
Consideration of Workshare Discount	:	Docket No. RM2009-3
Methodologies	:	

COMMENTS OF VALASSIS DIRECT MAIL, INC. AND THE SATURATION MAILERS COALITION IN RESPONSE TO ORDER NO. 243

(September 11, 2009)

Valassis Direct Mail, Inc., a wholly owned subsidiary of Valassis Communications, Inc., and the Saturation Mailers Coalition hereby submit their comments in response to Order No. 243. These comments, as with our earlier comments submitted on May 26, 2009 in response to Order No. 192 which instituted this proceeding, again demonstrate that the rate differential between Standard Saturation and High Density mail is not a “workshare discount” within the meaning of Section 3622(e) of the Postal Accountability and Enhancement Act (PAEA), and is therefore not subject to the pricing restrictions of that section. We also address the additional topics set forth in Order No. 243, including the appropriate product groupings and pricing treatment for products previously encompassed by the Enhanced Carrier Route subclass within Standard mail.

At the outset, we note that three parties – the Postal Service, ValPak, and Valassis/SMC – filed comprehensive comments concerning the proper statutory interpretation of Section 3622(e) in response to the Commission’s instituting order. Those comments, addressing both the plain language of the statute and its legislative history, conclusively show that the Saturation-High Density rate differential is not a “workshare discount” as defined in the statute. In its subsequent Order No. 243,

however, the Commission did not assess these legal arguments, but instead announced the holding of a public forum and further opportunity to comment on topics that, we submit, are at best collateral to the central legal issue.

Beyond this legal issue -- which precludes treatment of the density rate differential as a “workshare discount” under Section 3622(e) – we explain why, under accepted pricing principles, the Postal Service must have flexibility to adjust the Saturation-High Density rate differential based on market and profit optimization factors, whether or not these rates are formally classified as “separate products.”

I. PRICING FLEXIBILITY AS ENVISIONED BY THE PAEA IS CRITICAL TO THE POSTAL SERVICE’S VIABILITY, AND MUST NOT BE STIFLED BY OVERBROAD REGULATORY COST-LINKED PRICING CONSTRAINTS.

In its current economic straits, facing severe volume losses due to changed market conditions that threaten its solvency, the Postal Service has never had greater need for pricing flexibility to manage all its mail products and optimize its profitability. With the structural changes occurring in its markets and their impacts on USPS costs and revenues, the Postal Service can no longer afford to have its products priced primarily on the basis of cost differentials that do not adequately take into account market and demand factors.

This proceeding raises issues that will have a substantial bearing on whether the Postal Service will be able to manage and price its products flexibly in response to market conditions, as envisioned by the PAEA. The importance that Congress attached to pricing flexibility is reflected not only in the ratemaking objectives and the policies of the Act, but also in the structure of the statutory price-cap mechanism for market-

dominant products.¹ Congress, early on, rejected proposals that would have applied price caps at the rate-element level and thereby have frozen all rate relationships in place forever. Instead, in section 3622(d)(2)(A), it specified that rate caps be applied at the class level, thus giving the Postal Service flexibility within each class to adjust the prices of individual mail types by amounts either greater or less than CPI so long as the *average* class-wide price change is within the CPI cap.

The only specific limitation Congress imposed on pricing flexibility in Section 3622 is the workshare discount restriction of subsection (e), which requires, subject to enumerated exceptions, that “workshare” discounts “do not exceed the cost that the Postal Service avoids as a result of workshare activities.” Because this provision carves out an exception to the pricing flexibility envisioned for the Postal Service in the Act’s ratemaking objectives and factors, it should be construed narrowly. Otherwise, if misconstrued to apply as a restriction on every price differential within a mail class, the Commission would, through this one section of the Act, be effectively eliminating true pricing flexibility under the statute by imposing a rigid structure whereby every rate element and price differential is pegged to cost differentials without regard to marketplace and other pricing factors.

Another critical issue is the classification and treatment of product groupings under the PAEA. A product is defined in the PAEA as “a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be,

¹ The statutory ratemaking objective “to allow the Postal Service pricing flexibility” is set forth in section 3622(b)(4), and the policy concerning “the importance of pricing flexibility to encourage increased mail volume and operational efficiency” in section 3622(c)(7).

applied.” 39 U.S.C. section 102(6). Congress, in providing for the classification of mail into separate products, clearly intended that the designation as a “product” would be used to distinguish products in setting prices, rather than merely as a “descriptor” of a service offering.

