

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

Consideration of Workshare Discount  
Methodologies

Docket No. RM2009-3

Statement of John Haldi, Ph.D.  
Concerning  
Workshare Discounts

On Behalf of  
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and  
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## Purpose

The purpose of this statement is to support the Postal Service's position with respect to Standard Mail as articulated in its response filed on February 20, 2009 to Chairman's Information Request No. 1 (Docket No. R2009-2), and explain why it should be adopted by the Commission. (A summary of my previous postal work is provided in Appendix II.)

### I. Introduction

The Postal Accountability and Enhancement Act ("PAEA") contains the following provision defining "workshare discounts" for market dominant products:

**Workshare discounts.—**

(1) **Definition.**—In this subsection, the term "workshare discount" refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a). [39 U.S.C. § 3622(e).]

#### 1. Discounts

Before addressing the term "workshare discounts," some attention to the term "discount" may be helpful. Although the term "discount" is not explicitly defined by PAEA, as applied to postal tariffs, a discount would imply a stated deduction from a reference price for some purpose.<sup>1</sup> The discount would represent the "price difference" between the reference price and what the mailer actually pays for the item in question.<sup>2</sup>

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<sup>1</sup> A reference price usually is a tariffed rate/price. Use of a non-tariffed rate/price for a reference price can create problems. Fortunately, within Standard Mail, all reference rates/prices have been part of the regular tariff schedule.

<sup>2</sup> When mailers are **required** to presort or prebarcode the mail, the tariff schedule typically does not contain a price for mail that fails to meet the requirements. In the absence of an explicit price for mail **not** presorted (or prebarcoded), labeling any price difference for required presorting or prebarcoding as a "discount" is problematic.

Viewed in another way, discounts result in price differences; some price differences computed from a tariff schedule could be interpreted as representing “discounts.” Whenever two different prices are quoted, deducting the lesser price from the higher price is straightforward, but it should be obvious that every “price difference” thus computed does not necessarily represent what properly could be viewed as a “discount.”

- For instance, in First-Class Mail, the current price for a one-ounce letter is \$0.44, the price for a two-ounce letter is \$0.61, and the difference is \$0.17, but this price difference of \$0.17 is not considered to be a discount that is provided to mailers for sending a one-ounce letter in lieu of a two-ounce letter.
- Similarly, the price for a one-ounce flat is \$0.88, with \$0.44 being the difference between such a flat and a one-ounce letter, but again the price difference of \$0.44 does not represent a “discount” provided to mailers for sending a letter instead of a flat.

Thus, many price differences should not be viewed as “discounts.” If the Commission chooses to treat some “price differences” not usually regarded as “discounts” as “workshare discounts,” it will need to be completely clear about why it believes these differences are discounts at all, as well as what standard it is using to distinguish price differences that are said to represent “workshare discounts” from those that do not.

## **2. Workshare Discounts**

Of course, PAEA employs the phrase “workshare discounts,” not merely “discounts.” The statutory restriction on “workshare discounts” is defined herein in the same manner explained in the legal comments being submitted simultaneously by Valpak in this docket. That is, it applies only in the following circumstances:

- (i) the **workshare activity** must fall within one or more of **four activity categories**:
- presorting,

- prebarcoding,
- handling, or
- transporting mail;

(ii) the discount must be offered **in exchange for** performing workshare activities, and not offered for other reasons (such as demand factors reflecting high elasticity);

(iii) the discount must be based on a price differential existing **within a product** — that is, the workshare activity must be **optional** for the mailer, rather than being **required** to be eligible to use the product; and

(iv) if the workshare activity were **not performed** by the mailer, it would **need to be performed** by the Postal Service.

For further discussion concerning the definition and identification of workshare activities, *see* Section III, *infra*, and Appendix I.

### 3. Standard Mail Issues

In the instant proceeding, the Commission has expressed specific concern about the price difference between (a) Basic and High-Density density tiers, and (b) High-Density and Saturation density tiers:

In Standard Mail, the Postal Service did not use the existing methodology **based on costs avoided** by shape between Basic and High Density, and High Density and Saturation. ... With respect to Standard Mail, the Postal Service argues that density differences between Carrier Route Basic and High Density, and between High Density and Saturation are not a result of “presorting, prebarcoding, handling, or transportation” as worksharing is defined under 39 U.S.C. 3622 (e)(1). ... the Commission is initiating this proceeding to afford the Postal Service (and interested persons supporting its rationales) an opportunity to **address the legal, factual, and economic underpinnings of the methodologies used** by the Postal Service to develop its proposed First-Class Mail and Standard Mail **discount rates** in Docket No. R2009-2. [Docket No. RM2009-3, Order No. 192, pp. 1-2, Mar. 16, 2009, (emphasis added).]

The tariff schedule presented by the Postal Service in its price adjustment filing on February 10, 2009,<sup>3</sup> simply contains prices for Basic, High Density, and Saturation Mail. The tariff schedule does not contain any discounts, as such, nor are any prices labeled as “discount rates.” To be sure, one can compute price differences between Basic and High Density, and between High Density and Saturation. For reasons discussed in more detail below, it is my opinion that even if these price differences are regarded as discounts, they should be seen as density discounts and not be defined as “workshare discounts.” Thus, the limitations of 39 U.S.C. section 3622(e) would not apply.

#### **4. Workshare Cost Methodology**

These comments are focused on the scope of the Commission’s authority to regulate prices under 39 U.S.C. section 3622(e)(1), rather than a discussion of costing methodologies used by the Postal Service. Of course, if the Commission lacks authority to regulate certain price differentials as “workshare discounts,” the costing methodology employed by the Postal Service would not be relevant to any worksharing issue.

