates that, as a direct result of the DAL surcharge, the remaining DALs in the system have a much higher proportion of non-city/non-rural carrier deliveries than before – including substantial volumes to Post Office Boxes, Highway Contract, and General Delivery that must be excluded in calculating city and rural carrier costs. No adjustment is warranted.

II. TECHNICAL ISSUES CONCERNING COSTING DATA AND METHODOLOGY.

A. Transfer of DAL Delivery Cost Estimate from USPS-FY08-19 (Unit Delivery Cost) to USPS-FY08-32 (“B” Workpapers) (Order 169, Issue 4).

For FY07, the USPS introduced a new, improved method for identifying the volume of DALs in the postal system. This was done through modifications in the CCCS and RCCS data collections. In addition, the new information identified the relevant cost characteristics of those DALs: whether they were DPS, city sequenced, rural boxholder, etc. For that same year, the Unit Delivery Cost worksheets (USPS-FY07-19) were modified and refined from those of earlier years, but still were rather complex and difficult to follow. The much-improved FY07 CCCS/RCCS DAL information was used in those FY07 worksheets correctly but in a rather inelegant manner.

For FY08, the USPS has continued its refinement of the Unit Delivery Cost worksheets (USPS-FY08-19) and made them much easier to follow. Additionally, it has identified a much more refined way to distribute DAL costs (removing them from “letters” and transferring them to flats and parcels) within USPS-FY08-32 “B” workpapers (CS06&7.xls). The new approach to the attribution of DAL costs is a clear improvement and makes Unit Delivery Cost analysis much easier to understand and follow. It accomplishes what it is intended to accomplish.

B. The New High-Density/Saturation Adjustment to Transfer Non-Qualifying Letter-Shaped Volumes and Costs to Flats (Order 169, Issue 1).

In the past, when estimating unit mail processing and delivery costs for High-Density and Saturation letters and flats, the USPS identified letter and flat costs

and then divided them by letter- and flat-shape volumes. These unit costs were then used as a basis for High-Density and Saturation letter and flat rates. However, it has always been known that some letter shapes, and their associated costs, should be assigned to flats because those letter-shaped pieces are not automation compatible and are therefore rated as flats. For ease of exposition, we call these pieces letter-shapes-rated-as-flats (LSRAFs) and call letters that are rated as letters as letter-rated-letters (LRLs).

We have no conceptual problem with the transfer of High-Density/Saturation LSRAF cost and volume to High-Density/Saturation flats. For purposes of identifying unit costs of flat-rated pieces, it is appropriate to recognize that some flat-rated pieces are LSRAFs. Very simply, this comports with the basic rate-making concept that rates (for flat-rated and letter-rated pieces) should be matched with their associated costs. Thus, the LSRAF unit costs should be averaged into the unit cost for flat-rated mail and removed from the unit cost for letter-rated.⁴ That is what the USPS has attempted to do in this ACR.

We believe, however, that the implementation of this concept needs refinement. For purposes of developing unit costs, the USPS appears to have correctly identified the LSRAF volumes to be transferred to flat-rated mail. But it has not identified the

⁴ In Order 169, p.3, the Commission states: "Because letter-shaped mail generally incurs lower per-piece costs than flat-shaped mail, the accepted approach may be seen as preferable to the proposed method which adds the cost of these letter-shaped mailpieces to the cost of flat-shaped mail, and thus may not reflect the per-piece cost of flats." We do not entirely understand the rationale for this statement but disagree with its conclusion. Regardless if LSRAF unit costs are lower, the same, or higher than flat unit costs, they should be recognized in the unit cost for flat-rated mail. That is the only relevant point: we are trying to estimate the unit cost for flat-rated and letter-rated mail.

