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

CONSIDERATION OF WORKSHARE DISCOUNT METHODOLOGIES	Docket No. RM2009-3

INITIAL COMMENTS OF THE UNITED STATES POSTAL SERVICE
(May 26, 2009)

On March 16, 2009, the Commission issued Order No. 192, establishing the above-captioned docket, in order to "afford the Postal Service…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." Order No. 192 at 3. This proceeding therefore raises at least two questions:[1] first, for the purposes of pricing, does the application of section 3622(e), hold between "products" such as First-Class Mail Single-Piece Letters and Presort First-Class Mail Letters? Second, are differences in cost among the Saturation, High Density, and Basic price categories within Standard Mail "workshare" differences within the meaning of section 3622(e)? These Comments address both issues.

[1] The Order also allows parties to submit any "alternative workshare discount rate design and cost avoidance calculation methodologies" they consider appropriate. Order No. 192 at 3.

I. USE OF A BENCHMARK TO TIE PRICES FOR SINGLE-PIECE AND PRESORTED FIRST-CLASS MAIL TOGETHER IS INCONSISTENT WITH THE STATUTE, AND WILL PRESENT PRACTICAL PROBLEMS IN IMPLEMENTING SECTION 3622 WITH REGARD TO FIRST-CLASS MAIL

The ultimate question regarding First-Class Mail to be addressed in this rulemaking is the appropriate starting point for the pricing of Presorted Mail.[2] Specifically, the provisions of section 3622(e) of the new law govern the relationship between worksharing discounts and avoided costs, and if those provisions apply across separate products such as Single Piece and Presort First-Class Mail, the pricing flexibility intended for the Postal Service under the PAEA will be severely compromised. While such a link may have been understandable under the superseded structure of the Postal Reorganization Act (PRA), the substantial changes under the new pricing regime of the PAEA make that result no longer tenable.

As discussed in detail below, three types of considerations preclude rational application of the section 3622(e) to the pricing of Presorted Mail. First, in contrast with the old law, the language and structure of the new law plainly reveal that, when properly interpreted in consonance with section 3652(b), section 3622(e) is, as a matter of law, not intended to be applied to groupings of mail within different products. Second, as a matter of policy, under the current circumstances within First-Class Mail, rigidly focusing on estimates of avoided costs, to the exclusion of other factors such as cost coverages, unit contributions,

[2] For simplicity, consistent with the current MCS terminology, the term "Presorted" mail will be used throughout this document to refer to First-Class Mail paying other than Single Piece prices. Actually, Presort First-Class Mail Letters also embody other characteristics (depending on the rate category claimed) such as automation-compatibility, application of address hygiene procedures including Move Update, barcoding, etc**.**

previous percentage rate increases, market differences, and similar trends in customer responses to price changes, would not achieve the benefits which application of the new workshare provisions were intended to achieve when applied within products. Third, substantial practical difficulties would arise if the Postal Service, while forced by financial circumstances to obtain as much new additional net revenue as possible, were also to be required to add the impediments of section 3622(e) to a price design process that already must contend with obstacles such as a price cap that operates at the class level, and the whole-integer constraint for the price most used by the general public. Adding this additional obstacle into the mix could jeopardize the ability of the Postal Service to preserve rational rate relationships and use all of the allowed cap – potential results of great concern in the midst of the Postal Service's current financial crisis.

A. Under the Postal Reorganization Act, Presorted Mail Was Priced As a "Rate Category" Within the First-Class Mail Letters and Sealed Parcels Subclass

The pricing of Presorted Letters under the Postal Reorganization Act (PRA) evolved in the context of the *introduction* of discounts for presortation,. In the early years following postal reorganization in 1971, there were no discounts. Presort discounts for First-Class Mail Letters were first introduced in 1976. Thus, despite the wide disparity in the cost characteristics of First-Class Mail letters, all pieces (of the same weight, and ignoring the soon-to-be-defunct Airmail category) paid the same price. This was true even though some pieces actually were already being presorted by the customers. Presumably, those were instances in which the existing mail production technology made it possible for certain bulk mailers to generate their mailings in presort order just as easily as in any alternative print order, and they chose to do so for service reasons. First-Class Mail during that era was clearly a combination of a variety of high-cost mail and low-cost mail, all paying one average price.

With the introduction of presort discounts, prices were deaveraged for the first time. The challenge facing the Postal Service and the Commission at that time was to accomplish this deaveraging in a way that seemed fair both to the customers who would likely to be eligible for the new lower presort prices, and to the "status quo" customers who would not. These "status quo" customers were not eligible for the new presort prices because of the characteristics of their mail at the time the discounts were introduced. One possibility would have been to establish separate subclasses for the two types of mail. Separate subclasses for Presorted and Single-Piece mail would require the estimation of separate attributable costs, and the application of separate cost coverages based on consideration of all of the PRA section 3622(b) pricing factors. One might reasonably expect that roughly equivalent cost coverages would be appropriate for the two newly created subclasses. An alternative approach, and the approach that the Commission ultimately adopted, would be to retain one unitary subclass, and simply base the price difference (i.e., the discount) directly on the costs associated with the set of distinct operations that worksharing allowed the discounted mail to avoid. The alternative approach became known as the "rate category" approach, because Presort mail remain a price category with the broader First-Class Mail Letters and Sealed Parcels subclass, as opposed to its own separate subclass.[3]

The rate category approach offered some clear advantages. First, because all existing First-Class Mail letters were priced the same before the launch of presort discounts, at the introduction of presortation, there was no way for the data systems to report separate costs for what were, as yet, undefined potential new separate subclasses. In contrast, it was possible to develop cost models to estimate the costs avoided when customers performed distinct activities such as presortation that avoided specific Postal Service mail processing or other activities. More importantly, at least during the introductory phase of worksharing, a subclass approach focusing on cost coverages posed the threat of higher prices for "status quo" customers, while the rate category approach did not. When discounts are set essentially at the level of Postal Service costs avoided by customer mail preparation activities, the effect on the "implicit cost coverage" is unmistakable. Starting with base cost and revenue, and subtracting the same amount (the avoided cost estimate) from the unit cost in the denominator as subtracted (as the discount) from the unit revenue in the numerator, as a matter of simple arithmetic, the "implicit cost coverage" for workshare mail has to go up. The result is a workshare "implicit cost coverage" which exceeds that for non-workshare mail. But to the extent that "subclass treatment" would disfavor the disparity between the "implicit cost coverages" for the two subclasses and tend to force them towards equality, achievement of that

[3] Later, during the reclassification proceeding, the Postal Service did propose a separate Automation First-Class Mail subclass. That proposal, however, was rejected, in part, because the proposed subclass did not demonstrate different cost and demand characteristics. PRC Op. & Rec.Dec., Docket No. MC95-1, at III-53 (Jan. 26, 1996).

objective would necessarily require not only a reduction in workshare rates, but an increase in non-workshare rates as well. [4] The phenomenon is clearly described in an illustration presented by the Commission in its discussion on pages III-27 – 29 of its Opinion in Docket No. MC95-1 (Jan. 26, 1996).

As emphasized by the Commission on those pages of its Docket No. MC95-1 Opinion, allowing the introduction of the workshare discount to exert upwards pressure on prices for the "status quo" customers was viewed not only as undesirable, but also as inequitable. Therefore, the obvious solution was to go with the "rate category" approach, focusing only on avoided costs and ignoring any consequences on "implicit cost coverages." During the introductory phase of worksharing, this made sense for several reasons. First, as noted by the Commission in its MC95-1 Opinion, by effectively insulating the prices for "status quo" customers from adverse consequences, those customers had no reason to oppose the establishment of new discounts, smoothing acceptance of the transition. Second, as a substantial portion of bulk customers considered their options and, for the first time, faced the choice of whether or not to undertake the worksharing necessary to qualify for the new prices, pegging the discounts directly to the level of avoided costs sent the appropriate pricing signals to encourage efficient worksharing and discourage inefficient worksharing.

While all of this made sense during the period in which presortation and automation discounts were being introduced, over time, a wrinkle appeared. As suggested above, before the distinct categories of Presorted and Single-Piece

[4] Put differently, equal implicit cost coverages can only be attained when the discount is allowed to range higher than the avoided cost estimate.

mail existed, the data systems could not provide a CRA-type of measure of attributable costs for the two categories separately. Instead, cost differences were estimated by a modeling approach in which discrete costs of discrete operations avoided were combined to derive an aggregate cost avoidance figure. Implicitly, the assumption was that these models captured all of the relevant cost distinctions between Presorted and "status quo" mail, and, in all other respects, the remaining ("intrinsic") cost characteristics of the two groups are the same. When the intrinsic cost characteristics of the two groups are the same, and the estimated avoided costs thus exactly capture the differences in marginal costs, the unit contribution from the two groups will match if (and only if) the discount is set at the level of the avoided cost. In theory, the achievement of equivalent unit (cents per piece) contributions (between Presorted and Single-Piece) thus buttresses the fairness and equity of the rate category approach, notwithstanding the inevitable disparity in implicit percentage cost coverages.

The wrinkle that evolved was that, once the two separate categories existed in the mailstream, it became possible to estimate and report CRA costs for each category separately. And those CRA attributable cost estimates revealed that the intrinsic costs of Presorted and Single-Piece mail appear to be materially different, because the reported cost difference significantly exceeds the modeled avoided cost estimate. Thus, setting the discounts at the level of avoided costs does not achieve equivalent unit cost contributions.

The lack of equal unit contribution undermines the "equity" analysis. In the scenario alluded to above, in which the intrinsic cost characteristics are assumed to be similar, and the unit contributions are thus equivalent with a full passthrough of estimated cost avoidances in the discounts, the Postal Service is indifferent as to whether, hypothetically, an additional potential million units of volume is gained (or lost) from a customer who presorts or makes mail automation compatible, or from a customer who does not. Because the unit contributions from both are equal, the effect on the Postal Service's institutional cost recovery would be the same either way, notwithstanding the disparate implicit cost coverages for the two groups. But when the unit contribution is materially higher for Presorted mail, the Postal Service is <u>not</u> indifferent as to whether a potential million piece volume fluctuation comes from Presorted mail or from Single-Piece First-Class Mail. Relative implicit cost coverages under these circumstances become much more relevant. It is not necessarily equitable to shield "status quo" customers by capping discounts at avoided costs, when single-piece customers are not contributing to institutional cost recovery on either the same percentage *or unit* basis as Presorted customers.