## **II. Cost and Price Differences**

For many years, the Commission and the Postal Service have worked together to develop postal rates/prices that are more and more cost-based. This has been accomplished in a variety of ways — *e.g.*, (i) by having various price differences reflect a higher percent of measured cost differences, and (ii) through refinements in the Postal Service’s costing systems that have enabled de-averaging and creation of new price categories. As a result of this

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<sup>3</sup> Docket No. R2009-2, United States Postal Service Notice of Market-Dominant Price Adjustment (Feb. 10, 2009).

movement towards more cost-based prices, the general tariff schedule now contains a large number of explicit price categories, along with various discounts and surcharges.

All prices in the general tariff schedule — including, obviously, differences in those prices — present each mailer with options. For every option whose price reflects lower Postal Service costs, both mailers and the Postal Service can save money when that option is elected. Some, but by no means all, of those options that present mailers with opportunities to save money are properly classified as worksharing. However, the mere fact that a mailer chooses a lower cost option should not be construed as evidence that the mailer has engaged in a worksharing activity, or that the reduction in price paid by the mailer represents a workshare discount.

For purposes of applying PAEA's restrictions applicable to workshare discounts, the Commission is tasked with further defining which price differences are provided to mailers for undertaking worksharing in the form of **presorting, prebarcoding, handling, or transporting** their mail. In so doing, the Commission will need to consider whether the restrictions on workshare discounts contained in PAEA are applicable to a variety of cost-based price differences. It is suggested here that the primary distinguishing characteristics are (i) limited to whether mailers reduce their postage by virtue of presorting, prebarcoding, handling, or transporting their mail, and (ii) whether the activities of presorting and prebarcoding are optional. (Appendix I discusses a number of options that enable a mailer to reduce postage, but that do not represent worksharing activities.)

### III. Passthroughs

Whenever two different prices reflect a difference in underlying costs, it is a straightforward mathematical exercise to compute the extent to which the price difference reflects the cost difference. This general statement applies to all cost-based price differences, regardless of underlying causes for differences in cost. The result of this computation (expressed as a percentage) can be referred to as “the passthrough of costs into prices.” More often than not, however, it is referred to simply as “the passthrough.” Some passthroughs, but by no means all, do pertain to workshare opportunities, or “workshare discounts.” (Specific examples are discussed in Appendix I.)

Passthroughs in today’s tariff schedule reflect an interesting evolution. Discounts first were introduced for mailer presortation of First-Class Mail in the early 1970’s, and those early presort discounts typically were based on highly conservative estimates of avoided cost. Later, the Postal Service deployed automation equipment capable of reading a barcode. For mail that could be processed on automation equipment, discounts for prebarcoding also became part of the general tariff schedule. Later on, as evidence indicated that mailers were rather responsive to price signals represented by these discounts, the concept of **efficient component pricing** (“ECP”) was introduced, and passthroughs for worksharing discounts gradually were increased to the level of 100 percent.

In Docket No. R2006-1, John Panzar testified that ECP-like pricing also should apply to cost differences arising from other mail characteristics. The Commission’s Annual Compliance Determination (“ACD”) for FY 2008 recalls its general agreement with Panzar’s testimony.

In Docket No R-2006, the Commission decided that for mailers who might have control over decisions as to mail characteristics such as **shape**, the ECP concept goes **beyond worksharing**. The Commission in its decision noted that the virtue of ECP or an ECP approach **beyond worksharing** is that it continues to promote productive efficiency. Just as ECP should produce the least cost mail by incentivizing a mailer or third party to workshare if it can perform mail processing or transportation more cheaply than [sic] the Postal Service, so too it should provide appropriate incentives to minimize costs in the case of **shape and other mail characteristics**. Docket No. R2006-1, Opinion and Recommended Decision, at 87. [FY 2008 ACD, May 30, 2009, p. 37 (emphasis added).]

This rationale has resulted in ECP being applied to a number of cost-based price differentials where the passthrough, as well as the differential itself, **have little to do with worksharing as defined in PAEA**. The language in PAEA suggests that the maximum passthrough applicable to workshare discounts should not exceed 100 percent (with certain exceptions), whereas ECP suggests that passthroughs generally should be equal or close to 100 percent.<sup>4</sup> However, neither the size of a passthrough nor the applicability of ECP helps determine whether a price difference constitutes a “workshare discount” under PAEA.

#### **IV. Price Differences Between Basic, High Density, and Saturation**

In my view, the Commission’s concerns regarding Standard Mail, as stated in Order No. 192, do not appear unrelated to the evolution of Standard Mail.

In 1979, rate recognition for presortation to carrier route was given to advertising mail (then third-class, now Standard Mail). Since then, the volume of advertising mail has grown

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<sup>4</sup> Valpak has supported this approach in prior testimony and comments submitted to the Commission, *e.g.*, in Docket No. R2006-1, *see* testimony of Robert W. Mitchell, VP-T-1, and also Docket No. ACR2008-1, Valpak Initial Comments, pp. 22-23.

substantially and, more important to the issues here, handling of mail presorted to carrier route has undergone substantial evolution.

**Docket No. R90-1.** In Docket No. R90-1, Saturation mail was established as a separate price category within third-class mail. To qualify, mail had to be sent to at least 75 percent of all addresses on the route (or 90 percent of all residential addresses) and presorted to walk sequence.<sup>5</sup> At the DDU, carriers could case walk-sequenced Saturation mail, or take it directly to the street as an extra bundle, which avoided carrier casing altogether. Testimony at that time focused on high costs of manual sortation, and noted that carriers could case walk-sequenced mail faster, at lower cost, than mail not in walk sequence.<sup>6</sup> Qualification for this new category required far more density than any other price category within third-class. At that time, however, the lower cost of this new Saturation price category was considered to result primarily from the finer level of presortation, with the requisite density not given much credit as a causal factor. The rate schedule in the Commission's *Opinion and Recommended Decision* presented the price differences as discounts for presortation.