Particularly in the case of products differentiated on the basis of market characteristics, the workshare discount limitations of section 3622(e) should apply only to true workshare discounts within the product grouping, and not to rate relationships among product groupings which should be priced on the basis of both cost and market factors. Otherwise, if subsection (e) were used to restrict rate differentials among different products to just “workshare” cost differences, the designation of mail products would become a meaningless exercise, as the rates for all products within a class would be linked by cost differences without regard to market factors – a pricing constraint even more onerous than the old “cost of service” pricing of Standard Mail prior to the introduction of the Enhanced Carrier Route subclass in 1995. Clearly, Congress did not intend such a backwards step in pricing. It introduced the concept of “products” in conjunction with the class-wide rate cap mechanism as a means for the Postal Service to achieve the efficiency, pricing flexibility, and financial viability envisioned in the PAEA’s ratemaking policies and objectives.

II. THE SATURATION-HIGH DENSITY RATE DIFFERENTIAL IS NOT A “WORKSHARE DISCOUNT” SUBJECT TO THE PRICING RESTRICTIONS OF SECTION 3622(e).

Worksharing performed by a mailer is a substitute for activities that the Postal Service would otherwise have to perform itself, thus saving (avoiding) postal costs. The postal discount for that worksharing activity is then based on that cost avoidance.

However, as fully explained in the initial comments of the Postal Service, ValPak, and Valassis/SMC, there is no “worksharing” difference between Saturation and High Density mail; mailers of both undertake the identical worksharing: presorting the mail into carrier walk-sequence. If the Postal Service were instead to perform the walk sequencing of unsequenced mail, its (avoidable) unit cost of doing so would be the same for both types of mail. As the Postal Service stated:

“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.”
USPS Comments at 32.

The Saturation-High Density unit cost differential is instead due to differences in mailing density – i.e., the extent to which a mailing covers all addresses on a particular route. Those differences in mailing density are, in turn, the result of the mailers’ differing demographic and strategic business models and choices in deciding how best to target and serve their markets. Thus, Saturation and High Density mail are not “workshare” variants of the same product but instead are two separate postal products with separate and distinct cost and market/demand characteristics that must be taken into account in setting their rates.

A. Under The Terms Of The PAEA, Rate Differentials For Differences In Mailing Density Are Not “Workshare Discounts” Subject To The Pricing Limitations Of Section 3622(e).

Determination of the proper scope and meaning of “workshare discount” in Section 3622(e) is a critical threshold issue that we believe is dispositive, and that we had expected the Commission to address in response to the comprehensive comments filed by the Postal Service, ValPak and Valassis/SMC. Because the Commission in Order No. 243 did not address or assess this core issue, we will reiterate those points here. This issue is straightforward. The definition and scope of “workshare discount” is clearly set forth in provisions of subsection (e). We begin with the workshare discount definition in subsection (e)(1):

“(1) DEFINITION.—In this subsection, the term ‘workshare discount’ refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a).”

As stated, the term “workshare discount” refers to rate discounts “*provided to*” mailers “*for*” performance of certain enumerated activities. The natural meaning of “provided ... for” here is *not* that the “presorting,” etc., is simply a *precondition* for obtaining the discount but that it is the *raison d’etre* for the discount: that the discount reflects the savings *generated by* the “presorting,” etc., and is given in recognition of *that* savings.

This interpretation is strongly reinforced by the opening words of the very next subsection, § 3622(e)(2), setting forth the scope of the provision:

“(2) SCOPE--The Postal Regulatory Commission shall ensure that such discounts do not exceed *the cost that the Postal Service avoids as a result of workshare activity,...*” [emphasis added]

Thus, worksharing is an “activity” performed by the mailer that “results” in “avoided costs” for the Postal Service.