LSRAF-specific costs associated with that volume. Instead, it has assumed that the average unit cost for LSRAFs is equal to that for LRLs. However, we believe that, at the saturation level at least, LSRAFs are likely to have unit mail processing costs (prior to adjustment to origin-level) more similar to that for flats than to LRLs. This is because LSRAFs can avoid virtually all plant and DDU operations while LRLs cannot. For delivery, however, LSRAFs still are letter-shaped and therefore still would have a letter-shape cost, for both city and rural delivery. Moreover, LSRAFs are more likely to be sequenced by city carriers and mailed as boxholders on rural routes. Thus, LSRAFs are likely to have a slightly lower unit delivery cost than LRLs.

The USPS cost assumption in this case is probably adequate for this initial cut at the analysis. But, we hope the USPS will refine its approach in subsequent analyses.

C. ECR Unit Costs (USPS LR FY08-18).

In USPS FY08-18 (FY08 ECR Unit Costs, Tab Factors), the USPS assumes that 8.8% of both High-Density and Saturation letters are LSRAFs and transfers those costs to High-Density and Saturation flats. However, USPS FY08-26 (shp08PRC.xls, Tab Sat and HD Adjustment), shows that there is a difference in the proportion of LRAFS between High-Density and Saturation letters. It shows that 4.2% of High-Density letters are LSRAFs while 10.3% of Saturation letters are LSRAFs. Given that the FY08-18 analysis identifies separate High-Density and Saturation mail-processing costs by shape, these individual proportions should have been used instead of the average. Using the USPS method, this means that 4.2% of High-Density letter cost should be transferred to High-Density flat cost while 10.3% of Saturation letter cost

should be transferred to Saturation flat cost. The same proportions of LSRAF volumes should then be appropriately transferred to flat volumes.

However, we have detected an apparent error in the volumes used in USPS FY08-18 (FY08 ECR Unit Costs, Tab Results). Specifically, the volumes for WSH and WSS Letters, and for WSH and WSS Flats, do not match the volumes in either USPS-FY08-14 (Shape Indicia MCS FY2008r ACRV Col.xls, Tab Sat and HD) or in the Billing Determinants (USPS-FY08-4). The piece volumes affect not only the average unit mail-processing cost (prior to adjustment for origin entry) but also the origin-entry adjustment. In addition, and perhaps even more importantly, the corresponding pound volumes used to estimate the origin entry adjustment are also incorrect. These should be corrected to match the RPW/BD volumes.

Correction of these errors changes the unit mail processing cost for Saturation/High-Density letters and flats as shown below.

Table 2
Original vs. Corrected FY08 ECR Unit Costs
Adjusted to Origin Entry
(¢ per piece)

	Original Unit Cost	Corrected Unit Cost
Saturation Letters	1.844	1.848
High-Density Letters	1.416	1.411
High-Density Flats	2.597	3.107
Saturation Flats	1.892	1.867

Source: Corrected_FY08 ECR Unit Cost.xls (USPS-FY08-18)

Most changes are small. The greatest change is in the High-Density flat unit cost. This is due to the fact that the corrected High-Density flat piece volume changes very little, but the associated pound volume used to make the origin entry adjustment was substantially understated relative to the correct figure.

We have notified the USPS of these issues and it has stated that it will provide corrections soon.

Separately, we would point out that the Saturation flat unit mail processing costs in Table 2 above include the IOCS-identified DAL mail-processing costs. Properly, the Saturation flat unit cost should exclude the DAL mail-processing costs. The DAL surcharge should be compared to DAL unit costs while the Saturation flat rate should be compared only to the unit costs caused by the flats themselves. Because of the inclusion of DAL costs, the Saturation flat unit costs in Table 2 above are somewhat overstated, particularly since DAL costs may have increased due to DPSing. These costs are likely to be very small, but, in the future, they should be separated from the flat costs, just as is done for delivery costs.

D. Unit Delivery Costs (USPS-FY08-19).

We have two issues in the unit delivery cost area. First, in UDCInputs08.xls, Tab RPW Shape, cell D23, the high-density flat volume of “2,074,779” should be changed to “2,064,779.” This looks like a simple typographical error in the inputting of one of the volumes added together in the calculation within cell D23. This will have the effect of increasing the High-Density flat unit cost from 6.347 cents to 6.378 cents. This is another case where we have already notified the USPS and hope to see a correction soon.