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<sup>5</sup> Like all mail presorted to carrier route, such mail was able to bypass all sortation operations in Postal Service plants. When not entered at DDUs, it could be cross-docked at a plant and dispatched directly to DDUs.

<sup>6</sup> Testimony noted that the well-established minimum standard for casing letters was 18 per minute for letters, and 8 per minute for flats (known as "18/8"). Postal Service witness Shipe (USPS-T-10) testified that "ordinary" standard letters (not walk-sequenced) were actually cased a little faster than 18 per minute, but walk-sequenced Saturation letters could be cased at around 40-something per minute, and walk-sequenced letters of at least 125 pieces could be cased faster than "ordinary" standard letters, but not as fast as walk-sequenced Saturation letters.

**Docket No. MC91-2.** About one year later, in Docket No. MC91-2 and at the behest of the newspapers, a new price category for High Density mail (then called 125-piece) was established. This 125-piece price category also required walk sequencing. At that time, no automation requirements existed, hence barcoding was not an issue. Walk-sequencing meant that Saturation and this new 125-piece category were more finely presorted than all other categories of third-class mail. This finer presortation of Saturation and High-Density, to carrier route as well as to walk sequence, gave rise to significant cost differences vis-a-vis other categories of third-class mail that were less presorted.

Thus, when considering the entirety of third-class mail, these two categories were distinguished by the finer level of presortation. **As between High-Density and Saturation mail**, however, both were walk-sequenced and even back then the distinguishing characteristic, or cost driver, between these two categories was **density** as it affected the casing rate by carriers. **The rate schedule** in the Commission's *Opinion and Recommended Decision* **continued to present the price differences as discounts for presortation**, not only in this docket, but also in the next omnibus rate case, Docket No. R94-1.

**Docket No. MC95-1.** In Docket No. MC95-1, ECR received formal recognition as a separate subclass within Standard Mail. When the Commission created ECR, it stated:

Introduction. Of the new subclasses proposed by the Postal Service, only Enhanced Carrier Route has been shown on this record **to exhibit sufficiently distinct market characteristics** from the remainder of the subclass within which it currently is found to warrant treatment as a separate subclass for rate design purposes.... Apart from the [ECR] subclass that the Commission recommends, within each current subclass, the record indicates that the essential difference among groups of mail addressed by the Postal Service's proposal is the cost that is

avoided by the various tiers of worksharing involved, **rather than any differences in markets.** [Docket No. MC95-1, *Op. & Rec. Dec.*, ¶ 4208, p. IV-94 (emphasis added).]

In Docket No. MC95-1, Saturation, High Density (the renamed 125-piece walk sequence category), and Carrier Route (sometimes called Basic or Required presort) became components of the new ECR subclass, based largely on evidence that this new subclass served a different market with higher elasticity. It was clear, however, that only High Density and Saturation tended to be targeted to geographic areas instead of to specific addresses. ECR letters were not required to be barcoded, and prices continued to reflect the increased carrier casing speed for Saturation and High Density. As both categories were walk-sequenced, cost differences between the two reflected the faster carrier casing rate for Saturation resulting from its higher density. Significantly, the Commission's *Opinion and Recommended Decision*, for the first time, **omitted "discounts" in the tariff schedule**, and simply presented the recommended price for each density tier. Price differences could have been computed, of course, but they were neither computed nor shown as discounts.

**Evolution of the operating environment since Docket No. MC95-1.** ECR prices subsequently began to focus more on actual cost outcomes, rather than on modeled cost, which relied heavily on casing speed. This allowed fuller recognition of the cost effect of taking extra bundles directly to the street. And, as an increasing volume of ECR letters began to be DPS'd, an automation (prebarcoding) requirement was imposed, first on High Density and

Saturation letters, then on Carrier Route letters as well.<sup>7</sup> Also, at some point Carrier Route mail, both letters and flats, had to be walk sequenced.

Today, all three categories of the former ECR subclass — Saturation, High Density, and Carrier Route — have **identical requirements**. Letters and flats **must be walk sequenced**, and **all three letter** categories now have **identical automation requirements**. To the extent that cost differences exist when handling these three categories, the distinguishing characteristic is density, not the degree of presortation or prebarcoding of letters. As a result of these operational changes, the primary driver for cost differences has morphed from presortation (and prebarcoding in the case of letters) to density.

Another distinguishing characteristic of worksharing discounts is that they have been offered for **optional activities**, with the general understanding that if mailers do not presort their mail or prebarcode their letters, the Postal Service will do it. Such no longer is the case for these former categories of ECR, however. They now recall the old price categories in second-class (now Periodicals) and third-class (now Standard), where mailers always were required to sort to as high a level as the mailing allowed (except for walk-sequencing), and price differences were not quoted as worksharing discounts.

DPSing of ECR letters has becoming increasingly widespread; fewer letters in the former ECR subclass continue to be cased by carriers.<sup>8</sup> When High Density or Saturation

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<sup>7</sup> As yet, no automation requirements exist for flats, in either the Saturation, High Density, or Carrier Route category.

<sup>8</sup> This may happen to flats when Flat Sequencing System (“FSS”) equipment becomes widely deployed.

letters are not DPS'd and instead are sent (by the Postal Service) intact to the DDU, they can be taken out as an extra bundle, a kind of special treatment that is in limited supply and not always available. In today's operating environment, the previously-established carrier casing rates for Saturation, High Density, and Carrier Route letters and flats — the original basis for estimating costs avoided in the established methodology — would appear to have less importance.<sup>9</sup>

With respect to Saturation and High Density flats, the situation is similar. Both are walk-sequenced, and carriers take much of this flat mail directly to the street as an extra bundle. The basis for estimating costs avoided by Saturation versus High Density flats is not altogether clear. For the portion of flats prepared manually by carriers — *i.e.*, either cased or collated — any cost difference would reflect the different densities involved. Since both Saturation and High Density flats are presorted to walk-sequence, the driver of any differential cost seemingly would be density.