By these terms of the statute, the rate differential between Saturation and High Density mail is *not* a “workshare discount” within the meaning of subsection (e). Saturation mail is, indeed, lower cost than High Density mail. But the cost difference is not due to any “workshare activity,” since both types of mail have the identical “walk-sequence” preparation requirement. The rate differential between the two is not “provided ... for” that “activity,” but rather for something else, namely, their differences in postal cost due to their differing levels of mailing density.

Mailing density, of course, is not the result of an “activity” performed by the mailer, such as presorting of the mail; nor is it a substitute for some “activity” that the Postal Service would otherwise itself have to perform. Rather, just as in the case of mail-piece shape and weight, mailing density is a characteristic of the mailing that is driven by the mailer’s assessment and business approach to serving its market. The mailer’s choice of shape, weight, and density do, indeed, have cost implications, but those are not “workshare” cost implications.

This fundamental distinction between mailing density and worksharing is aptly described by the Postal Service in its initial comments:

“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).” USPS Initial Comments at 33.

This interpretation is further reinforced by the types of workshare activities Congress enumerated in its workshare discount definition. The definition in subsection (e)(1) lists only four activities: “the presorting, prebarcoding, handling, or transportation of mail.” These four enumerated “workshare activities” have a key element in common. Each involves *additional work that the mailer must undertake* to earn the discount – work that the Postal Service would otherwise have to perform itself. The very term “*workshare discounts*” connotes the same.

As the Postal Service’s initial comments show, Congress intended to limit the reach of the subsection (e) workshare-discount pricing restriction to these four enumerated types of workshare activities. If a workshare activity falls within the *statutory* definition of “workshare discount,” it is subject to the pricing constraint. If not, it is not so constrained, regardless of how the Commission might label or characterize it.

B. Both The Language Of Section 3622(e) And Its Legislative History Demonstrate That Congress Intended A Specific And Narrow Definition Of Workshare Discounts.

The Newspaper Association of America (NAA), in its reply comments in Docket ACR2008 (at p. 7), has argued that, at the time the PAEA passed, Congress should be “presumed to have known” that the Postal Rate Commission had previously established various kinds of “workshare” discounts, and that Congress’s intention must therefore have been that its definition in the statute encompass all of them. In other words, whether or not what the Postal Rate Commission had deemed a “workshare”

discount meets the terms of the PAEA's statutory definition, it should be presumed to be encompassed by that definition.

In its initial comments in this proceeding, the Postal Service fully disposed of NAA's statutory-intent argument, pointing out that Congress considered but rejected a more expansive definition of "workshare discount."

"[T]he 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.' ... 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 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." USPS Initial Comments at 38 (citations omitted).

Moreover, NAA's argument incorrectly presumes Congress intended to have the statutory definition (and hence, the pricing restriction) turn on *the label* that the PRC attaches to a discount, regardless of its *true character* as a workshare activity. Under NAA's contention, the statute ought to have stated simply that the Commission has the authority to define workshare discounts however it chooses. That was clearly not Congress's intention, as evidenced by both the plain language of the statute and its legislative history.

Rather, Congress was well aware that the four types of workshare activities it specified in its statutory definition are the four types of activities that actually require the mailer to undertake additional "work" to earn the discount. Its *exclusion* of other types

of activities beyond those four was intentional. Given the very incongruity of “mailing density” as a true worksharing activity, that conclusion is irrefutable with respect to the Saturation-High Density rate differential.

This legislative history also disposes of any uncertainty concerning the clause at the end of the statutory workshare definition – “as further defined by the Postal Regulatory Commission under subsection (a).” The fact that Congress rejected a more expansive definition -- “presorting, barcoding, dropshipping, *and other similar discounts*, as further defined under regulations which the Postal Regulatory Commission shall prescribe” – demonstrates that Congress did not intend to give the Commission unfettered discretion to expand the scope of the workshare discount pricing restriction however it wants, either by adding new types of activities to the list or decreeing that certain other types of rate differentials are “workshare discounts” regardless of their true nature. The only reasonable reading, consistent with the legislative history and the actual wording of subsections (e)(1) and (2) as discussed above, is that this clause allows for the modification of worksharing categories *within* the enumerated types of activities, such as creation of a new discount for mailer preparation of automation-compatible flats – a mailer workshare undertaking that qualifies within the statutory definition of “the presorting, prebarcoding, handling, or transportation of mail.”