Second, in UDCModel08, Tab 11.BYSummary, the Saturation flat unit cost used to develop the final USPS Table 1 figure is developed as the cost of addressed Saturation flats (derived from row E117 in Tab 11.BYSummary). We disagree with that approach. Instead, the Saturation flat unit cost should include the costs of all Saturation

flats (as well as costs for any Saturation LSRAFs), whether they are addressed or not. Again, the concept that supports this choice is that rates for flat-rated pieces should be based on the costs for flat-rated pieces. And, both addressed and unaddressed flats are flat-rated pieces. The Commission in R2006 appeared to agree (see PRC Opinion at 283, ¶¶ 5554 and 5564). With that change, the result is a Saturation flat unit cost of 4.42 cents rather than 4.48 cents.

E. Rural Delivery Costs (USPS-FY08-32 (CS10.xls)).

The Rural Mail Count (RMC) provides two key pieces of information used to attribute rural carrier costs:

- The average weekly measures for each of the measured carrier activities, including the volumes of delivered mail by shape and associated cost characteristics (e.g., non-DPS/SS other letters, DPS letters, regular flats, boxholders, COD, etc.) – i.e., “mail types.”
- The rural carrier agreement evaluation factors (time standard) for each of the measured carrier activities, including individual standards for delivery of each “mail type.”

The RMC proportions of average weekly time for each mail type are used to divide rural delivery accrued costs into variable cost pools by mail type, while the Rural Carrier Cost System (RCCS) is used to distribute each cost pool among rate categories.

Clearly, the intent of this process is to develop unit variable costs for each mail type that are proportional to the original evaluated unit times/costs.⁵ If this is done as intended, it provides the correct cost information to use in developing rates that signal to mailers, at least in part, the actual rural carrier costs caused by their mail.

⁵ This means they should have equal “markups” over evaluated cost. Markups are required because there are some piggybacks within CS10 that cause the evaluated times/costs to be “marked up.” Also, the evaluated times/costs do not reflect additional rural costs caused by changes in weekly volumes and route characteristics over time.

Unfortunately, there is a proportional mismatch between the RMC average weekly volumes by mail type and those collected by the RCCS. The proportions of mail type differ between the two, as shown in the following table.

**Table 3
Comparison of RMC and RCCS Proportions by Mail Type**

Mail Type	Weekly RMC Pieces (1)	RMC Proportions (2)	RCCS Total Volume (3)	RCCS Proportions (4)
Other Letters	3,078	19.15%	8,442,492	15.24%
Flats	3,569	22.21%	12,722,609	22.96%
Parcels	215	1.34%	704,112	1.27%
Boxholders	891	5.54%	1,841,308	3.32%
DPS Letters	8,165	50.81%	31,373,292	56.63%
SS Letters	153	0.95%	318,033	0.57%
Total Letters	11,397	70.91%	40,133,817	72.44%
Total	16,071	100%	55,401,847	100%

Note: Calculated from CS10.xls, RMC volumes for evaluated and other routes combined on a weighted-cost basis.

The disparity occurs because the proportions of mail types in the system differ between the RMC average weekly measure and the RCCS annual estimate of volume. This is likely due to multiple causes – e.g., differences between RMC routes and all rural routes, seasonality of volumes and changes in volumes over time (the RMC occurs for two to four weeks in early spring while RCCS collects data all year), volume differences from FY06 to FY08, and even, perhaps, changes in other features of rural routes.

This disparity between RMC and RCCS proportions causes tremendous variation in the “markups” of evaluated unit cost by mail type compared to the final unit variable costs, as shown in column 8 of Table 4 below. It should be noted that the average “markup” should be roughly 267% (see column 11 of Table 5 below).