**Evolution of the tariff schedule since Docket No. MC95-1.** In every omnibus rate case since Docket No. MC95-1, tariffs have been presented for Basic, High Density, and Saturation **without any mention of discounts**, *i.e.*, no discounts for presorting or

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<sup>9</sup> Because the Postal Service wants to DPS as much letter mail as possible, it has eliminated DDU entry prices for all the former ECR subclass categories of letters. However, not all letters are DPS'd, and walk-sequencing continues to add value (i) on all routes not served by DBCS equipment, and (ii) whenever DPS is not available, *e.g.*, due to equipment failure or excess demand (capacity constraint). Walk-sequencing of letters thus continues to give the Postal Service additional operational flexibility.

prebarcoding of letters.<sup>10</sup> Significantly, since mail in every tier now must be walk-sequenced, and letters in every tier now must be prebarcoded, the product contains no “reference price” for mail which fails to meet the presort and prebarcode requirements, and for which the Postal Service would otherwise have to perform the activity. Thus, although it is a straightforward exercise to compute the price difference between (i) Basic and High Density, and (ii) High Density and Saturation, the defining difference between the three tiers is now density, not the level of presortation.<sup>11</sup>

Depending on the mailer’s marketing strategy, the density of a mailing is optional. Density is not a worksharing option under PAEA, however, as it has nothing to do with presorting, prebarcoding, handling, or transportation by the mailer. Mailers interested in geographical coverage can elect to include or delete as many addresses as they like, but whatever they submit is what the Postal Service delivers. The Postal Service does not alter the density of a mailing. In that respect, when density is viewed as a cost driver, it is similar to shape, weight, or addressing mode, none of which are altered by the Postal Service, and none of which reflect worksharing activities. *See* Appendix I for further discussion on this score.

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<sup>10</sup> Thus discounts, as such, disappeared from this part of the general tariff schedule long before enactment of PAEA.

<sup>11</sup> Saturation letters continue to provide value to the Postal Service, *e.g.*, the option of taking them directly to the street as an extra bundle, and the highest casing rate whenever carriers case letters.

**V. Specific Comments on a Suggested Standard for Establishing Prices and Price Differences of Basic, High Density, and Saturation Standard Mail.**

**The Commission’s conversion/reversion standard supports viewing High Density and Saturation as separate products.** In First-Class Mail, the Commission has used what might be described as a “conversion/reversion” standard. For instance, in Docket No. R2000-1, the Commission stated:

The Commission also views a benchmark as a “two-way street.” It represents not only the mail most likely to **convert** to worksharing, but also, to what category current worksharing mail would be most likely to **revert** if the discounts no longer outweigh the cost of performing the worksharing activities. [Docket No. R2000-1, *Op. & Rec. Dec.*, ¶ 5089 (emphasis added).]

More recently, the Commission stated:

The Commission continues to believe that this benchmark “represents not only that mail most likely to **convert** to worksharing, but also, to what category current worksharing mail would be most likely to **revert** if the discounts no longer outweigh the cost of performing the worksharing activities.” [Docket No. R2006-1, *Op. & Rec. Dec.*, ¶ 5109 (emphasis added).]

Application of this **conversion/reversion standard** to Saturation and High Density mail helps illustrate that the difference between these two categories is not simply a matter of worksharing. If the price difference between each tier is increased, a High Density piece will not convert to Saturation, nor will a Basic piece convert to High Density. Conversely, if the price difference between Saturation and High Density were to be reduced or eliminated, then a substantial volume of Saturation Mail simply might disappear with mailers converting to lower cost geographical advertising alternatives. Some, perhaps much, of the saturation volume

would not “revert” to High Density. Thus, the price difference plays no role in moving mail from a less workshared to a more workshared status (or vice versa), which is what worksharing is all about. Basic, High Density, and Saturation are best priced independently as though they were separate products.

**Marketing factors are important, and deserve recognition.** Since Docket No. MC95-1, price differences between 5-digit presort (Standard Regular) and carrier route (Carrier Route ECR) have not been set on the basis of worksharing or cost differences or passthroughs. This is because they were in separate subclasses, **defined by marketing factors.**

For similar reasons, the difference between Carrier Route and High Density is not a matter of worksharing. The point is that mailers using High Density or Saturation have the intent of sending to all or nearly all persons in a geographic area, whereas mailers using the carrier route category are sending to specific addresses on the route. The latter category has a different intent and would be expected to have a different elasticity, not nearly as high as the elasticity of High Density or Saturation.

Moreover, the High Density and Saturation categories also should be viewed as separate products. As discussed above, the difference between these two categories is not defined by worksharing. From an economic perspective, there is no reason to believe that the only essential difference between High Density and Saturation is cost. Regular users of Saturation, such as Valpak, Valassis or Harte Hanks, use High Density only relatively rarely. The decision on which tier to use is determined largely by marketing considerations.

**Prices for separate products should be based on costs incurred, plus an appropriate markup.** Mailers are not provided with a price difference, a reduction in prices, or a “discount” for somehow transforming their Basic mail into High Density, or transforming High Density into Saturation mail. For all the reasons discussed herein, it is my opinion that neither the term “worksharing discount” nor even the term “discount” should be applied to price differences between these three categories of Standard Mail.

It is important that prices for the three products discussed here be able to take account of and reflect different **elasticities of demand**. In other words, prices for these three products should be based on **costs incurred** for each, plus a **markup** that is appropriate to each, with prices for the three products set independently. Setting prices in this manner is a straightforward proposition.