The apparent presence of intrinsic cost differences between Presorted and Single-piece First-Class Mail conceivably could have supported migration from the "rate category" approach towards the establishment of separate subclasses. Under the PRA, however, the Commission declined to accept intrinsic cost differences as a sufficient basis to justify "subclass" treatment. Instead, the Commission took the view that differences in both demand and intrinsic costs were required to justify subclass status. *See*, *e.g.,* Docket No. MC95-1, Opinion & Rec.Dec. at III-9 -10 (Jan. 26, 1996). In practical terms, the absence of satisfactory evidence of demand differences between Presorted and Single-piece in First-Class Mail precluded establishment of separate subclasses.

Nevertheless, the prevalence of the “rate category” approach under the PRA did not preclude the Commission and the Postal Service from exercising substantial flexibility in pricing First-Class Mail. The bedrock of ratemaking under the PRA was the breakeven constraint. Overall revenue had to meet overall costs. Because each class (in practice, each subclass) was required to cover at least its own attributable costs, the true pricing constraint under the PRA was to set prices to generate the level of aggregate institutional cost contribution required to achieve breakeven. The pricing exercise (i.e., the allocation of the institutional cost burden) was a zero-sum game – what one subclass or class did not contribute, some other subclass or class would have to cover. The overall institutional cost target was set by the revenue requirement, which was driven by the Postal Service’s overall financial need.

The greater measure of flexibility was available in the process of setting subclass cost coverage targets. Application of the pricing factors provided some limitation on the magnitude of the burden shifting between subclasses that could be employed to reach overall contribution recovery target, but this constraint was relatively fluid. Subclass cost coverages were heavily influenced by historical precedent, and also, from case to case, by the subclass percentage rate increases implicit in any given set of subclass cost coverages. Overall, though, there was generally enough flexibility in the ratemaking process to accommodate pricing determination driven by, for example, the First-Class Mail whole-integer constraint through, at least in part, higher or lower cost coverages (and thus higher or lower price increases) for other classes (primarily Standard Mail).

In concrete terms, First-Class Mail ratemaking under the PRA tended to play out as follows. Under the "rate category" approach, the starting point for Presorted prices was the single-piece base "stamp" price. The avoided costs estimates guided the magnitude of proposed price differences within the subclass. But clearly the dominant factor in the pricing exercise was the whole-integer constraint on the stamp price. Rounding up or down to the nearest cent potentially shifted hundreds of millions of dollars. Adjusting passthroughs and other pricing levers (such as additional-ounce prices) within the subclass could only achieve a certain amount of net revenue calibration. The safety valve was the subclass cost coverages, which, if necessary to preserve reasonable rate relationships, allowed the institutional cost burdens to be adjusted up or down to make all of the pricing factors mesh across all of the subclasses. Realistically, depending on how the whole-integer constraint operated in any particular scenario, First-Class Mail Letters subclass might see a higher or a lower cost coverage than otherwise might have been the case.

To summarize, the salient features of Presorted pricing for First-Class Mail under the PRA were as follows. Without satisfactory evidence of cost <u>and</u> demand differences, Presorted and single-piece letter mail remained as rate categories within the same subclass. Accordingly, the price differences between the two were pegged to the estimate of the costs avoided by customer activities including presortation, barcoding and making mail automation compatable. While the whole-integer constraint certainly complicated First-Class Mail pricing, there was the ability under the PRA for ratemakers to adjust subclass cost coverages (i.e., for both First-Class Mail and for other classes) to balance all ratemaking factors, while meeting the overall Postal Service breakeven constraint.

B. Maintaining a Rigid Cost-Based Link Between Single Piece and Presorted First-Class Mail Prices Is No Longer Appropriate in the PAEA Environment

Enactment of the PAEA in 2006 fundamentally altered the objectives, policies, and procedures regarding postal pricing and classification. Strict adherence to a formulaic relationship between Presorted and Single-Piece prices for First-Class Mail is now not only impractical, but is also inconsistent with the new law. Pricing prescriptions based on the PRA are no longer necessarily applicable.

1. The Entire Pricing Process Has Been Changed

In contrast with the PRA, in which the Postal Service initiated omnibus rate cases at multi-year intervals as necessary to maintain financial breakeven, market dominant price changes under the PAEA are now an annual occurrence. The maximum allowed overall increase for each class of mail is essentially capped at the reported level of the most recent 12 months' inflation, as measured by CPI-U. Price averaging is thus allowed *within* classes to meet the overall cap, but is not allowed *between* classes. For First-Class Mail, the whole-integer constraint looms large in the context of smaller, more frequent annual price changes.

A prominent goal of the PAEA was to provide the Postal Service with increased flexibility in pricing, as compared to the prior pricing regime. This is evident both from the language of the statute, as well as from its legislative history. See, e.g., 39 U.S.C. 3622(d)(4), (c)(7); SEN. REP. NO. 108-318 at 8, 10 (2004). The Commission has also recognized that increased flexibility is central to the Congressional design. See, e.g., Order No. 66 at 51; Order No. 43 at ¶ 2025; Order No. 26 at ¶ 3070.

2. Congress in the PAEA Affirmatively Modified the Criteria for Mail Classification

In addition to changing the structure of pricing, the new law made equally substantial changes in mail classification. As discussed previously, the Commission took the view under the PRA that the establishment of separate subclasses required the showing of differences in both cost and demand. The full range of pricing factors would not be applied to a type of mail unless both these criteria for subclass treatment had been met. In the PAEA, however, Congress enacted language which unambiguously loosened the new classification criteria. It did so by defining a product as "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied." 39 U.S.C. § 102(6). And whereas subclass had been the primary level of classification under the PRA to which the pricing factors were applied, product became so under the PAEA. Therefore, while a failure to establish both cost and demand differences impeded treatment as a subclass under the PRA, the existence of either cost or demand differences is sufficient under the PAEA to require treatment as a product.

Based on the PAEA's new definition of product, when developing the Mail Classification Schedule, the Postal Service concluded that Presorted and Single-

Piece First-Class Mail are separate products. On pages 11-12 of the submission on September 24, 2007 of its proposed MCS in response to Order No. 26, the Postal Service indicated:

> The Postal Service also proposes to disaggregate letters and postcards into a single-piece product and a bulk product. The costs are clearly different for those letters/postcards that are entered in bulk and meet the many eligibility characteristics for bulk prices, as opposed to those pieces that are entered individually; indeed, the costs for bulk First-Class Mail have been separately reported in the CRA for many years. Also, on a broad level, the nature of the communication and its purpose differ between bulk and single piece letters/postcards, with the former generally used for business applications involving groups such as customers and the latter generally used for individual correspondence or transactions. Thus, from both a cost and a market perspective, bulk letters and postcards are a much different product than are single-piece letters and postcards.

The Commission confirmed that the Postal Service's First-Class Mail product classifications are in accord with the statutory definition, and that the Presorted and Single-Piece products "represent postal services with distinct cost or market characteristics." Order No. 43, Docket No. RM2007-1 (Oct. 29, 2007) at 103. The Commission held open the possibility that classifications into products are subject to future adjustments, but only "as conditions change." *Id*. Presumably, under the "changed conditions" standard, a future adjustment would require a showing that all cost or market characteristic that were distinct in 2007 are no longer distinct at the future point in time when the adjustment is being contemplated.

The new statutory definition of product hinges on differences in costs or demand. As quoted above, the Commission's Order No. 43 affirmance of Presorted and Single-Piece letters as separate products neglected, apparently intentionally, to clarify whether the basis for the Commission's conclusion was cost distinctions or market distinctions. As discussed in detail later in these comments, the Postal Service submits that Presorted and Single-Piece First-Class Mail manifest both distinct cost characteristics and distinct market characteristics. But, more importantly, regardless of the basis on which the Commission concluded that Presorted and Single-Piece First-Class Mail are separate products, the consequences of that determination are substantial in terms of the applicability of the workshare discount provisions of section 3622(e) of the new law.

3. Workshare Relationships are to be Analyzed within, not between, Products

The statute demonstrates that workshare relationships are to be analyzed on an intra-product rather than an inter-product basis. This is a necessary consequence of construing sections 3622(e) and 3652(b) together. See Motion Picture Ass'n of Am., Inc. v. FCC, 309 F.3d 796, 801 (D.C. Cir. 2002) ("Statutory provisions *in pari materia* normally are construed together to discern their meaning.") (citing Erlenbaugh v. United States, 409 U.S. 239, 244 (1972)). Two relevant questions in this regard are whether the two statutes were enacted in the same act, and whether they are "obviously designed to serve the same purpose and objective." See, e.g., U.S. v. Villanueva-Sotelo, 515 F.3d 1234, 1248 (D.C. Cir. 2008) (citing 2B NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 51:3 (6th ed. 2000 & Supp. 2007-2008)). Interpreting these provisions together is consistent with the general rule that statutes are to be read as a whole. See, e.g., Coit Independence Joint Venture v. Fed. Savings & Loan Ins. Corp., 489 U.S. 561, 573 (1989) (noting that the sections of an act do not exist in isolation, but are part of statutory framework that must be read as a whole).

These two provisions were enacted in the same legislative act (the PAEA), refer to "workshare discounts,"[5] and work together to a common purpose of ensuring that such discounts do not exceed the costs avoided by the Postal Service as a result of the customer undertaking the worksharing activity, except in specified circumstances. The scope of section 3622(e) should therefore be construed in a manner consistent with section 3652(b). Indeed, the two provisions are complementary, in that section 3652(b) mandates the provision of information necessary to apply the standards set forth in section 3622(e) (i.e., to determine whether the 100 percent threshold has been crossed, and thus whether it is necessary to determine whether one of the specified exceptions applies). The inter-connectedness of these provisions is confirmed by the legislative history, which notes that the purpose of section 3652(b) is "[t]o ensure that workshare discounts are appropriately established." See SEN. REP. NO. 108-318 at 20. Whether "workshare discounts" are "appropriately established" depends on whether they are consistent with section 3622(e).

As such, it is illogical to suggest that section 3622(e) would apply to a relationship for which section 3652(b) does not mandate the provision of cost information. Because section 3652(b) only requires that costs avoided and passthroughs be reported "with respect to each market-dominant product for

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[5] There is nothing to suggest that the terms "workshare discount" as used in sections 3622 and 3652(b) have a different meaning. See Yousuf v. Samantar, 451 F.3d 248, 256 (D.C. Cir. 2006) (noting that it is the "normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning.").

which a workshare discount was in effect,” the standards of section 3622(e) should be applied within each market-dominant product, rather than between market-dominant products.