But no matter how broadly that clause might be read, it cannot be stretched to allow the Commission to declare “differences in mailing density” to be a “workshare activity” subject to the pricing restriction. Density is not an “activity” but rather a non-workshare mail characteristic that cannot be wedged into subsection (e). Such an unbounded interpretation would infringe upon the pricing flexibility Congress so clearly

intended to afford the Postal Service. That is why Congress, wisely, defined “workshare discount” narrowly, confined to the four specified types of mailer worksharing activities. Mailing density is not one of them, and moreover, does not, in any common sense of the word, involve a “worksharing activity” by the mailer.

C. The Cost Differences Between High Density And Saturation Are A Function Of Mailing Density, Not Mailer Worksharing

In our initial comments filed on May 26th, we addressed in detail the faulty analogies drawn by NAA in Docket ACR2008 and the Commission in its ACR Report which implied that density is an element of other workshare discounts such as drop ship and presort discounts. Valassis/SMC Initial Comments at 7-10. In the interest of brevity, we here summarize the critical defect in those analogies.

“Just as in NAA’s earlier faulty analogy to drop ship discounts, the Commission’s analogy to presort discounts confuses the volume needed to reach a discount threshold with the *extra worksharing activity* that the mailer must undertake to save postal costs and *earn* the discount. In the presort examples cited above by the Commission, merely having sufficient mailing density to reach the next higher “presort discount” tier does *not*, by itself, entitle the mailer to the discount. In addition to having sufficient density, the mailer *must also actually undertake the extra work necessary to “presort” the mail* as prescribed by the Postal Service. The discount is *not* given for density; it is given for the mailer’s *presort preparation and the resulting postal cost savings*. And the discount itself is based on the cost avoided by the Postal Service as a result of receiving that mail at the higher rather than the lower presort level, i.e., the *presort-related* cost savings between the two tiers.” *Id.* at 9.

Those drop ship and presort discount examples are fundamentally different in nature from the rate differential between High Density and Saturation mail – a difference that goes to the heart of the statutory “workshare discount” restriction in Section 3622(e). As between these two rate tiers, mailing density is the *sole* distinction for rate eligibility purposes – the *sole* requirement for entitlement to the lower Saturation rate.

An existing High Density mailer does not need to undertake any additional “worksharing” to qualify for the Saturation rate. It only needs to increase the number of pieces in its mailing up to the “saturation density” level. That is not “worksharing.”

D. The Other Topics Raised in Order No. 243 Cannot Justify Treatment Of The Saturation-High Density Rate Differential As A Worksharing Discount, Either In Whole Or In Part.

In Order No. 243, the Commission has presented a number of topics for discussion that, in our view, are subsidiary to the controlling question of whether the Saturation-High Density rate differential is a “workshare discount” within the meaning of Section 3622(e). We discuss these below:

1. The Commission’s Discussion And Questions Confuse The Distinctions Between Differences In Mailing Characteristics And Mailer Worksharing.

In general, the Commission’s questions and issues confuse and mix together two separate types of cost differences: (1) differences among *mailing characteristics* such as volume, density, weight and shape; and (2) differences among *mailer worksharing alternatives*.

Differences in mailing characteristics are driven by the mailer’s business objectives and market needs. These are product-related differences rather than “activities” that would otherwise be performed by the Postal Service, for which the Postal Service should have discretion to:

- Recognize these characteristics by deaveraging the average rate for the category in which these products are mailed; and
- Determine the price its wants to set for each of these characteristics.

Because these characteristics are truly product-related, the Postal Service

should have flexibility to determine prices for these characteristics, regardless of whether or not they are identified formally as a "product." Sometimes, the Postal Service cannot completely separate out a "product" (subclass) because it cannot identify criteria that would keep it separable from other "products" (i.e., that cannot eliminate arbitrage) or perhaps because the volume of that particular "product" is so small as to not be worthwhile to separate out.