Changes in **costs incurred** can reflect any number of factors, with density likely being the most important cost driver. But density is not a worksharing option, as are presorting, prebarcoding, handling, and transportation. Consequently, (i) any **costs avoided** by virtue of higher density do not constitute a worksharing cost difference, and (ii) any price differences based on **costs avoided** by virtue of higher density should not be construed as “discounts,” much less “workshare discounts.” Applying the workshare language of PAEA and restricting passthroughs in the manner prescribed there to these three products is not consistent with maximizing profits under a rate cap. For these important products, the Postal Service should not be prohibited from taking individual demand factors into account, and should not have its flexibility in setting prices so restricted.

**Anomalous costing results.** The anomalous costing results for Saturation and High Density letters deserve mention. In the ACR for both FY 2008 and FY 2007, the cost of Saturation letters was found to be higher than the cost of High Density letters, which on its face appears anomalous to both the Postal Service and the Commission (and to Valpak). Previously, in every case from Docket No. MC95-1 through Docket No. R2006-1, Saturation letters has had a consistently lower cost than High Density letters. This consistency would indicate that the most recent cost results are indeed anomalous.

## APPENDIX I

### Analysis of Cost-based Price Differences as Worksharing Discounts

This appendix takes several current, cost-based postal price differentials and reviews them in accordance with the analysis presented above to assess whether they should be subject to PAEA restrictions on workshare discounts based on the legal definition adopted, as well as the application of good economic principles.

#### 1. Price Differences Based on Presortation

Until mail reaches its final destination, it must be sorted to finer and finer levels, incurring additional cost for each sortation. Consequently, when mailers undertake **optional** presortation of their mail in ways that enable the Postal Service to avoid some otherwise-required sortation effort, that helps the Postal Service avoid certain handling costs. A discount, or lower price, provided to a mailer for such optional presortation clearly would qualify as worksharing under PAEA.<sup>12</sup>

The issue becomes less clear, however, when presortation to some specified level is **required** in order to qualify for a particular product. For example, assume that within product A no surcharge (or higher price) is available to mailers that do not presort. For those that either cannot or do not wish to presort to the required level, their option is to switch to another, higher-priced product — B. The question that then arises is whether the price and cost differences between two different products, A and B, reflect presortation and should be considered a matter of worksharing subject to PAEA. If there were no worksharing between products, which I believe to be the better view, then there is no worksharing in this situation.

#### 2. Price Differences Based on Prebarcoding

If the Postal Service needs to have a barcode on each piece of automatable/machinable mail as it enters the processing network, then when mailers do not put a barcode on their mail, the Postal Service can and will do so.<sup>13</sup> Under PAEA, discounts provided to mailers for

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<sup>12</sup> Presort discounts are based on estimated **costs avoided**.

<sup>13</sup> The wide-area Barcode reader on flats sorting machines is apparently able to read printed addresses with accuracy similar to that achieved with barcodes, so that barcoding of addresses on magazines is not necessary (provided the address label is correctly positioned). Similarly, Saturation wraps bypass all machine sortation (including FSS), hence do not require a barcode. As the Postal Service wants to be able to process Detached Address Labels (“DALs”) on DPS equipment, however, these now require a barcode.

**optional** prebarcoding also clearly qualify as worksharing.<sup>14</sup> And when prebarcoding is **required**, an issue arises similar to that for presortation. Again, if there were no worksharing between products, there would be no worksharing in that situation.

### 3. Price Differences Based on Shape: Non-standard First-Class Letters

Within First-Class Mail, the Postal Service imposes a surcharge for non-standard letters (*e.g.*, square letters).<sup>15</sup> The basis for the surcharge is that letters of non-standard size are considered non-machinable, hence must be processed manually, at higher cost; *i.e.*, the cost driver for such manual processing is shape. Mailers who consider sending non-standard letters can avoid the surcharge by changing the shape of their letters, which helps the Postal Service avoid extra handling costs of manual sortation that it otherwise would have to incur.<sup>16</sup>

Does the non-standard surcharge for handling First-Class letters constitute an example of a workshare activity? And, if so, does PAEA impose a statutory requirement on the price-to-cost ratio, or passthrough of cost, to the non-standard surcharge? It is my suggestion that the answer to these questions is no.

It is true that mailers can voluntarily avoid the surcharge and reduce their postage cost by altering the shape of non-standard letters, and so doing helps avoid extra Postal Service handling costs. But if mailers elect to transform non-standard letters to standard size and thereby reduce their cost of postage, that reduction in postage **has not been achieved on account of any presortation, prebarcoding, handling, or transportation by the mailer.** Moreover, when mailers, for whatever reason, prefer to send letters with non-standard shape and pay the higher price, once such letters are entered, the Postal Service **does not undertake to transform the shape of any non-standard letter.**<sup>17</sup> This latter point also helps distinguish the non-standard surcharge from optional worksharing activity such as presortation or prebarcoding.

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<sup>14</sup> Prebarcode discounts also are based on estimated **costs avoided**.

<sup>15</sup> The non-standard surcharge is based on an estimate of **costs incurred**, not on costs avoided.

<sup>16</sup> Greeting card companies sometimes provide rectangular envelopes for square greeting cards, which enables users to pay the normal price while sending a square card.

<sup>17</sup> N.B. Some surcharges do not have cost implications. When this occurs, a price-to-cost ratio does not exist. As an example, the Postal Service requires a small additional fee for letters or flats with a repositionable note pasted on the outside of the envelope. However, processing and delivery of envelopes with repositionable notes does not entail any additional cost. See Docket No. MC2007-2, *Op. & Rec. Dec.*, p. 7.