In addition, the fact that section 3652(b) is placed within the provision governing the Annual Compliance Report is not a basis for inferring that section 3622(e) can be applied more broadly. The Postal Service does not quarrel with the notion that the Commission may logically require that compliance with section 3622(e) be examined in contexts other than the Annual Compliance Report itself. The Commission has done so by requiring that the Postal Service discuss, in each price change notice under section 3622(d), how its new prices are consistent with section 3622(e) (though the Postal Service uses the cost data provided in the most recent Annual Compliance Report). See 39 C.F.R. 3010.14(b)(5), (6). This does not mean, however, that section 3622(e) can be understood to apply more broadly than is indicated in section 3652(b). The statutory scheme set forth by Congress clearly emphasized post-implementation review, through the Annual Compliance Report / Annual Compliance Determination process of sections 3652 and 3653, over pre-implementation review, as a means of ensuring compliance with the provisions of chapter 36. Indeed, under the language of section 3622, the only mandated topic of pre-implementation review was ensuring compliance with the price cap. See 39 U.S.C. 3622(d)(1)(C). The Commission has recognized the inherently limited scope of the pre-implementation review in its regulations. See 39 C.F.R. 3010.13(j). Thus, it makes perfect sense that Congress would, in the context of the PAEA as a whole, place the detailed reporting requirements necessary to support implementation of section 3622(e) in section 3652. Subsection (b) of section 3652 therefore represents Congress' express determination as to the type of workshare information that needs to be provided in order to support the implementation of section 3622(e).

4. Single Piece and Presorted Mail Have Different Cost Characteristics and Different Market Characteristics

As explained in the immediately previous section, the establishment of Single Piece and Presorted First-Class Mail as separate products under the PAEA precludes application of the workshare discount provisions of section 3622(b) to the price differences between component elements of the two products. Section 3622(e) only applies to price differences within the same product. The result, however, is not only compelled by the provisions of the law, but is also appropriate as a matter of pricing policy. This is because Presorted and Single-Piece First-Class Mail are fundamentally distinct types of mail, and it would therefore be counterproductive to allow one aspect of rate design (maintaining price differences that rigidly match estimated cost avoidances across components of the two different products) to become the exclusive driver, or even just the primary driver, of relative prices between the two products. These policy considerations are thus rooted in the intrinsic differences between the two types of mail. Those differences, and their policy ramifications, are discussed in greater detail in the attached Technical Appendix.

As discussed above, the provisions of the PAEA dramatically changed the regulatory regime by which Single Piece and Presorted prices are established and evaluated. But yet another change between the PRA environment and the current landscape is entirely unrelated to the enactment of the new law. That change, which was equally true even during the latter years of the tenure of the PRA, is that it no longer makes sense to consider setting prices for Presorted mail as an exercise associated with the *introduction* of a new ratemaking concept. The notions that Single Piece customers are “status quo” customers, and that the predominant consideration in setting Presorted prices must be to avoid creating any upward pressure on the institutional cost burden placed upon those customers relative to the burden they bore when separate Presort prices did not exist, are thoroughly outdated concepts. Worksharing in First-Class Mail has been a fact of life for over thirty years. For the vast majority of customers, the choice as to whether to retool and redesign processes to enable presortation and making mail automation compatible was made long ago. Current institutional cost allocations need to be based on current conditions, and that includes current market conditions as well as current costs.

The Commission has historically looked at “worksharing” in First-Class mail as a “two-way street.”

> 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.”

PRC Op.R2000-1, paragraph [5089]. Critically, however, it is unlikely that a change in price signals through a reduction in presort discounts would actually result in large quantities of presorted First-Class Mail re-converting to Single-Piece mail. Once mail owners and consolidators have invested in equipment and determined procedures for presorting mail, it is unlikely that they would abandon these procedures and choose to send their mail via Single-Piece First-Class Mail if Presort First-Class Mail prices were to increase. But while raising Presorted prices (lowering the "discounts") may not drive customers to Single-Piece; it could drive them out of the mail altogether. For example, a bank considering mailing notices to cardholders advertising optional new service features is unlikely to ponder whether to send the notices as Single-Piece or Presort. The bank is far more likely to consider whether to send them by mail at all, particularly if many of the same customers can be reached with the same message via the Internet. Even if the mail is the preferred method to reach a customer, the bank is much more likely to consider whether Standard Mail is the appropriate substitute for Presorted First-Class Mail, rather than Single-Piece First-Class Mail.

In the past, the Postal Service and the Commission have assumed that the letter mail pieces most likely to convert from Single Piece to Presorted are found among those pieces which are entered as metered mail, or with an IBI indicia. As shown in the table below, while there has been movement within those two groups (metered and IBI) in recent years as IBI has become much more prevalent, the combined share of total Single Piece represented by those two types of indicia has remained remarkably constant, approximately 36 percent over each of the last five years.[6] If material amounts of Single Piece mail had been converting to Presorted over this period, one would have expected this percentage to decline accordingly. Given that the percentage instead remained stable, on its face, this table tends to confirm the proposition that Presorted is

[6] This contrast with the mid-to-late 1990s, when this combined percentage was at 41 percent in 1994, and hovered in the 38-39 percent range for the rest of the decade.

essentially a mature product, and that the conversion of Single Piece mail to Presorted has generally run its course.

FIRST-CLASS MAIL SINGLE-PIECE VOLUME BY INDICIA
VOLUME DATA IN BILLIONS

Year	Stamps	Meter	PVI	IBI	PI	BRM	Other		Met & IBI
2004	24.3	12.9	0.2	2.0	0.8	0.7	0.0	40.9	
Percents	59.5%	31.5%	0.4%	4.9%	2.0%	1.8%	0.0%		36.4%
2005	23.5	10.3	0.1	3.9	0.9	0.7	0.0	39.1	
Percents	59.7%	26.1%	0.4%	9.8%	2.2%	1.8%	0.0%		36.0%
2006	22.5	7.3	0.1	6.2	1.2	0.7	0.0	38.1	
Percents	59.0%	19.2%	0.3%	16.3%	3.1%	1.9%	0.0%		35.6%
2007	21.2	4.3	0.1	8.7	1.3	0.7	0.0	36.4	
Percents	58.2%	11.8%	0.3%	23.9%	3.7%	1.9%	0.0%		35.6%
2008	19.3	2.6	0.1	9.5	1.3	0.6	0.0	33.5	
Percents	57.5%	7.7%	0.3%	28.3%	4.0%	1.9%	0.0%		36.1%

The emergence of Presorted mail as a mature product standing on its own has substantial policy implications. When pricing Presorted First-Class Mail, the Postal Service needs to be cognizant of its product cost coverage, its product unit contribution to institutional costs, the different markets in which it competes, and the likely response in those markets to Presorted product price changes. Consideration of these factors by no means presupposes that estimated cost differences between Presorted mail and single-piece mail should therefore be ignored. Under the PAEA, price increases between the Presorted product and the Single-piece product are necessarily interrelated, because the price cap applies to First-Class Mail as a whole. The Postal Service fully intends to keep the estimated cost avoidance in mind when setting prices for First-Class Mail products. But, as a matter of policy, it simply makes no sense to assert that the foundation for the entire Presorted pricing structure must be based on a single estimated cost link between the Presorted product and a separate product, Single Piece.

5. Attempting to Impose a Rigid Bridge Between Single Piece and Presorted Prices Imposes Major Practical Obstacles Under the PAEA Pricing Regime

As a principal component of the modern system for market dominant postal product price regulation, section 3622(b)(4) permits the Postal Service to exercise pricing flexibility. As a matter of law, the Postal Service has demonstrated that one constraint on that flexibility, the workshare discount provisions of section 3622(e), operates only with respect to price relationships within, not between, products. As a matter of policy, the above discussion additionally indicates why it is beneficial to be able to balance the price relationships between Single Piece and Presort on the basis of the totality of demand and cost factors, rather than allow those relationships to be driven exclusively by avoided cost estimates between fundamentally different types of mail. Beyond legal and policy considerations, however, there are additional practical considerations which militate strongly against the imposition of rigid mechanistic relationships between Single Piece and Presorted in the context of the new PAEA price setting process. Specifically, rigid price design constraints yield untenable prices and pricing relationships.

As a practical matter, the Postal Service's authority to exercise the pricing flexibility permitted by subsection (b)(4) would be severely constrained by a requirement to continue to rely on a fixed measurement of cost avoided as the price difference between the one-ounce First-Class Mail Single-Piece Letter price (in the Single Piece Letters and Cards product) and the "starting" price (Mixed

AADC) for one-ounce automation letters (in the First-Class Mail Presorted Letters and Cards product). Given the penny rounding constraint for the First-Class Mail stamp price and the cap dictated by the change in the Consumer Price Index, matching the stamp prices increase to the cap is difficult. For example, the Docket No. R2009-2 overall First-Class Mail price change was constrained by a cap of 3.8 percent.[7] A 1-cent increase in the price of the basic First-Class Mail stamp from 42 to 43 cents would have resulted in approximately a 2.4 percent increase, while a 2-cent increase to 44 cents led to a 4.8 percent increase. For the stamp to increase by the cap amount precisely, the stamp price would have been 43.6-cents.

At a minimum, then, given the whole-integer constraint on the stamp price, there needs to be some flexibility in the setting of other prices (at something other than the "cap" amount) in order for the Postal Service to be able to fully use the cap allowance. The question then becomes whether the Postal Service is forced to select a stamp price *other* than the nearest rounded amount. In the R2009-2 notice, as well as the R2008-1 notice, the Postal Service did use the rounded amount, and used the other prices to "level" the increase at the cap.

One way to illustrate further the practical problems that result from rigid relationships between price categories within a cap-constrained class is to develop simple hypothetical examples. For simplicity, the following example assumes two price categories (single piece and presort), with equal weighting.[8]

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[7] The cap actually includes any unused pricing authority; however, for simplicity, in this document, the cap is described as the amount authorized by the relevant formula.

[8] Given the fact that the overwhelming majority of First-Class Mail pieces are either presorted letters (whose categories are therefore linked by workshare pricing rules) or one-ounce single piece letters, this simplifying assumption is very close to an accurate representation of the real situation in First-Class Mail.

It uses today's price of 44 cents to represent single piece, and the Mixed-AADC automation price of 38.2 cents to represent presort.

The first table below assumes modest inflation, leading to a cap of 1 percent for each of three years.[9] It shows what the weighted "revenue-per-piece" is for this hypothetical 50/50 mix of mail based on the current prices assumed for the two categories, and projects this weighted average unit price forward under the assumption that the full cap would be used (Column 2). Column 3 shows the "single piece" price that would occur if the cap percentage were applied to the starting point price, with the result rounded to the nearest whole cent. Column 4 shows the effective increase (after the rounding) for this price. In this example, the stamp would always round-down, and remain the same as the previous year. Column 5 is the "presort" price that would result from full use of the cap, with the percentage change in Column 6.