The density-related Saturation/High Density price difference is a good example. So is piece weight in Standard mail. Even if both "products" are formally placed in a single "product" grouping, the Postal Service should be allowed to recognize each characteristic separately and, pursuant to the PAEA, it should be permitted to price each as it sees fit based on market factors and profit optimization. Their associated rates may be loosely based on costs but are not due to worksharing. Thus, regardless of whether the mailing characteristic is considered a formal "product," it can generally be treated as such for ratemaking purposes. Efficient Component Pricing does not apply because these are different products even if not formally identified as such. The Commission's Question 3 on page 8 suggests this possibility – asking whether “rates for Saturation mail [should] be set as though it serves a separate market, even though it is not classified as a separate product?” The answer to that question is “yes.” Just as in the case of weight and shape, density-related market differences should be reflected in Postal Service pricing whether or not they are formally designated as a separate product.

The Commission's discussion of differences among *mailer worksharing alternates*, however, leads to confusion when it recognizes that, within a formal

"product" grouping, there may be differing *mailing characteristics* that have an impact on worksharing cost avoidances (or on other postal operational costs). Ratemaking treatment in this case is both logical and simple. Where the Postal Service does recognize a specific mailing characteristic – e.g., separate product groupings by shape – then the cost avoidance for worksharing alternates *within* each shape product *should* reflect the avoided worksharing costs for that particular shape. In other words, when an "informal" product such as shape is recognized in rates and it also has worksharing alternates, the avoided cost differential among the alternates *should* be based on the informal product's specific mailing characteristics. Examples of this process occurred in Docket R90-1 when presort differentials were deaveraged by shape, and more recently in Docket R2008-1 when dropship differentials were deaveraged by shape.

On the other hand, postal rates may not explicitly recognize a type of mailing characteristic, for example mailing density within Standard Letters. In that case, the worksharing cost avoidances for Standard Letters will recognize cost avoidances for letters but will be based on the *average* mailing density for Standard Letters. Or, the USPS may recognize a mailing characteristic – for example piece weight – in its rate schedule but be unable (from a practical standpoint) to recognize differences in worksharing cost avoidances by piece weight. Thus, when it estimates worksharing cost avoidance, it assumes *average* piece weight. This is completely acceptable ratemaking – deaveraging the average formal product cost to develop rates for products and worksharing alternates within products, but continuing to use averaging for mail characteristics where deaveraging is considered either impractical or not substantively informative.

By contrast to the above, for High Density and Saturation, the ratemaking process is simple. As discussed in other sections, cost differences between High Density and Saturation are due entirely to mail characteristics (principally mailing density) and there are no true worksharing differences between them. Moreover, the Postal Service can identify the separable total cost for each so that there is no cost averaging between them. Thus, the rates for these products are distinguished entirely by their mail characteristics. As such, they are each separate products despite being placed in the same formal product.

2. The Definition of Workshare Discounts Is Prescribed In The Statute, And Cannot Be Broadened To Encompass Mail Characteristics Such As Mailing Density That Do Not Meet The Statutory Definition.

At page 4 of its Order, the Commission has posed as a “policy issue” whether a “worksharing discount should be defined as:”

- A “pure” presorting, prebarcoding, handling, or transportation activity that is a direct substitute for an equivalent Postal Service activity; or
- A “pure” worksharing activity as described above, plus other cost-reducing mail characteristics that are facilitated by or naturally support the “pure” worksharing activity, e.g., walk sequencing and density.

The definition of workshare discount as set forth in the statute is controlling. While the Commission has discretion to consider what types of costs or methodologies should be used to estimate workshare discount savings, it does not have authority to redefine as “worksharing” under Section 3622(e) mailer activities or mailing characteristics that fall outside the statutory definition. In particular, the “pure-plus”

variant cannot be used to wedge the Saturation-High Density rate differential into the ambit of the Subsection (e) pricing restriction.

Even aside from this fatal legal problem with its “pure-plus” alternative, the Commission’s characterization of it actually illustrates its illogic. Mailing density is indeed a cost-reducing mail characteristic of Saturation mail compared to High Density mail. However, that difference in mailing density is clearly not “facilitated by” the “pure” worksharing activity of walk sequencing, nor does the difference in density “naturally support” walk sequencing. Both Saturation and High Density mailings are walk-sequenced to the same degree. The density differences between the two are wholly unrelated to worksharing; they are instead purely a function of the mailer’s business decision on how best to serve its market.