#### 4. Price Differences Based on Shape: Letters vs. Flats

It is well documented that the handling cost for a flat exceeds the handling cost for a letter. And, in consequence thereof, the Postal Service now charges First-Class flats a higher price.<sup>18</sup> Consequently, in First-Class Mail there now exists a letter-flat price differential, as well as a passthrough of the letter-flat cost difference, and the Commission has suggested that ECP applies to shape-based differentials.<sup>19</sup> Therefore, for the shape-based difference in prices for First-Class letters and flats, it is legitimate to pose questions similar to those for the surcharge for non-standard First-Class letters. That is, since the price difference between First-Class letters and flats (of equal weight) is for the extra costs of handling flats, does that price differential constitute an example of worksharing? And, if so, does the workshare language in PAEA impose a statutory requirement on the passthrough of the cost difference into prices?

If the First-Class letter-flat difference is deemed to be worksharing, then it clearly would make sense to pose similar questions for the shape-based price differences between Standard letters and flats, where current price differences reflect very little of the cost differences.

In both instances — *i.e.*, for the letter-flat differential in both First-Class and Standard Mail — it again would be my suggestion that the price differential is not worksharing. If mailers elect to reduce their postage costs by converting flats to letters, that reduction in postage is **not the result of any presorting, prebarcoding, handling, or transportation by the mailer**. Furthermore, when mailers, for whatever reason, elect to send flats and pay the higher price, once the mail is entered the Postal Service **does not undertake to transform the shape of any flat into a letter**. Again, this characteristic also helps to distinguish the mailer's option with respect to shape from worksharing options such as presorting and prebarcoding.

#### 5. Price Differences based on Weight: First-Class Letters

Ever since posts started transporting and delivering letters, they have charged for extra weight.<sup>20</sup> In the United States, weight brackets for First-Class letters increase by the ounce.<sup>21</sup>

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<sup>18</sup> Flats in Standard Mail have paid a higher price since Docket No. R90-1.

<sup>19</sup> The higher price for a First-Class flat is based on **costs incurred** to handle flats. In the general tariff schedule, the price(s) for flats is neither a surcharge nor a discount. Generally, no reference is made to the passthrough of costs to prices, but computing such a passthrough would be straightforward.

<sup>20</sup> Long ago, before envelopes became common, letters customarily were folded  
(continued...)

Consider a First-Class letter that weighs between 1 and 2 ounces. Compared with a letter that weighs less than 1 ounce, the 2-ounce letter currently pays an additional 17 cents for the additional ounce. If the mailer somehow finds a way (such as by changing paper stock) to reduce weight to under 1 ounce, the mailer then pays a lower price, which supposedly helps the Postal Service avoid the cost of handling and transporting the extra weight. Can such a mailer be said to have engaged in a workshare activity by virtue of having reduced weight of the letter? Here again, it is my suggestion that the answer is negative.

When mailers reduce their postage cost by reducing weight, they **have not engaged in presortation, prebarcoding, handling, or transportation**. Further, when mailers, for whatever reason, elect to send heavier letters and pay the higher price, **the Postal Service does nothing to reduce the weight of any letter**. Weight-based price differences for “letters” (which, broadly defined, includes flats), do not represent worksharing differences, regardless of whether the price difference reflects more or less than 100 percent of the cost difference.<sup>22</sup> This again illustrates that whether mailers can reduce their postage by electing certain options is not dispositive of whether such options constitute a worksharing activity. The distinguishing characteristic is when mailers undertake an optional activity that the Postal Service otherwise would need to perform in the normal course of handling, transporting and delivering the mail — *e.g.*, presortation or printing barcodes on the mail.

## 6. Price Differences based on Weight: Parcels and Bound Printed Matter

The situation with respect to price differences based on weight for parcels and Bound Printed Matter is similar in some respects to that just discussed for letters. For parcels and Bound Printed Matter (“BPM”), however, prices are shown in charts that reflect both weight

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<sup>20</sup>(...continued)

and sealed with wax. For such early “pre-enveloped” letters, a fee was assessed for each sheet of paper.

<sup>21</sup> In Europe, as well as all other countries that use the metric system, weight brackets are based on grams, which enable even finer weight increments. One ounce is equal to 62.50 grams, hence weight increments that increase by 10, 20, or even 50 grams would be finer than one-ounce increments.

<sup>22</sup> Postal Service studies on extent to which weight affects handling costs have been unconvincing. An assiduous attempt to determine whether weight-based price differences represent more or less than 100 percent of cost differences might result in an improvement of our knowledge concerning cost causation, but it would be a fool’s errand so far as worksharing is concerned. To the extent that price increments for weight are based on costs, they are based on **costs incurred**, not costs avoided.

and zone (*i.e.*, distance).<sup>23</sup> For any given zone, it is possible to compute the difference between prices for packages of any two weights. To illustrate, two parcels to, say, zone 5, and weighing just under 3 and 4 pounds, respectively, pay different prices. The difference between the two represents the incremental price for an additional pound to zone 5. This price increment reflects the fact that heavier weight entails higher handling and transportation cost. And the price increment divided by the cost increment is the passthrough of costs into prices.<sup>24</sup>

If mailers, for whatever reason, elect to reduce their postage by somehow reducing weight of their packages, such lower postage **does not result from mailer presortation, prebarcoding, handling, or transportation**. Conversely, when mailers, for whatever reason, elect to send heavier packages and pay the higher price, **the Postal Service does nothing to change the weight of any parcel**, as was the case with letters discussed above. Hence it would be my view that the incremental price for each additional pound (or the decrement in prices for each 1-pound reduction in weight) should not be interpreted as representing a workshare activity that is subject to the worksharing requirements of PAEA. As with letters, whether the incremental price for additional weight represents more or less than 100 percent of the incremental cost is not a relevant consideration vis-a-vis the workshare language in PAEA.