Table 1

	cap	overall rev/pc inflated by the cap	single piece price (rounded)	effective change	effective presort price	effective change
	(1)	(2)	(3)	(4)	(5)	(6)
Year 0		*41.1*	*44*		*38.2*	
Year 1	1.0%	41.5	44	0.0%	39.0	2.2%
Year 2	1.0%	41.9	44	0.0%	39.9	2.1%
Year 3	1.0%	42.3	44	0.0%	40.7	2.1%

[9] The Postal Service believes that such modest inflation numbers are certainly plausible, especially in light of recent predictions of a continuing weak economy. Moreover, and more importantly, the types of problems described in the examples below arise in any instance where the cap in a given year, when applied to the current price of the stamp, does not result in an whole number. A hope that CPI in the future will result in cap amounts that are always "just right" is obviously problematic.

Table 1 shows that the presort price would have to bear the entire brunt of the cap increase each year. Over the course of the three years, the increase for the presort price would be about 6.5 percent, compared to zero for the single piece price. While this outcome might not be ideal, it would nevertheless allow the Postal Service to keep within the price cap and meet its need for increased revenue. However, to the extent the presort price category has a higher contribution-per-piece, and a similar price elasticity, it would seem counter to good business practice to load all of the price increase authority onto it, as is done in this example.

Now suppose that a relationship between the two prices were imposed that required an effective 100 percent passthrough of a specific cost differential between the two categories in Year 1. Table 2 illustrates that scenario with a cost differential in Year 0 of 4.5 cents (which happens to be the FY2008 cost differential as reported in the FY2008 Annual Compliance Determination). The cost differential is assumed to grow in the future years at the same pace as the inflation implied by the cap. Forcing the 100 percent relationship leads to an untenable outcome (breaking through the cap in Year 1), therefore subsequent years are not contemplated in this scenario.

Table 2

	single piece price	cost avoidance	effective presort price	overall class price	overall price change
	(1)	(2)	(3)	(4)	(5)
Year 0	*44*	*4.5*	*38.2*	*41.10*	
Year 1	44	4.55	39.5	41.73	1.5%

Since Year 1 violates the cap (the overall price change is 1.5 percent, but the cap is only 1 percent), the only alternative available (assuming the 100 percent passthrough cannot be increased) to the Postal Service would be to lower the single piece price, even though the cap allows a 1 percent increase. Lowering the single piece price would, in turn, force a reduction in the presort price, since the two prices are rigidly linked by the 100 percent passthrough limit. This outcome would be highly problematic for the Postal Service because the average revenue per piece would actually go down (see Table 3, column 5), further weakening the Postal Service's financial position.[10]

Table 3

	single piece price (1)	Cost avoidance (2)	effective presort price (3)	overall class price (4)	overall price change (5)
Year 0	*44*	*4.5*	*38.2*	*41.10*	
Year 1	43	4.55	38.5	40.73	-0.9%

To salvage at least some revenue out of the price change opportunity (again, assuming a 1 percent cap), the price differential between single piece and presort could be set at less than 100 percent, which is permissible under the

[10] Of course, in reality there are more than two price categories in First-Class Mail. That in no way invalidates these observations of perverse outcomes arising from rigid relationships, as the price effects on these other categories could be viewed as "plug" figures unrelated to such objectives of the PAEA as pricing flexibility, efficiency, assuring adequate revenues, and a "just and reasonable rate schedule". Also, it is possible to "bank" unused pricing authority, so it is not mandatory that the entire cap be used; however, the financial outlook is unlikely to warrant forgoing a timely infusion of revenue as a realistic option anytime soon.

workshare pricing rules. This scenario, too, would lead to undesirable outcomes, as Table 4 shows:

Table 4

	single piece price (1)	cost avoidance (2)	effective presort price (3)	avg price for the class (4)	overall price change (5)	percent change for presort (6)	effective pass-through (7)
Year 0	*44*	*4.5*	*38.2*	*41.10*			
Year 1	43	4.55	40.0	41.50	1.0%	4.7%	66%

In order to produce the 1 percent increase allowed by the cap (in Column 5), the presort price would have to be set at 40 cents (in Column 3), which equates to a 66 percent passthrough (column 7) of the cost avoidance in Column 2. Since the single piece price was reduced to 43 cents (as described in the prior step in this example), the increase for presort has to be 4.7 percent (Column 6). This is even more disruptive than the example in Table 1, in that the single piece price would decrease 2.3 percent, causing the gap in the price change between the two categories to be 7 percentage points.

In summary, this simple example shows that there are practical implications of adhering to a set of constraints that includes: the traditional rounding of the stamp to an integer, the price cap, and adherence to a set price relationship between two major products. And while this example does not include other categories that, in reality, would be at the Postal Service’s disposal for adjustments that could blunt the implications of the aforementioned constraints, it is important to note that there are limits to the effectiveness of these “levers”. For example, in FY2008, the first ounce of single piece letters generated $14 billion, and the first ounce of presort letters generated $16 billion. Together, they represented 77 percent of the revenue in the First-Class Mail "bucket" for cap compliance purposes. To the extent the prices within these two categories were to be tied together with specific relationships to one another, then one decision (presumably the stamp price) would dictate the prices that represent almost 80 percent of the class. As noted above, the integer constraint makes that "decision" one that is not open to many options, presuming that the Postal Service wishes to use the full cap. The remaining 20 percent, then, would be acting as filler to try to meet the cap. This would include the prices for parcels, which in FY2008 had revenue of more than $700 million. In the context of First-Class Mail, that amount is not large, but it rivals Single Piece Parcel Post with its revenue of $718 million. Certainly, the prices for such a large product should not be relegated to "plug" status, but that is effectively what could happen if the great majority of prices are determined through a mechanistic linking process.

The solution to avoiding these practical difficulties, yet remaining true to the objectives of the pricing process, is one introduced above. Construing section 3622(e) in a manner consistent with 3652(b) presents a means of harmonizing the various elements of section 3622, as it relates to First-Class Mail, because it helps avoid the practical difficulties illustrated in this section of our comments. In this regard, the Postal Service recognizes the legitimate interests of the Commission and other interested parties in ensuring that price increases for First-Class Mail, under the cap, do not disproportionally benefit the large customers who utilize the Presorted prices, at the expense of the Single-

Piece customers. However, it is unnecessary to establish a benchmark between Single-Piece and Presort, governed by section 3622(e), in order to accomplish this purpose. Rather, section 3622 provides alternative bases by which the Commission can ensure that prices do not become unjustifiably beneficial for First-Class Mail Presorted customers, at the expense of First-Class Mail Single-Piece customers, over time. For instance, section 3622(b)(8) requires the Commission to ensure that the Postal Service maintains a "just and reasonable" rate schedule, a term that has generally been understood as precluding rates that are "excessive." See, e.g., Docket No. RM2007-1, Initial Comments of the United States Postal Service at 19 (April 6, 2007) (citing case). A consistent pattern of price increases that favors Presorted mail at the expense of Single-Piece mail over time could, all else being equal, conceivably lead to the violation of this provision.

II. DIFFERENCES IN ADDRESS DENSITY DO NOT CONSTITUTE STANDARD MAIL WORKSHARING

Price categories whose application is predicated on differences in address density, rather than any worksharing activity performed by a customer that would otherwise have to be performed by the Postal Service, are not workshare discounts within the meaning of the PAEA. Specifically, within Standard Mail, the price relationships between High Density mail and Saturation mail should not be governed by section 3622(e), the workshare provisions of the new law.

A. Price Differentials Based on Address Density Do Not Fall Within the Plain Meaning of Section 3622(e)

NAA has argued in prior proceedings that the Standard Mail High Density and Saturation price categories fall within the scope of section 3622(e) because they constitute workshare discounts provided to customers for "presorting" (in particular, walk-sequencing). See Docket No. R2009-2, Supplemental Comments of the Newspaper Association of American on Notice of Market-Dominant Price Adjustment at 2 (March 6, 2009) (hereinafter "NAA Supplemental Comments"); Docket No. ACR2008, Reply Comments of the Newspaper Association of America at 5-10 (February 13, 2009) (hereinafter "NAA Reply Comments"). This argument is incorrect. The difference between High Density and Saturation is the address density of the mail (i.e., the number of pieces going to individual carrier routes), rather than any additional worksharing activity performed by a customer that saves the Postal Service from performing work that it would otherwise have to perform. This is because both types of mail must be presorted by carrier route and sequenced. Thus, because these prices are not "provided to mailers for the presorting, prebarcoding, handling, or transportation of mail," they are not "workshare discounts" subject to section 3622(e); nor are the cost differences between them costs avoided "as a result of [a] workshare activity."

The language of section 3622(e) demonstrates that it applies to discounts provided for discrete, enumerated mail preparation activities performed by a customer, which would otherwise have to be performed by the Postal Service. Section 3622(e)(1) defines "workshare discount" as a "rate discount provided to mailers for the presorting, prebarcoding, handling, or transportation of mail," terms that may be “further defined by the [Commission]” pursuant to its authority under section 3622(a). These four enumerated activities are activities that the Postal Service would otherwise have to perform, in the normal course of business, such that having the customer perform some (or all) of that activity allows that mail to avoid certain processing steps. See SEN. REP. NO. 108-18 at 43 (“Subsection 3622(e) defines a ‘‘workshare discount’’ as a rate discount provided to mailers for presorting, prebarcoding, handling, or transportation of mail. These are activities that would ordinarily be performed by the Postal Service.”). Indeed, the word “worksharing” suggests a division of labor between the Postal Service and the customer, with the customer performing an activity in lieu of the Postal Service (and thus “sharing” the “work” that is required in order to efficiently process the mail). See id. at 12 (noting that worksharing “enable[s] customers to pay lower rates when they perform mail preparation or transportation activities such as presorting, prebarcoding, and certain other mail handling activities that would otherwise be performed by the Postal Service.”). Practically, the Postal Service cannot change the density of a mailing, by any activity it undertakes. If a mailing only goes to 125 addresses on a carrier’s route (typically about 25 percent), no mail preparation or transportation activities can make that mailing go to 75 percent of the addresses on the route.

Under section 3622(e)(2), the Commission must ensure that these discounts “do not exceed the cost that the Postal Service avoids as a result of the workshare activity, unless” one or more of the statutory exceptions apply. This is to ensure that customers do not receive a discount for work they perform, that could be performed more cheaply by the Postal Service. See id. at 43 (“The

[Commission] is required to establish rules for workshare discounts that ensure that these discounts do not exceed the cost that the Postal Service avoids as a result of the worksharing activities performed by the mailers, subject only to four exceptions.");150 CONG. REC. S6,001 (daily ed. May 20, 2004) (statement of Sen. Carper) (noting that the workshare provision "prohibits the Postal Service from outsourcing work that could be performed cheaper in house while maintaining pricing flexibility."). In turn, this presumes that a customer is faced with a choice of whether to engage in the workshare activity, or to instead tender the mail to the Postal Service without engaging in that activity, presumably after considering the costs it would incur to perform that activity itself, in relation to the discount it will receive (which reflects the Postal Service's costs of performing that activity).