Table 4
RMC Evaluated Unit Cost Vs. Unit Variable Cost from RCCS Distribution

Mail Type	RMC Evaluation Factor (Minute) (5)	RMC Evaluated Unit Cost (6) = (5)*\$0.228	Unit Variable Cost Using RCCS Volume (7)	“Markup” of Unit Variable Cost to RMC Eval Cost (8) = (7)/(6)
Other Letters	0.0699	\$0.0159	\$0.0539	338.1%
Flats	0.1143	0.0261	0.0673	258.1%
Parcels	0.5000	0.1140	0.3209	281.4%
Boxholders	0.0400	0.0091	0.0407	446.4%
DPS Letters	0.0333	0.0076	0.0182	239.0%
SS Letters	0.0587	0.0134	0.0657	491.0%
Total Letters			0.0260	

Note: \$0.228 = \$13.6856/60. Hourly rate of \$13.6856 from National Payroll Hours Summary Report, Pay period FY08-20 YTD; calculated from CS10.xls.

The disparity among markups produces the wrong unit costs for ratemaking. For boxholder mail the problem is particularly severe; the RMC cost pool percentage of 5.54% is 66% higher than the RCCS volume proportion (i.e., 5.54/3.32 from Table 3 above, columns 2 and 4). This causes boxholder RCCS-based unit cost to be excessively high relative to the true RMC evaluated cost – a 446% markup vs. a 267% average markup (compare column 8 of Table 4 above, with column 11 of Table 5 below). There is also a severe disparity for SS letters but there are very few SS letters in the system and, for ratemaking purposes, their costs are consolidated with those of DPS and other letters such that the total letter disparity is very small.

The boxholder problem is especially serious because boxholder mail is used extensively by only one type of mail – Saturation flats – and represents a large portion of Saturation flat rural volumes. Moreover, an incorrect boxholder unit cost provides the wrong information for making decisions on the promotion of simplified address mail.

At this time, one way to correct this disparity is simply to adjust the RCCS mail type volumes so they match the RMC weekly proportions by mail type. This would provide equal markups over RMC evaluated cost for each mail type, as shown in column 11 below.

Table 5

Mail Type	RMC Proportion of System (2) (Table 3)	RCCS Volume Adjusted by RMC Proportions (9) = (2)*Total RCCS Volume	Revised Unit Variable Cost (10)	“Markup” of Revised Unit Variable Cost to RMC Est. Cost (11) = (10)/(6)
Other Letters	19.15%	10,611,407	0.0429	269.0%
Flats	22.21%	12,302,356	0.0696	266.9%
Parcels	1.34%	739,635	0.3055	267.9%
Boxholders	5.54%	3,071,731	0.0244	267.6%
DPS Letters	50.81%	28,148,738	0.0202	266.3%
SS Letters	0.95%	527,979	0.0396	295.7%
Total Letters	70.91%	39,288,124	0.0266	
Total	100%	55,401,847		

Note: Calculated from CS10.xls

Comparing the corrected unit costs in column 10 with the USPS results shown in column 7 of Table 4, the unit cost for letters (combined other, DPS, and SS letters) would increase only slightly ($2.3\% = 2.66/2.60$), flats would increase somewhat more ($3.4\% = 6.96/6.73$), but boxholder unit cost would decrease considerably ($60.0\% = 2.44/4.07$). Clearly, this is a better way to attribute and distribute rural variable costs among the mail types.

F. Standard Destination Entry Cost Avoidances (USPS LR FY08-13).

The Standard destination entry cost avoidance non-transportation models in FY08-13 assume that clerk-mailhandlers always unload mail at the DDU and take it to the appropriate staging area, regardless of whether it comes from the plant or is

dropped at the DDU by the mailer. However, when Valassis drops mail at the DDU, it virtually always unloads the mail to the DDU dock and sometimes even takes it to the appropriate staging area (that sometimes is inside the building). This likely is true for most Saturation flat mailers that drop at the DDU. This mailer worksharing, although, relatively minor, should be recognized in the models. In the future, we ask that the proportion of time this activity is relevant is identified and recognized in the DDU cost avoidance estimates.