## 7. Price Differences based on Point of Entry: Standard Mail

Standard Mail (including its predecessors third-class mail and Standard A Mail) historically had a uniform price for delivery anywhere in the country. As a result of Docket No. R90-1, starting in February, 1991, the Postal Service introduced lower prices, in the form of discounts, for Standard Mail entered at destinating BMCs, SCFs, and DDUs. These destination entry discounts have encouraged many mailers to dropship and enter mail deeper into the postal network, at destinating facilities. When bulk mailers elect to by pass their local BMEU and dropship to more distant destinating facilities, they clearly provide a service that the Postal Service otherwise would have to perform. Drop shipping, which is always optional, and entering mail deeper into the network helps the Postal Service avoid **transportation** costs as well as **handling** costs at intermediate facilities, hence destination entry discounts are

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<sup>23</sup> For the weight dimension of the chart, the higher prices are reflective of costs incurred to **handle** parcels of greater weight. At the same time, lower prices are reflective of lower costs incurred when **handling** parcels of lower weight. When discussing Parcel Post, it has not been customary to refer to the difference in costs incurred between different rate cells as “costs avoided.”

<sup>24</sup> If costs in each rate cell have been subjected to a substantial markup, as occurs with Priority Mail (a competitive product), then the passthrough of weight-related costs into prices will be substantially in excess of 100 percent.

considered to be a workshare activity subject to requirements in PAEA applicable to the passthrough of cost differences into price differences.<sup>25</sup>

In passing, it should be noted that destination entry may involve no mailer-incurred transportation costs whatsoever. When a truck arrives at a postal facility, the Postal Service has no way to determine whether the truck has traveled 2 miles or 2,000 miles, or where the mail would have been entered if no destination-entry discounts were offered. All destination-entered Standard Mail receives the appropriate discount from the “full” price, but not all destination-entered mail in fact is dropshipped from a more remote location. Consider, for instance, a mailing to Chicago residents that is printed and entered in Chicago. Such a mailing is not dropshipped in the customary sense, as it normally would be entered in Chicago. In such instances, the mailer receives a discount without undertaking any special effort that helps the Postal Service avoid any **transportation or handling** costs.<sup>26</sup> Therefore, when the worksharing discount restrictions are interpreted to apply to all destination-entry mail, it would necessarily be over-inclusive of the statutory definition.

## 8. Price Differences Based on Addressing Mode

Detached Address Labels are surcharged based on **costs incurred**. Mailers of Saturation flats who elect to use on-piece addresses avoid the extra handling that DALs require, which means they pay a lower price by virtue of avoiding the DAL surcharge. This lower price does not reflect a worksharing activity, however, because **it is not the result of mailer presortation, prebarcoding, handling, or transportation.**<sup>27</sup> Moreover, when mailers elect to use DALs, **the Postal Service does not transfer the address from the DALs to the accompanying wraps.** Interestingly, Saturation wraps with on-piece addresses do not require a barcode, whereas DALs, for which there is a surcharge, must have a barcode; *i.e.*, Saturation flats using the addressing mode **with** a barcode pay **more than** Saturation flats using the addressing mode **without** a barcode.

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<sup>25</sup> Destination entry discounts are based on estimated **costs avoided**.

<sup>26</sup> This illustrates that a worksharing discount need not be synonymous with avoided costs in every instance.

<sup>27</sup> It is possible to compute a cost-to-price ratio for DALs. In my view, this cost-to-price ratio is **conceptually are very similar** to those ratios for bundles, pallets and sacks in the periodicals rate structure (*see* Section 10, *infra*), and if those **cost differentials are caused by worksharing**, then so is the price differential between Saturation flats that have on-piece addressing and those with DALs.

## 9. Price Differences Based on Packaging Preparation

It is understood that Congress largely, if not entirely, exempted Periodicals from restrictions on workshare discounts. 39 U.S.C. section 3622(e)(2)(C). However, an examination of Periodicals price differences is nevertheless instructive to establishing consistent principles which apply across all classes, and which would apply to Periodicals as well if Congress were to remove this special treatment of Periodicals in the future.

Periodicals prices now contain separate elements for bundles, sacks and pallets. The tariff schedule containing these prices is displayed using a bottom-up approach (similar to that for BPM); *i.e.*, discounts related to these cost drivers do not appear in any part of the Periodicals tariff schedule, and all prices are developed on the basis of **costs incurred**, not costs avoided.<sup>28</sup> Under these circumstances, the concept of “costs-avoided” is not applicable. Aligning prices for these preparation options with Postal Service costs can, appropriately, have an important affect on the postage paid.

Every Periodicals mailer has some latitude, or options, with respect to preparation. For instance, no Periodicals mailer is required to submit mail on a pallet; all periodicals can be in sacks, should a mailer prefer. A mailer also can prepare and submit sacks containing relatively few pieces if preferred.<sup>29</sup> The way mail is prepared can affect the level of presortation, as well as postage, but the relationship is neither linear nor reciprocal. For instance, finer presortation could increase the number of sacks, and that would increase cost, both for the mailer and the Postal Service. By contrast, when work is shared between mailer and the Postal Service, an increase in cost for the mailer results in a decrease in cost for the Postal Service.

**Simply because mailers** can reduce their postage costs by **choosing** various preparation options to does **not mean** that such options constitute **worksharing** activity. The Periodicals’ preparation options under discussion here are not unlike mailers’ choice of: (i) standard vs. non-standard envelopes; (ii) letter vs. flat shape; (iii) heavier vs. lighter weight; and (iv) on-piece addresses vs. DALs, all of which were discussed above. Just as the Postal Service does

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<sup>28</sup> Whenever a tariff schedule is based on costs incurred, noticeably absent are explicit discounts based on costs avoided. Tariff schedules based on costs incurred typically do not define any reference prices or benchmark costs from which various discounts could be developed using costs avoided. This observation is especially applicable to the existing “bottom-up” Periodicals rate schedule. To transform that tariff structure into a “top-down” rate structure, one would need to identify a set of benchmark costs and reference prices from which various discounts could be deducted in order to arrive at the existing prices. At the very least, such a transformation could be rather difficult.