Presorting occurs when customers separate mail into physically distinct containers (trays, bundles, sacks, pallets, or other approved containers), or insert physical markers into trays of letters, such that the resulting divisions or containers of mail replicate the physical separations that the Postal Service would itself have made in the normal course of its operations if it were given the same mail, unsorted, or only partially presorted. The essential and characteristic element of <u>pre</u>sorting is therefore that the customer performs activities that the Postal Service would otherwise have had to perform itself, in order to process and deliver the mail. Thus, a customer who sorts to 5-digits allows the Postal Service to avoid one stage of mail processing, when compared to mail that is only sorted to 3-digits. Consequently, presorting mail avoids work for the Postal Service, hence its proper characterization as "worksharing" in section 3622(e).

While sequencing performed by a customer is logically seen as a form of "presorting," the difference between the application of the High Density price as compared to the Saturation price (as well as the Carrier Route price as compared to the High Density price) is based not on the sequencing performed by a customer, but on the address density of the mailing. This is because mail in each of these categories must be presorted by carrier route and sequenced.[11] A customer qualifies for the Saturation price rather than the High Density price not because his mail is walk-sequenced (the customer would have to walk sequence its mail to qualify for High Density), but because its mail meets the density requirements for Saturation. Thus, because the level of presortation does not differentiate these price categories, the discounts are being "provided to mailers" based on the fact that a mailing has a higher address density, not for the fact that a mailer has undertaken additional "presorting." As such, the "costs avoided" when these categories are compared to one another are due to unit cost differences resulting not from additional customer worksharing, as defined in the PAEA, but from address density.

It thus cannot be said that mail that is eligible for the High Density price is less "workshared" than mail that is eligible for the Saturation price. Both types of mail have had the maximum amount of presort worksharing done on them by a

[11] There are two forms of address sequencing permitted by the Postal Service's mailing standards: walk-sequencing and line-of-travel (LOT) sequencing. While High Density and Saturation mail must be walk-sequenced, customers of Carrier Route mail have the choice of walk-sequencing or LOT sequencing. For mail that is to be taken out by the carrier as a third bundle, like many Saturation mailings, walk-sequencing is necessary. For mailings that are cased by the carrier, walk-sequencing provides no cost avoidance compared to LOT sequencing, so use of LOT with Carrier Route mail is not a less workshared variant of walk-sequencing.

customer.[12] No amount of further work, done either by the customer or the Postal Service, can convert High Density to Saturation. If a customer tenders unsorted or partially presorted mail, the Postal Service must sort that mail into finer mail processing categories. In contrast, the Postal Service performs no action on a low density mailing to convert it to a high density mailing, nor can it do so, without combining it with mail from other customers. A Saturation mailing is therefore not a High Density mailing with some additional work performed by the customer. This fact necessarily implies the converse: presenting the Postal Service with a higher density mailing does not avoid work the Postal Service would otherwise have done on lower density mail. There is simply no "work" that is being "shared" between the Postal Service and the customer, in the same manner that occurs with presorting, or the other enumerated worksharing activities in section 3622(e).

Whether a given body of mail is eligible for the High Density or Saturation categories therefore depends not on whether a customer chooses to undertake additional worksharing, but on the intrinsic characteristics of the body of mail. A given body of mail with sufficient address density can potentially qualify for either the 5-digit price category, or for one, but only one, of the High Density / Saturation price categories. In other words, a customer can choose to not presort the mail further and qualify for the 5-digit price, or the customer can choose to presort the mail further and walk-sequence it, but it cannot choose

[12] The fact that this mail has undergone some worksharing is irrelevant, because the issue here is whether cost differences between these categories of mail is worksharing, not whether some worksharing is done to convert the mail from other categories to Saturation / High Density / Carrier Route mail (certainly, given sufficient density, 5-digit mail could be presorted to carrier route and walk-sequenced).

between High Density and Saturation prices: the factor that determines which set of prices (High Density or Saturation) then applies is the address density of the mail, a factor intrinsic to the body of mail and which no amount of worksharing can alter.

It is true that the different density tiers (Saturation, High Density and Carrier Route) have different unit costs, reflecting the fact that mail with higher address density should have lower unit costs, all else being equal.[13] However, not all cost differences can be characterized as "worksharing" cost differences subject to section 3622(e). While Congress could have imposed the pricing limitations of section 3622(e) on all practices that theoretically lower the Postal Service's costs (whether they do in practice or not), Congress did not do so, instead restricting the scope of that section to a well-defined list of four actions, of which address density is not one. Indeed, there are many other mail piece characteristics that affect costs but, like address density, are not "worksharing" within the meaning of section 3622, such as shape and machinability.

The cost differences between the density tiers are akin to mail shape-based cost differences, rather than presort tier cost differences. Typically, parcel-shaped mail costs more than flat-shaped mail to process and deliver, and flat-shaped mail costs more than letter-shaped mail. However, the Postal Service does not convert flats to letters, so a letter does not avoid shape-converting work that the Postal Service would otherwise have done on a flat (such that a letter can be considered a workshared version of flat). Likewise, the

[13] In theory it is hard to argue against the proposition that higher address density mail should produce lower unit costs, all else being equal. Yet, costs filed in the ACR suggest that it is sometimes empirically difficult to observe this proposition.

Postal Service does not convert parcels to flats, so a flat cannot be considered a workshared version of a parcel. Similarly, as discussed above, the cost differences between the density tiers are not costs, capable of being avoided, of converting mail from one address density to another.

Moving from High Density to Saturation (or from Carrier Route to High Density) therefore does not allow the Postal Service to avoid an activity that it would otherwise have to perform. The Postal Service will generally engage in the same processing activities with respect to both types of mail; those activities can just be performed more efficiently when the mailing is a Saturation mailing as compared to a High Density mailing. Higher address density thus, as a theoretical proposition, allows the Postal Service to perform certain work, that only it can do, more efficiently, unlike worksharing where a customer undertakes work that either the customer or the Postal Service can do, thereby eliminating the need for the Postal Service to perform the same work. The differences between density tiers therefore stand in contrast to the differences between the various tiers in worksharing categories like presorting or dropshipping. Moving from one worksharing tier to a more heavily worksharing tier allows the Postal Service to avoid an activity it would otherwise have to perform (e.g., 5-digit mail avoids a processing step that will have to be performed on 3-digit mail, while DDU mail avoids a transportation leg that would otherwise have to be performed on DBMC or DSCF mail).

Finally, while it is true that a minimum level of address density is necessary for presorting, that fact does not make address density equivalent to "presorting." This is because a prerequisite for some activity is not the same as the activity itself, as the following examples demonstrate:

> Example 1: Both presorting and drop shipping are worksharing categories within the meaning of section 3622(e). Presorting is a prerequisite for drop shipping (for example, only 5-digit presorted parcels can be drop shipped at the destination delivery unit since each delivery unit only handles parcels addressed to specific 5-digit areas). But, even though presorting is required for drop shipping, presorting is a totally different activity from drop shipping.
>
> Example 2: Automation is a worksharing category (i.e., "prebarcoding"). One prerequisite for automation is machinability (nonmachinable mail cannot be automation mail), but machinability is not, itself, worksharing. <u>See</u> PRC Op., R2006-1, at ¶ 4030 (identifying non-worksharing mail characteristics to include "weight, shape, and machinability").
>
> Example 3: Drop shipping to the DDU is worksharing. One prerequisite for drop shipping non-carrier route presorted pieces to the DDU is that the pieces be parcel-shaped. Non-carrier route letters and flats cannot be deposited at DDUs because they must first be processed at upstream facilities. But, even though being the correct shape is required for DDU entry, shape is not a worksharing category. Order No. 43 at ¶ 2118.

Because address density is therefore not equivalent to the action of "presorting," it does not fall within the scope of section 3622(e)(1).

B. NAA's Argument that Section 3622(e) Constitutes a Congressional Ratification of Prior Treatments of these Discounts is Unfounded

As shown above, the relationship between High Density and Saturation (as well as Carrier Route and High Density) does not fit within the plain meaning of section 3622(e). NAA presumably would argue in response that section 3622(e) nevertheless applies to these prices because the "Commission for nearly 20 years repeatedly and consistently treated the difference between High Density and Saturation flats as a presort workshare discount," a past treatment that has been "codified" by Congress. See NAA Supplemental Comments at 2. See also NAA Reply Comments at 5-8. As discussed below, this argument lacks merit.[14]

As an initial matter, the fact that the density discounts may have been described as "workshare discounts" in the past is fundamentally irrelevant. The plain language of section 3622(e) clearly indicates that Congress did not intend to simply "codify" the Commission's prior characterizations of "workshare discounts," such that a price relationship that may have been described as "worksharing" in the past is *ipso facto* a "workshare discount" within the meaning of the PAEA. Rather, section 3622(e)(1) sets forth a clear, unambiguous, and exhaustive definition of "workshare discount." This definition does not make reference to past uses of that term, such that it can be shown to encompass any and all activities that may have, rightly or wrongly, been characterized as "worksharing" under the prior pricing regime.[15] In addition, section 3622(e) does not give the Commission the discretion to define "workshare discount" as it sees fit, in a manner similar to the broad grants of authority granted to the Commission elsewhere in the Act. Instead, section 3622(e) limits the term to discounts "provided to" mailers who engage in four enumerated activities, with the only discretion accorded to the Commission the ability to further articulate the meaning of those terms. There is nothing in the language of section 3622(e), or

[14] NAA has also argued that it is important that the Commission has treated the High Density / Saturation relationship as worksharing in previous proceedings under the PAEA, which it characterizes as "contemporaneous agency interpretation[s] deserving of weight." NAA Reply Comments at 8. However, this fact is completely irrelevant to this proceeding. First, the Commission has left open the possibility of not applying section 3622(e) to these discounts; indeed, that is the very purpose of this proceeding. Furthermore, even if this were not true, it is of course axiomatic that the Commission's interpretation of the PAEA must not conflict with the plain language of the statute.

[15] In contrast, in another provision of the PAEA, Congress defined the mail classes for purposes of applying the price cap by express reference to the particulars of the prior pricing regime. See 39 U.S.C. 3622(d)(2)(A).

in the context of the rest of the statute, that would indicate that this definition should not be applied according to its plain terms.