3. **Attempts To Define Or Unbundle Or Analytically Decompose Worksharing Discounts That Have Non-Worksharing Cost-Reducing Components Are Problematic.**

At page 5 of the Order, the Commission has posed three variations on the theme of “whether a discount that reflects both cost-reducing characteristics that are directly related to a worksharing activity, and others that are indirectly related to, or unrelated to the worksharing activity:”

- Should be defined as “worksharing” or “non-worksharing” according to some rule, such as which cost-reducing effect is thought to predominate;
- Should be unbundled so that separate discounts are developed for the worksharing and non-worksharing components; or
- Should remain bundled, but be analytically decomposed into its worksharing and other components so that section 3622(e) standards may be applied to the worksharing component.

In deciding, at the outset, whether a particular rate differential can be “defined” as a “workshare discount” within the meaning of the statute, these variations are irrelevant.

The statutory definition controls, and cannot be expanded upon by resort to non-worksharing characteristics. The Commission's three variants can only come into play if the rate differential independently falls within the statutory workshare definition.

Aside from this legal definitional constraint, these variations raise practical problems. Decomposing a cost differential into separate "worksharing" and "non-worksharing" components, and deciding which element predominates, would not be an easy task, particularly since these cost components may be interrelated (as in the case of shape and weight) and impossible to isolate except by arbitrary allocations or models. Even if they were unbundled or decomposed, what is the practical effect for rate setting? Unbundling, for example, would presumably require two sets of discounts: a worksharing component discount subject to section 3622(e), and a separate non-worksharing component that might or might not be restricted to the cost difference. Even in the case of a bundled discount, decomposing the workshare component for testing its compliance with section 3622(e) leaves a perplexing question: what becomes of the non-worksharing component for pricing purposes? Is that component also included in the actual rate discount for pricing purposes; and would it be constrained to cost differences?

4. **The "Gains In Efficiency" Due To Mailing Density Cannot Be Construed As A Worksharing Activity Subject to Section 3622(e).**

At page 8 of the Order, the Commission has posed the notion that "the observed cost difference" between Saturation and High Density mail due to mailing density "could be characterized as gains in efficiency brought about by worksharing activity, *i.e.*, the Postal Service's cost per piece of sorting mail to walk-sequence order

declines as density increases.” It then suggests that the cost differentials relative to Carrier Route flats could be used as a benchmark in order to achieve “the mathematical equivalent of retaining the link between High Density and Saturation mail.” This kind of bootstrap approach cannot be used to metaphysically convert the density-driven cost differences into a “workshare discount” within the meaning of the statute. The cost difference *between* the two is not caused by any mailer “activity” that the Postal Service otherwise would or could perform, but is due solely to the mailer’s market-driven choice of its mailing density.

Here again, the Commission confuses costs associated with product-related mail characteristics and costs associated with worksharing. Both High Density and Saturation mailers do *identical* walk-sequencing. The avoided postal cost associated with that *walk-sequencing* is the *same* for both High Density and Saturation – a postal clerk or carrier has to take a completely *unsequenced* mailing and sort it by hand, one piece at a time. Consequently, increases in mailing density would *not* increase the efficiency of avoidable postal walk-sequencing. The greater efficiency of walk-sequenced Saturation mail has nothing to do with worksharing, but is due to density-related efficiencies.

In sum, none of the analogies or variations presented by the Commission can change the fact that the rate differential between Saturation and High Density is outside the scope of the statutory definition of “workshare discounts” in section 3622(e).

III. THE ECP CONCEPT AND THE WORKSHARING COST PASSTHROUGH CONSTRAINT ARE INAPPLICABLE TO THE SATURATION/HIGH-DENSITY RATE DIFFERENTIALS

In the past, the Commission (and the Postal Rate Commission before it) sometimes appeared to view the concept of Efficient Component Pricing (ECP) as the “be all and end all” of postal pricing, applying it not only to true worksharing discounts but also to mail characteristics such as shape. In Docket R2006-1, the last fully-litigated rate case, for example, the Rate Commission drastically escalated the letter-flat rate differentials above the significantly-increased differentials proposed by the Postal Service, citing the principles of ECP. The result was predictable. Flat volumes plummeted, much of it leaving the postal system entirely; and the significant portion of flats that reconfigured into letter-shape pieces then caused a myriad of postal handling problems due to their bulk and configuration that are still being addressed by the Postal Service and the industry.