<sup>29</sup> At one time, skin sacks containing as few as 6 magazines was allowed.

not change the size or weight of any mail, or take addresses from DALs and print them on accompanying wraps, so also when mailers submit bundles of mail inside sacks, **the Postal Service does not dump the sacks and consolidate the bundles onto pallets.** Any such re-containerization is completely hypothetical, and not something that the Postal Service otherwise would do. Consequently, when Periodicals mailers submit pallets instead of sacks, the Postal Service does not “avoid” the cost of converting sacked bundles into palletized bundles. And, since the Postal Service does not consolidate mail in that manner, any mailer (or agent, such as a large printer) who creates pallets instead of sacks cannot be said to engage in an activity that the Postal Service “otherwise would have to do.”

The Commission, in its FY 2007 ACD, discussing prices for bundles and other container in Periodicals, stated that:

These price-to-cost ratios are based on estimates of direct costs of various drivers. Therefore, they are **not identical** to workshare passthroughs, but **conceptually are very similar**. They show **cost differentials caused by worksharing activity**. [p. 87, emphasis added.]

To the extent that costs of various drivers are known and prices have been based at least partially on those costs, it is possible to compute a price-to-cost ratio for every driver, be it shape, weight, distance traveled, container, package, or whatever. For reasons stated in the various examples discussed herein, I would concur with the Commission that cost-to-price ratios based on the cost of handling bundles, sacks and pallets are **not identical** to workshare passthroughs.<sup>30</sup> Whether they are **similar** could be a matter of opinion, but I must respectfully demur, however, with the statement that “[t]hey show cost differentials caused by **worksharing activity**.” Instead, I would suggest that the matter is considerably more complex, and that these cost-to-price ratios be interpreted as simply reflecting (to some degree) the costs that the Postal Service **incurs** to process packages of various types, shapes and weight, which largely are at the mailer’s option.

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<sup>30</sup> Whether ECP should be applied to these passthroughs is a different matter, and beyond the scope of this docket.

## APPENDIX II

### Postal Experience of John Haldi

#### Work for U.S. Post Office Department

- 1966, Acting Director, Office of Planning — responsible for establishing the Office of Planning.

#### Published Books and Articles

- A book, *Postal Monopoly: An Assessment of the Private Express Statutes*, American Enterprise Institute for Public Policy Research (1974).
- An article, "The Value of Output of the Post Office Department," which appeared in *The Analysis of Public Output*, pp. 339-387. National Bureau of Economic Research, 1970.
- "Measuring Performance in Mail Delivery," in *Regulation and the Nature of Postal Delivery Services*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 1992.
- "Costs and Returns from Delivery to Sparsely Settled Rural Areas," (with L. Merewitz), in *Managing Change in the Postal and Delivery Industries*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 1997.
- "Transaction Costs of Alternative Postage Payment and Evidencing Systems," (with John Schmidt), in *Emerging Competition in Postal and Delivery Services*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 1999.
- "Controlling Postal Retail Transaction Costs and Improving Customer Access to Postal Products," (with John Schmidt), in *Current Directions in Postal Reform*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 2000.
- "Saturday Delivery: Who Provides It? Who Needs It?" (with John Schmidt), in *Postal and Delivery Services: Pricing, Productivity, Regulation and Strategy*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 2002.
- "An Evaluation of USPS Worksharing: Postal Revenues and Costs from Workshared Activities," (with William J. Olson), in *Competitive Transformation of the Postal and Delivery Sector*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 2004.
- "Enhancing Competition by Unbundling the Postal Administration," (with William J. Olson), in *Progress Toward Liberalization of the Postal and Delivery Sector*, Crew & Kleindorfer, eds. Kluwer Academic Publishers, 2006.

- “Economic Imperatives That Drive Further De-Averaging of Postal Rates,” (with William J. Olson), mimeo.

### **Postal Rate/Regulatory Commission Testimony**

- **Docket No. R77-1** – testimony regarding third-class nonprofit rates.
- **Docket No. MC78-2** – testimony regarding third-class nonprofit presort discounts.
- **Docket No. R80-1** – testimony regarding third-class nonprofit rates and rate design.
- **Docket No. R84-1** – testimony regarding second-class nonprofit rates, and third-class nonprofit rates and rate design.
- **Docket No. SS86-1** – testimony regarding nonprofit mail markup.
- **Docket No. R87-1** – testimony regarding second-class nonprofit rates, third-class nonprofit rates and peak load costs, Registered Mail rates, and insurance rates.
- **Docket No. R90-1** – testimony regarding second-class nonprofit mail, third-class nonprofit mail, registered mail rates, and Priority Mail rates and nonpriority Alaska Air Service.
- **Docket No. SS91-1** – testimony regarding nonprofit mail.
- **Docket No. R94-1** – testimony regarding third-class nonprofit mail and Priority Mail rates and rate design.
- **Docket No. MC95-1** – testimony regarding reclassification of Standard Mail (A) regular.
- **Docket No. MC96-3** – testimony regarding Business Reply Mail.
- **Docket No. R97-1** – testimony regarding Priority Mail, Standard Mail (A) ECR.
- **Docket No. R2000-1** – testimony regarding Priority Mail, First-Class Mail and Standard ECR Mail, and Parcel Select.
- **Docket No. R2005-1** – testimony regarding Standard Mail ECR.
- **Docket No. R2006-1** – testimony regarding Standard Mail ECR.