In addition, the legislative history confirms Congress specifically intended to limit section 3622(e) to discounts provided for "presorting, prebarcoding, handling, and transportation of mail." Earlier reform bills defined "workshare discounts" as "presorting, barcoding, dropshipping, *and other similar discounts*, as further defined under regulations which the Postal Regulatory Commission shall prescribe." See H.R. 4341, 108th Cong. § 204 (2004); H.R. 4970, 107th Cong. § 204 (2002) (emphasis added). Indeed, one of those bills (H.R. 4341) contained two different definitions of "workshare discount," one in the predecessor to section 3652(b) that included the expansive phrase "and other similar discounts," and one in the provision that became section 3622(e) that limited the term to those discounts "provided to mailers for presorting, prebarcoding, handling, or transportation." See H.R. 4341 at §§ 204, 206. Subsequent bills corrected this inconsistency by adopting a single definition of the term, without the reference to "other similar discounts," which is the approach used by the PAEA. See, e.g., H.R. 22, 109th Cong. §§ 204, 206 (as passed by House); S. 2468, 108th Cong. §§ 201, 204 (2004). See also SEN. REP. NO. 108-318 at 43 (noting that workshare discount is defined "as a rate discount provided to mailers for presorting, prebarcoding, handling, or transportation of mail."). Thus, this history shows that Congress considered, but did not accept, defining "workshare discount" expansively, in a manner that would have encompassed a broader range of activities than the four listed. Cf. John Hancock Mutual Life Insurance Co. v. Harris Trust & Savings Bank, 510 U.S. 86, 100-01 (1993) (rejecting an interpretation of statutory language in part by noting that "Congress had before it, but failed to pass" language that would support such an interpretation).

Furthermore, NAA's argument that the High Density and Saturation prices fall within the scope of section 3622(e) because 1) "Congress is presumed to have known and understood the Commission's historical treatment of presort discounts, including High Density/Saturation differential as a presort discount" (Reply Comments at 7), and 2) Congress intended to "codify" that treatment by including the term "presorting" in section 3622(e), is also unfounded. Before a statute can be interpreted as incorporating a particular, pre-existing regulatory definition of a term that has been used in the statute (here, a definition of "presort" that encompasses "density"), there must "naturally" be "indications in the statutory language or history" of such a Congressional intent. New York v. E.P.A., 413 F.3d 3, 19 (D.C. Cir. 2005); Continental Airlines, Inc. v. D.O.T., 843 F.2d 1444, 1454 (D.C. Cir. 1988). In addition, it must be shown that the prior regulatory interpretation of the term was clearly specified, such that it is logical to believe that Congress was aware of that interpretation. This requires a demonstration that the Commission clearly and consistently characterized the High Density and Saturation discounts as being "presort" discounts under the prior pricing regime. See Office of Communication, Inc. of United Church of Christ v. F.C.C., 327 F.3d 1222, 1226 (D.C. Cir. 2003) (declining to find that Congress had codified a particular administrative interpretation of the term "broadcasting" as including subscription television services in part by noting that the agency had previously "exhibited some inconsistency" as to whether subscription television service was, or was not, “broadcasting”). See also Environmental Defense v. Duke Energy Corp., 549 U.S. 561, 576 n.6 (2007) (noting that the regulatory definition of a term must be settled prior to presuming that Congress incorporated that definition into a statute).

The Commission in numerous instances under the PRA recognized the distinction between presortation / walk-sequencing on the one hand, and address density on the other. This recognition began in the Commission’s discussion of the High Density and Saturation discounts in Docket No. R90-1. In that docket, while the Postal Service proposed to recognize only walk-sequenced mail with Saturation density, see PRC Op., R90-1, at ¶ 5899, the Commission recommended what it characterized as a “two-tier walk-sequencing discount,” consisting of Saturation and what ultimately became known as High Density. Id. at ¶ 5917. The difference between these two “tiers” was not walk-sequencing (since both tiers required walk-sequencing), but the density of the mailings. See id. at Appendix Two, page 8 (recommended DMCS language).

Contrary to NAA’s characterizations, the Commission’s discussion of its recommended discounts demonstrates that it recognized that they encompassed two distinct elements: walk-sequencing and density. In particular, NAA is incorrect in its claim (at page 6 of its Reply Comments) that “the word ‘density’ nowhere appears in the Commission’s discussion of the discounts”; rather, the Commission clearly indicated, at the very beginning of that discussion, its recognition that “route coverage *or density*” was a distinct concept from “walk sequencing.” See id. at ¶ 5884 (emphasis added). The Commission also recognized the distinction between density and sequencing in its discussion of the Postal Service cost study upon which it relied in recommending the discounts, noting that the study estimated casing productivities "under 4 different presequencing methods (walk, street, and two ZIP+4 methods), and at two different coverage levels" (i.e., saturation and 125 piece). Id. at ¶ 5904.

Therefore, the Commission recognized the conceptual difference between presortation / walk-sequencing and density from the beginning. In subsequent cases, while the Commission sometimes referred to the Saturation and High Density prices as being "presort" discounts, see, e.g., PRC Op., R97-1 at ¶ 5573, the Commission also consistently distinguished between the "density tiers" of Standard ECR and the "presort tiers" of Standard Regular. Examples of this include the discussion in PRC Op., R2005-1 at ¶ 6047, and PRC Op., R2000-1 at ¶ 5379. Compare also, e.g., PRC Op., R2006-1, Appendix One page 16 (note 2) with page 19 (note 4); and PRC Op., R97-1 at ¶ 5521 with ¶ 5563. Furthermore, the price charts and DMCS language described the Standard Regular categories as being "presort categories," but did not apply the same descriptor to the Standard Mail ECR categories. Overall, the fact that the Commission often distinguished between "density" and "presort" precludes an argument that Congress, by making section 3622(e) applicable to discounts for "presorting," thereby implicitly intended that density discounts be subject to that provision. See Office of Communication, 327 F.3d at 1226.

This lack of perfect consistency in the Commission's prior characterization of these price categories is not surprising, because the characterization of a discount as being "presort" had no particular legal significance in the prior pricing regime. There was, for example, no formally promulgated, well-established regulation defining “presort” for Congress to adopt. Indeed, “presort” was often used as a generic shorthand; for instance, the “presort tree” used in Standard Mail rate design included passthroughs based not only on presortation, but on other characteristics such as shape. See, e.g., PRC Op., R2006-1 at ¶¶ 5450-53. In such a circumstance, it is not appropriate to say that there was a well-established, precise regulatory definition of the term “presort” which one can legitimately infer that Congress was aware of, and intended to “codify” through its incorporation of that term in section 3622(e). At the very least, there was certainly not a clear understanding that the term “presort” necessarily included “density,” meaning that it is not reasonable to be infer that Congress, by merely incorporating the term “presorting” in the PAEA, must have meant to also include “density” as well. See, e.g., Environmental Defense, 549 U.S. at 576 n.6 (noting that the regulatory definition of a term must be settled prior to presuming that Congress incorporated that definition into a statute).

The language of section 3622(e) supports this interpretation. Congress did not draft section 3622(e) so as to define the term “presorting” by reference to any specific, prior Commission interpretation or exegesis as to its meaning. Rather, Congress simply incorporated the term “presorting” into section 3622(e), while authorizing the Commission to “further define” its precise meaning. It therefore left it up to the Commission to reasonably determine which particular discounts are being “provided to mailers for the presorting…of mail.” This belies the notion that Congress had a specific intent to “codify” a precise understanding of the meaning of “presorting.” See Continental Airlines, 843 F.2d at 1454 (declining to find that Congress had codified a particular regulatory definition of the term "commuter airline" by noting that Congress might have "defined [that term] with greater specificity by explicitly incorporating definitional references to agency regulations, but it chose not to do so). See also Baptist Health v. Thompson, 458 F.3d 768, 774-75 (8th Cir. 2006) (declining to hold that Congress had codified a regulatory definition of a term in part because the legislative language incorporated only the term, rather than incorporating the entire regulatory definition, and because the statute did not expressly reference the regulation). The lack of a specific reference to any prior Commission interpretation of "presorting" is particularly relevant considering Congress did define another statutory term by express reference to a specific prior Commission definition (i.e., the definition of "class" in section 3622(d)(2)(A)). See New York, 413 F.3d at 19. In addition, there is nothing in the legislative history that would indicate that Congress in mind had a precise, pre-existing regulatory definition of "presort" (which included the density discounts) when it passed the PAEA.

Furthermore, it is fundamentally inappropriate to interpret section 3622(e) so that its application to a particular price category is based on historical practice, rather than on its plain language. That language makes the application of section 3622(e) dependent on whether a discount is being "provided to" a mailer who performs one of the specified workshare activities, not whether a discount may have, at one time, been considered to be "worksharing." Postal classifications change, in response to changes in postal operations and other factors, in such a way that may fundamentally alter the relationship between prices. As such, something that was once a discount "provided to" mailers for a certain workshare activity may no longer be properly characterized in that way; for instance, while a difference between Carrier Route and High Density letters used to be the requirement that High Density letters be automation compatible, that is "prebarcoded," whereas Carrier Route letters did not have this requirement, that fact changed when Carrier Route letters were also required to be automation compatible. When the Commission "further define[s]" the meaning of the terms "presorting, prebarcoding, handling, and transportation of mail," it must consider present realities, not historical practice.

In the end, NAA is left with the assertion that there is "[n]othing in the legislative history [that] remotely hints that the Congress, through this provision, intended to disrupt the Commission's longstanding treatment of…the High Density/Saturation discounts…." NAA Reply Comments at 7. However, as discussed above, the legislative history indicates the fallacy of NAA's argument that Congress could not have intended to exempt any price category previously characterized as "worksharing" from the scope of section 3622(e). Furthermore, the absence of legislative history explaining that Congress meant to exclude the density discounts from the scope of section 3622(e) is certainly not sufficient to justify departing from statutory language that, in the context of the statute as a whole, is unambiguous.

In summary, Congress provided in the PAEA a formal, statutory definition of "workshare discount." It is clear from the language of that definition, as well as from its legislative history, that Congress intended to delineate the precise scope of section 3622(e), to apply to discounts that are currently being "provided to" mailers in exchange for one of four enumerated workshare activities. There is nothing in the context of the statute as a whole that would indicate that this language should not be applied according to its plain terms. The fact that certain discounts that may have been previously considered "worksharing" under the PRA do not fall within the four corners of that definition is simply a consequence of the language promulgated by Congress. See California ex rel. Brown v. Watt, 668 F.2d 1290, 1304 (D.C. Cir. 1981) (noting that the language of the statute is "the most important manifestation of legislative intent").

Furthermore, NAA's attempt to argue that "presorting" as used in section 3622(e) encompasses discounts predicated on address density is unavailing. "Presort" and "density" are distinct concepts, a fact that the Commission has recognized in the past. Nor is there a reasonable basis, from either its language or legislative history, to infer that Congress intended to incorporate by reference an understanding that "presort" encompasses "density." The Commission must therefore apply section 3622(e) according to its plain language, and recognize that discounts that are "provided to" mailers because of the address density of their mail are not "workshare discounts" under the PAEA.