This illustrates a critical limitation on the use of ECP: it appropriately applies only within a homogeneous product that has no demand or market differences, such that cost differences are the only relevant pricing factor; otherwise, misapplication of ECP across different products, by ignoring demand differences, can lead to uneconomic outcomes.

In the case of shape and weight, the Commission has since determined that these mail characteristics are not appropriate for application of ECP because they are akin to product differences that are driven in large measure by the mailer’s marketing objectives and business needs, unlike most typical presort discounts where the mailer decides whether or not to undertake additional mail preparation work to achieve a discount that is based on the costs thereby saved by the Postal Service due to that

workshare activity. For this same reason, ECP is inappropriate for setting rate differentials for mailing-density differences, and in particular, the Saturation-High Density rate differential.

One of PAEA's key policies and objectives is to provide the Postal Service with pricing flexibility so that it can be responsive to the needs of its mailers and markets, manage its system effectively, and ensure adequate revenues to remain viable. A critical step in developing efficient (i.e., market-responsive and contribution-maximizing) prices is to identify the separate and distinct (relatively homogenous) products within the postal system, so that each may be priced to reflect its individual cost and market/demand characteristics. Pricing flexibility should allow rates for each of these separate products to be based on both cost and market/demand information. Such principles are widely acknowledged to maximize rate efficiency and contribution to institutional costs.

In designing efficient workshare discounts for a particular postal product with homogeneous market/demand characteristics, these pricing principles simply boil down to the ECP concept of basing the workshare discount on avoided postal cost.² Thus, ECP is appropriate for the development of worksharing discounts for an *individual mail product* where mailers of that product can choose either to workshare or not. The mailer makes that choice based on a comparison of its own unit workshare cost to the postal rate discount. As long as the worksharing discount equals the Postal Service's unit

² The statutory concepts of "products," "workshare discounts," and "cost that the Postal Service avoids as a result of the activity" are fully consistent with the Ramsey/ECP approach and our interpretation of the statutory language on both product differentiation and pricing, as well as worksharing discounts.

avoided cost to accomplish the same work, the mailer will be able to make an efficient decision (either to workshare or not) that minimizes the combined (mailer/postal) resource cost of the mailing.³

Importantly, under the proper application of ECP, the Postal Service will receive the same unit contribution and total contribution regardless of whether the mailer workshares or not. For example, if drop ship discounts are set at a 100-percent passthrough of avoided cost, the Postal Service will be indifferent as to whether a mailer decides to drop ship to a destination SCF or to a DDU, because the rate differential will equal the cost differential – and the net unit and total contribution to institutional costs will be unchanged.

That is *not* true, however, if a mailer decides to change from Saturation distribution to High Density, or *vice versa*. Private delivery is a viable hard-copy alternative to Saturation and a portion of High Density mail products. Except for demographically-selective High Density mailings, these mailers can use private delivery to cover portions of their markets, and both also have the option to switch their entire mailing to private delivery. If the Saturation-High Density rate differential were arbitrarily constrained to the cost differential (through misapplication of ECP), then a decision by an existing High Density or Saturation mailer to switch its mail distribution choice from

³ In this way, ECP encourages technical efficiency related to the operational cost of a specific product. On the other hand, Ramsey pricing encourages allocative efficiency among all products in the system, to the extent all products are identified as such. This difference is immensely important. Technical efficiency ensures that an operation is conducted in an efficient manner, without regard to demand factors (or more, precisely, presuming that demand factors are inconsequential). Allocative efficiency considers the value of each operation and product, including demand factors, so that the overall social efficiency and value of the system can be maximized.

one product to the other (for reasons other than just a marginal change in volume), would not change unit contribution but could dramatically change *total* contribution since mailing density/volume could change substantially – especially if the shift involves consolidating across products or moving mail volume either to or from private delivery systems. In that case, even though the per-piece contribution would be the same at a 100-percent passthrough of the cost differential, the Postal Service would be worse off, losing total volume and contribution due to the reduced mailing density.