III. **ECR “WORKSHARING DISCOUNT” CONCEPT (ORDER 169, ISSUE 9)**

At page 5 of Order 169, Issue 9, the Commission states:

“The Postal Service’s analysis of Standard Mail worksharing discounts does not present the established method of estimating cost avoidances between (1) Basic and High Density, and (2) High Density and Saturation for letters, flats, and parcels. See USPS-FY08-3 and ACR at 50-51.”

This apparent view that rate differences between Basic, High Density, and Saturation are purely a function of – and statutorily restricted by – “worksharing” cost differences is a throwback to the days when these types of mail were considered rate categories within a singular subclass grouping. Indeed, through linkage of these two “discounts,” the Commission’s approach would create a direct worksharing link and statutory restriction on rate differences between Basic and Saturation mail. That outcome would effectively eviscerate the Postal Service’s eminently well-reasoned conclusion that these mail groupings are truly separate and distinct products, not merely worksharing categories within a single homogeneous product.

We agree with the Postal Service that the cost and rate differentials between these products are not a function of “worksharing,” i.e., extra mail preparation activities

that a mailer voluntarily undertakes to eliminate handlings or costs that the USPS would otherwise incur, such as “presorting, prebarcoding, handling, or transportation of mail” as listed in the Section 3622(e)(1) of the PAEA. The differentials are instead a function of the *mailing density* chosen by the mailer as suitable for its *marketplace* objectives.

Indeed, a mailer’s decision to mail to only ten addresses on a route (the minimum for Basic) or to all 450 addresses on a route (Saturation) has nothing whatsoever to do with worksharing activities or the discount; it is a marketplace decision driven by the nature of the mailer’s business and the customers it serves or the products it sells. Valassis or other saturation mailers will not suddenly shift to 10-piece-per-route distribution if the rate differential between Basic and Saturation is reduced, nor will a catalog company suddenly opt for saturation distribution if the rate differential is increased. They are in entirely different businesses with different business models and marketplace characteristics: the cataloger needs selective distribution to a highly-targeted demographic profile or list of specific customers, typically thinly dispersed across broad swaths of the nation; while the saturation mailer needs distribution to all consumer households within a selected local geographic market, typically dictated by store locations and marketing radii of local advertisers.

Their competitive circumstances and price sensitivities are likewise distinctively different, and while the differences in their price elasticities may change over time, any such changes in relative elasticities will be driven by their respective and differing marketplace characteristics. They are, quite simply, different “products” under any rational and informed understanding of that term.

The difference between High-Density and Saturation mail within High-Density/Saturation Letters and High-Density/Saturation Flats is also not due to true worksharing since the key distinction between the two rate categories is that High-Density mail is delivered to less than 75% of total deliveries or 90% of residential deliveries on a route while Saturation mail is delivered to over that percentage. Here, too, the cost differences are due primarily to the differing “density” characteristics of the mailings, *not* to differences in the way mailers prepare their mailings. Moreover, High-Density (flat) mailers are typically mailers who do attempt to saturate carrier routes but do so through the combined use of private and postal delivery. This is clearly not a worksharing characteristic but a market/demand-based characteristic.

Arbitrary treatment of mailing-density-related cost and market differences among and within products as “worksharing” will arbitrarily constrain the rates for those products by virtue of the statutory worksharing cost-avoidance limitation – a limitation that by its terms, and by common sense, was not intended to encompass density-related cost differences that are a function of mailer marketplace objectives. This would substantially reduce the Postal Service’s needed flexibility to price its products on the basis of both operational and market/demand differences and thereby maximize both overall mailer welfare and institutional cost contribution.

Respectfully submitted,

/s/

John M. Burzio
Thomas W. McLaughlin
Burzio McLaughlin & Keegan
1054 31st Street, N.W., Suite 540
Washington, D. C. 20007-4403
(202) 965-4555; Fax (202) 965-4432
bmklaw@verizon.net

Counsel for Valassis Direct Mail, Inc.

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