III. IF THE COMMISSION WERE TO EXPAND THIS PROCEEDING TO ADDRESS COSTING METHODOLOGY ISSUES IN DETAIL, THE POSTAL SERVICE WOULD LIKE TO RAISE MATTERS THAT SHOULD BE INCLUDED IN ANY SUCH EFFORT

The Postal Service believes that the primary objective of Docket No. RM2009-3 is to address the Postal Regulatory Commission's concern that the Postal Service did not use the existing methodologies for calculating First-Class Mail Presorted prices, as well as comparable issues in Standard Mail. However, Order No. 192 states that "interested persons, including the Postal Service, may submit alternative workshare discount rate design and cost avoidance calculation methodologies." Order No. 192 at 3. But for this statement, the Postal Service would not raise the issue of the costing methodologies in this docket at all. That is because, as the Commission acknowledged in its ACR2008 Annual Compliance Determination, the Postal Service has followed the Commission approved costing methodology in its Docket No. ACR2008 filing.[16]

However, given the invitation by the Commission and the expectation that other parties will seek to revisit the established cost methodologies, the Postal Service recommends that the Commission consider a change in the established methodology in one discrete area: the proper classification of cost pools. The Postal Service believes that the classification of cost pools should be based upon operations, taking into consideration the empirical, operations-based incurrence of costs relative to the presort levels of the mail. Admittedly, this was a contentious issue in Docket No. R2006-1. The Postal Service has complete materials to support its proposed reclassification of cost pools. However, before filing the materials in this docket, it would like to recommend the following procedural option.

If intervenors raise significant cost methodology issues in their responses to Order No. 192, there is a possibility that the cost pool classification issue and other cost methodology issues could swamp this docket and the fundamental questions about pricing methodologies. In addition, the application of costing methodology to pricing is not independent of the issues raised above. For example, the establishment of the bulk meter benchmark in earlier dockets was based on a pricing assumption about the mail most likely to convert to presorted

[16] PRC-ACR2008 LR3-FY 2008 First-Class Mail

First-Class Mail, *See, e.g.,* Direct Testimony of David R. Fronk, USPS-T-32, Docket No. R97-1, at 20-21. To avoid this outcome, the Postal Service recommends that the Commission bifurcate those issues into a separate docket.[17] If the issues are bifurcated, the Postal Service will file its support for the cost pool reclassification in the new docket. If not, it will evaluate the other issues raised by intervenors and decide whether to pursue the cost pool classification issue.

CONCLUSION

For the reasons explained above, with respect to the First-Class Mail question, the language of the statute does not permit application of the provisions of section 3622(e) within products. Therefore, in order best to allow realization of the entire range of statutory objectives, the Postal Service should have the flexibility to design prices for Presorted First-Class Mail that take account of a broad array of market and cost factors, not just the estimated costs avoidance between a Single-Piece benchmark and the least presorted tier of Presorted mail. With respect to the Standard Mail question, differences in cost among the Saturation, High Density, and Basic price categories are <u>not</u> “workshare”

[17] See Order No. 192 at 3.

differences within the meaning of section 3622(e). Pricing for those products should not be encumbered by striving to meet inapplicable requirements.

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Respectfully submitted,

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TECHNICIAL APPENDIX – COST AND DEMAND

This Technical Appendix is organized as follows. First, it begins with a discussion of the cost differences between Single Piece First-Class Mail and Presorted First-Class Mail. Second, it examines quantitative and qualitative information on differences in the demand (or market) characteristics of the two products. Third, it briefly discusses some of the pricing consequences of these differences, particularly in the context of efficiency.

1. Cost Characteristics

The cost characteristics of the First-Class Mail Single-Piece Letters product and the Presort Letters product are different. Table A-1 shows the historical CRA costs for these categories.

Table A-1
Attributable Cost – First Class Mail All Shapes[18]

	Cents per piece		
	Single-Piece	*Presort*	*Ratio SP To Presort*
FY2002	26.83	10.83	2.5
FY2003	26.48	10.32	2.6
FY2004	26.47	10.10	2.6
FY2005	28.69	10.62	2.7
FY2006	29.83	11.11	2.7
FY2007	31.21	11.82	2.6
FY2008 (Letters only)	25.20	11.25	2.2

Source: CRA, 2002 - 2008

Cost differences are primarily due to significant differences in mail processing costs arising from two sources: (i) presortation, barcoding, and

[18] Letters comprise the bulk of First-Class Mail.

making mail automation compatible and, (ii) the nature of the mailpieces themselves. In FY 2008, the first year for which CRA data were available by shape, Single-Piece letters' unit attributed cost is 25.20 cents while for Presort letters the cost is 11.25 cents per-piece.

This FY08 difference in CRA letter mail attributable cost of 13.95 (25.20 – 11.25) cents can be compared with the avoided costs estimates for letter mail presented on page 52 of the FY 2008 ACD (March 30, 2009). The highest cumulative cost avoidance shown in the ACD is 9.4 cents for Auto 5-Digit letters, and that category is less than half of the total volume of Presorted letter mail. On a volume-weighted basis, the average cumulative letter mail cost avoidance is under 8 cents, or just above half of the CRA attributable cost difference. Clearly, there is a substantial portion of the CRA cost difference between Presorted and Single-Piece First-Class Mail that is not explained by cost avoidances relating to mail preparation activities. Equally clearly, setting the discounts to match the avoided cost estimates would not result in equal unit contribution to the recovery of institutional costs for the two types of letter mail.

The portion of the cost differences between these two categories that does not arise from presorting, prebarcoding, handling or transportation of the mail by customers results from variations in a broad array of mailpiece characteristics for Single-Piece and Presort Letters categories, including dimensions of the mailpieces, entry profile, level of automation compatibility, and machine readability. The Single-Piece Letters product tends to be a heterogeneous collection of a number of subgroups of mail exhibiting wide variation of these mailpiece characteristics. For example, Single-Piece First-

Class Mail, especially household mail, comes in a broad range of envelope sizes, and a significant percentage of single-piece mail has handwritten addresses. At the same time, a substantial percentage of mail originating from the household consists of courtesy reply envelopes provided by businesses, which are most often used for bill payment. Courtesy reply mail pieces typically are of standard business size, and bear a machine-generated address, a Facing Identification Mark (FIM), and a barcode.

The cost characteristics of Presorted First-Class Mail (i.e., business-originated) reflect entry in large quantities, as compared to those of single-piece mail. There are also many other entry profile and mail quality differences, including but not limited to the number of postal facilities through which the mail travels and the proportions of the mail that are undeliverable-as addressed.

2. Market Characteristics of Single-Piece and Presort Mail

There are discrete, clearly definable customer segments and types of mail within both of the Single-Piece and Presort categories. Single-piece mail is comprised of household mail and some business mail. Clearly, it would be erroneous to suggest that the salient distinction between Single-Piece customers and Presorted customers is the line between households and non-households (businesses, nonprofits, etc.). Nonetheless, it is possible to draw a meaningful boundary line that distinguishes between the two markets. Using Presorted prices requires levels of volume that only non-household customers produce; it also requires a perceived level of importance to the non-household customer that justifies the initial effort to make arrangements for enhanced mail preparation.

Mail preparation is not a casual activity that an organization can undertake on a whim. While virtually every business will engage in some amount of mailing, businesses will undertake specialized mail preparation activities only when mailing activity reaches a certain threshold importance within the totality of activities in which the business engages. The salient line of demarcation, therefore, puts non-household entities with mailing activity sufficient to justify managing that activity as part of their ordinary course of business on one side of the line, and leaves households and other non-households who generally have less focus on mailing issues on the other side of the line. Of course, like the result of any line-drawing exercise, this line may not be perfect. Nonetheless, the notion that customers who engage in mail preparation are likely to attach more importance to mailing activity than customers who do not lays an appropriate foundation for expecting differences in the uses and market characteristics of Single-Piece First-Class Mail and Presorted First-Class Mail. These differences are further explored below, drawing heavily on information from the Household Diary Study.

Household Mail

According to the FY 2008 Household Diary Study (HDS), approximately 5.6 billion pieces of mail representing correspondence of various types (personal, holiday and non-holiday greeting cards, invitations, etc.) were sent and received by households last year. In addition, approximately 2 billion pieces of mail were sent by households to non-households that can be classified as correspondence mail. Following is the data from the HDS, which highlights the difference in mail volume and trends based on three sectors: Household to Household (HH to HH), non-household to household (NHH to HH), and household to non-household (HH to NHH).

Table A-2
First-Class Correspondence Mail Sent/Received by Sector

Sector	Volume (Millions of Pieces)			Change, 2006-2008
	2006	2007	2008	
HH to HH	**6,079**	**5,610**	**5,646**	-7.1%
NHH to HH	8,461	9,175	8,780	3.8%
HH to NHH	2,034	2,132	2,083	2.4%
TOTAL	16,574	16,917	16,509	-0.4%

Source: 2008 Household Diary Study, p. 21; HH to HH highlighted data are detailed in Table A-3

Within Household to Household correspondence, which totaled 5.6 billion pieces in FY 2008, there is a variety of correspondence types, profiled below.

Table A-3
Personal Correspondence Sent/Received

Correspondence Type	Volume (Millions of Pieces)			Change, 2006-2008	Share of 2008 total
	2006	**2007**	**2008**		
Personal Letters	1,138	1,116	1,046	- 8.1%	18.5%
Holiday Greeting Cards	2,612	2,117	2,278	-12.8%	40.3%
Non-Holiday Greeting Cards	1,323	1,454	1,374	3.9%	24.3%
Invitations	566	597	555	- 1.9%	9.8%
Announcements	141	130	122	-13.4%	2.2%
Other Personal	299	196	271	- 9.4%	4.8%
Total	**6,079**	**5,610**	**5,646**	**- 7.1%**	**100.0%**
Internet Cards	1,001	942	975	- 2.7%	

Source: Household Diary Study, 2008, p. 24

Personal Correspondence mail can be readily segmented into six different groups, including personal letters, holiday and non-holiday greeting cards, invitations, etc. The impact of substitutions (primarily via the Internet) vary by correspondence type. Although Personal Correspondence is declining, the rate of decline varies by correspondence type. For example, Holiday Greeting cards declined 12.8 percent over this period, while Non-Holiday Greeting Cards have increased 3.9 percent from 2006-2008. This suggests that electronic diversion is slower for this segment compared to other areas of Personal Correspondence, including Personal Letters and Announcements.

As shown in the previous table, A-2, the reduction in correspondence volume from 2006–2008 (-0.4 percent), was driven by the decline of Household to Household mail. Mail volume originating from businesses and organizations (non-households) had the majority share of correspondence, comprising approximately 53 percent of all correspondence mail. Thus, although one often thinks of correspondence as being single-piece Household to Household mail, that segment is declining. Businesses are critical to the health of correspondence mail, but business correspondence mail nevertheless differs from business transactions mail. For example, the process for presortation of outgoing bills (which are generally handled in large, bulk, uniform mailings with personal information in each envelope), is not the same as the process that businesses use for their routinely generated letters, such as customer response letters sent on a one-time basis or other office “white mail.”

Transactions mail, primarily sent via First-Class Mail has a different profile from correspondence mail, as shown in Table A-4, below.

Table A-4
Transactions Mail Sent/Received *

Transaction Type	**Volume (Millions of Pieces)**			**Change, 2006-2008**	**Share of 2008 Total**
	2006	**2007**	**2008**		
Business					
Bills	19,080	18,788	18,655	- 2.2%	44.8%
Bill Payments	9,949	10.202	9,704	- 2.5%	23.3%
Statements	6,920	7,133	6,560	- 5.2%	15.7%
Confirmations	2,738	3,242	2,824	3.2%	6.8%
Payments (to HH)	1,439	1,418	1,324	- 8.0%	3.2%
Orders	612	560	537	-12.2%	1.3%
Rebates	173	169	162	- 6.2%	0.4%
Total Business	**40,911**	**41,512**	**39,766**	**- 2.8%**	**95.4%**
Social/Charitable					
Requests for Donations	708	733	754	6.5%	1.8%
Donations	524	550	657	25.4%	1.6%
Bill	212	194	180	-14.9%	0.4%
Confirmations	355	273	331	-6.8%	0.8%
Total Social/Charitable	**1,798**	**1,749**	**1,921**	**6.9%**	**4.6%**
Total Transactions	**42,709**	**43,261**	**41,687**	**- 2.4%**	**100.0%**

* Primarily First-Class Mail; some Standard Mail
Source: 2008 Household Diary Study, pages 29-30

Not all transaction mail is mailed from non-households. Bill payments, originating from households, comprise about 25% of transaction mail, or 9.7 billion pieces in FY 2008. For the most part, these payments are mailed in return envelopes provided by billers. These envelopes have some special characteristics recognizable by postal automation as well as an inserts that have address and delivery point barcodes that are visible through the window and that are used for sortation of mail on postal machinery. Households typically affix stamps and mail these pieces at Single-Piece letters prices.

The HDS provides data on how transactions mail sent and received by households can be delineated into different segments, and provides information on trends by type of mail (bills, bill payments, statements, etc.). Household attributes – such as the rate of migration to the Internet, demographic characteristics including age, income, education, and household size[19] – differ within these groups. The HDS provides rich data throughout, further lending credence to the notion that business-originated mail is different from household-originated mail.

Business-Originated Single-Piece First-Class Mail

As discussed earlier, not all mail sent by businesses is automatically presorted. Depending on the volume and the regularity of large volume mailings, many businesses, especially those that are small to medium-sized, may choose to mail using Single-Piece First-Class Mail. General office mail that is often

[19] For both correspondence and transactions, younger households send and receive less mail, due to a generational difference in adaptation to electronic alternatives.

referred to as ”white mail” because of its characteristics: uniform envelope size, machine-generated addresses with a meter strip, has generally been targeted by the presort bureaus to convert into Presort First-Class Mail by spraying a required barcode and combining this mail with mail from other customers to achieve finer presort levels.

Presort Mail

Presort mail has three large segments of mail – correspondence, transaction, and advertising. Tables A-1, A-2, and A-3, above, provide detail on correspondence and transaction mail. Advertising is a standalone segment (about 8.2 billion First-Class Mail pieces in FY 2008[20]) that does not exist to any appreciable extent in the Single-Piece product category. Although the majority of advertising mail is sent via Standard Mail, a significant amount is sent via First-Class Mail. The 2008 HDS estimates that 16.5% of all advertising mail received by each household per week was sent via First-Class Mail.[21] This represents a decline in the advertising share of FCM, over the past 8 years, as shown in Table A-5, below.

[20] See 2008 Household Diary Study, p. 41.
[21] *Ibid*.

Table A-5
First-Class Mail and Standard Mail Advertising Volumes, 2002-2008

Mail Classification	Change 2002-2008	Volume (Billions of Pieces)						
		2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
FCM Advertising	-10.9%	18.4	17.5	16.3	18.4	18.0	16.9	16.4
Standard Mail	16.7%	71.1	74.2	78.1	83.5	86.9	83.4	83.0
Total Advertising by Mail	**11.0%**	**89.8**	**92.0**	**94.8**	**102.2**	**105.1**	**100.5**	**99.6**

Source: The Household Diary Study, 2002-2008

However, it should be noted that the typical decision for businesses is not whether to use First-Class Single-Piece Mail or Presort for advertising, but rather whether FCM Presort or Standard Mail should be used.

In addition to advertising, Presort mail includes some business correspondence and transaction mail that originates from non-households. While both Single-Piece and Presort serve transactional purposes, the transactions are different in nature. Bills and statements going from non-households to households are less likely than bill remittances to divert to the Internet. Evidence of this trend is supported by findings in the 2008 HDS, which notes that households reported paying 31 percent more monthly bills by electronic methods in 2008 than in 2006.[22]

There is evidence in the business media of a desire by the consumer to retain paper-based notification of payments due.[23]: The relative “staying power”

[22] USPS 2008 Household Diary Study, p. 32.
[23] *e.g.*, see American Banker (April 24, 2009, p. 12) where Carol B. Barkley, the marketing director in U.S. Bancorp's corporate payments unit, said her company encourages people to receive their statements online, but it does not require them to do so. "We have some clients who feel the need to have paper. We do not mandate paperless billing, and as far as I'm concerned, we never will," she said.

of paper-based bill statements from nonhouseholds to households is substantiated the 2008 USPS HDS ,[24] which shows that while bill payment methods have undergone a substantial shift in 2006-2008, the average number of bills received by mail has not declined so sharply: an average of 18.98 bills and statements were received via mail per household in 2006, compared with 17.99 in 2008.[25] Among other consequences, this means that a letter bill (Presort) does not necessarily trigger a letter payment (Single-Piece). Clearly, this implies different demand characteristics, although the sender influences the recipients' decisions to some extent, such as offering incentives to pay bills electronically.

The third component of Presort mail, correspondence, is unlike the other two components. It is less likely to be regular and periodic in nature, like the other components, and is more likely to be triggered by *ad hoc* events or customer queries that are unrelated to the factors that drive either advertising or transactions mail.

Price Elasticities and Product Alternatives

The different customer bases for Single-Piece and Presort mail support the Postal Service's view that these products do, indeed, serve different markets with demand characteristics being one of the differentiators between them. One often-discussed way to examine demand characteristics is own-price elasticity. One problem with this approach, however, is that unrelated products can have similar elasticities. Further, calculated price elasticities for First-Class Mail

[24] 2008 USPS Household Diary Study, p. 37.
[25] *Ibid.*

Single-Piece and Presort are averages that may obscure distinct variations within each product, variations that can be determined through other methods.

Price elasticities are one tool that can be used in conjunction with other indicators and information about markets and demand. One key gauge of differences between products is the availability of substitutes and the degree to which customer groups migrate to substitutes. The substitutes for Single-Piece First-Class Mail and Presort First-Class Mail tend to be different. For example, the users of Presort Mail have many other available Postal alternatives – *e.g.*, any piece of mail that can be sent as First-Class Mail advertising could probably be sent via Standard Mail. And while electronic alternatives are available to both Single-Piece and to Presort First-Class Mail, the migration rates from mail to the internet vary by postal product and by type of mail.

3. Policy Implications of Cost and Demand Differences

The issue to be addressed regarding cost and demand differences can be summarized in one question. Given what we know about cost and market differences between the single-piece and presort First-Class Mail, would it be sound policy to require a pricing structure premised on the notion that the starting point for presort First-Class Mail pricing design must always be the estimated cost avoidance between a single benchmark type of Single Piece mail and the least presorted pieces of presort First-Class Mail? The clear answer to this question is "no."

The Postal Service now operates under a price-cap, which limits price increases for each class to equal the overall rate of inflation. There exists some flexibility regarding price increases for individual products, as long as the overall price-cap requirement is met. Historically, the discussion of presort First-Class Mail pricing has focused on the assumption that customers who presort their mail are given a lower price because, by presorting their mail, these mailers reduce the mail processing costs for the Postal Service. This discussion has been driven by the application of the efficient component pricing rule (ECP) which states that the discount for a workshare activity should equal the Postal Service's resulting cost savings. If, for example, it costs the Postal Service 5 cents per piece to sort mail, then the ECP presort discount should be 5 cents. The ECP discount ensures that the entity which can sort the mail at the lowest cost will have an incentive to do so.

ECP is designed to create productive efficiency because the overall costs of processing are minimized by having the least cost entity perform the individual task. Low cost mailers presort and high cost mailers do not presort, since in the latter case, it is less costly for the Postal Service to sort the mail. However, establishing discounts also establishes prices for presort mail, thereby creating a potential conflict between productive efficiency (ECP) and other factors which should also be evaluated[26]. Practically, customers pay prices not discounts, and the effect of any absolute price level (or change in prices) on customer behavior needs to be considered in determining what price should be set for a product.

As, Prof. Panzar succinctly, noted that “efficient ‘discounts’ do not necessarily yield efficient ‘rates’.” USPS-RT-13, Docket No. R97-1, at 15.

Attempting to lock in the absolute price difference between two products (i.e., Single-Piece and Presort) at the amount of estimated cost avoidance can be suboptimal when there are intrinsic differences in attributable costs above and beyond the estimated cost avoidances. As indicated above, we do in fact face those conditions. The Commission implicitly appears to acknowledge the dilemma on page 36 of the FY 2008 ACD (March 30, 2009) when noting:

> Efficient rates within a class also serve to maintain parity in unit cost contribution. The Efficient Component Pricing Rule (ECP) requires that cost differences equal cost differences.

But if ECP rates (i.e., those in which rate differences exactly equal estimated avoided costs) do not maintain parity in unit cost contribution, because of other intrinsic cost differences, then such ECP rates are not necessarily efficient. In a pricing regime in which overall percentage price increases are capped across the entire class, seeking nonetheless to insist that a preference for ECP rates should still apply under these circumstances could result in the Postal Service losing contribution relative to equally reasonable pricing choices. It is much more rational to allow greater flexibility to consider CRA cost differences and differences in demand, both of which are ignored under the ECP approach.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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