In this regard, the Commission in Order No. 243 misconprehends the nature of the incentive for Saturation and High Density mailers to sort their mail in walk sequence.

At page 7, the Commission states:

“Alternatively, a mailer who presents High Density or Saturation mail rather than Carrier Route mail to the Postal Service does so because the difference in his cost between sorting to line of travel and sorting to walk-sequence is less than the corresponding rate difference. Accordingly, the cost of sorting mail to the line-of-travel order as reflected in the attributable delivery cost of Carrier Route mail could be viewed as the appropriate benchmark for both High Density and Saturation mail.” Order at 7.

Contrary to this assumption, in virtually every case, the mailer’s cost to sequence its mail in line-of-travel or walk-sequence is lower than the postal cost to do the same, because the mailer’s cost is principally the cost of software changes whereas the postal cost is labor sorting cost. Consequently, the mailer will always choose the lowest-cost rate option available for its mailing, given its mailing characteristics and requirements. The decision to mail at a particular rate level is *not* based on the cost to sort by LOT or walk-sequence. Instead, it is based on what that mailer’s market requires, the market value of each unit of mail, and how the mailer chooses to serve its market. For example, if a mailer’s market requires saturation of carrier routes, then the Carrier

Route or High Density rate options wouldn't make sense, even if the mailer's LOT cost was less than its walk-sequencing cost. On the other hand, if the mailer chooses to use alternate delivery for a portion of its distribution, then High Density or Carrier Route might be selected. Thus, the Carrier Route-High Density-Saturation rate differentials are far more important price signals for mailer decisions on alternate delivery and mailing volumes than on pre-sequencing.

Indeed, for full-saturation mailers, walk-sequencing to qualify for the Saturation rate is not an option but a business necessity. Full-saturation mailings, by their nature, are highly price sensitive, with postage representing the majority of their costs. A mailer who does not sequence could not afford to mail a saturation-density mailing at the 5-Digit Presort rate; its customers would simply find another supplier who does, and it would go out of business. In essence, from the saturation mailer's business perspective, the level of the pre-sequencing discounts does not influence its decision whether to undertake the pre-sequencing activity, but rather its decision whether to mail at all, and how much to mail.

This reality demonstrates four relevant points:

First, if mailers don't make mailing decisions based on worksharing cost differentials, then ECP is not relevant. If the mailer has already made its decision on the amount of volume to mail, ECP maximizes technical efficiency by having the mailer make the most efficient choice between doing the work itself or having the Postal Service do it; and ECP then ensures the same contribution to the Postal Service regardless of which party does the work. But neither of these are concerns in the case

of Carrier Route-High Density-Saturation mailers who make decisions based on their individual markets' mail-density requirements and not on their cost to "workshare."

Second, the mailers' choices of density level reflect their market/demand differences – those choices are an empirical demonstration of their market/demand differences.

Third, if the mailer's key decision is how much volume to mail rather than how much worksharing to perform, then market/demand differences must be recognized in postal pricing so that the Postal Service can not just "protect" but also maximize its revenue/contribution from those products.

And, fourth, if mailers have alternatives to postal delivery, then it is critical for the Postal Service to price in the most efficient manner so as to prevent inefficient volume and contribution diversion. Since the Postal Service has considerable qualitative information on the market/demand differences among these products, it should be permitted to price as it sees appropriate, even if it does not yet have full quantitative demand model results.

IV. SATURATION AND HIGH DENSITY MAILINGS ARE DIFFERENT POSTAL PRODUCTS FOR WHICH THE POSTAL SERVICE NEEDS FLEXIBILITY TO PRICE IN RESPONSE TO MARKET CONDITIONS

As explained in our initial comments, High-Density and Saturation mailings are different postal products with differing market/demand and cost characteristics – a circumstance where the ECP concept is inapplicable. The Commission in Order No. 243 has asked for further comment on this issue, although we would note at the outset that the Commission has misidentified the relevant market for assessing postal services. At page 8 of the Order, the Commission says it is looking for evidence that

these products serve different markets. That is far different from determining whether Carrier Route, High Density, and Saturation have *different postal market/demand* characteristics. What is important, from a postal pricing perspective, is mailer demand for postal services (an intermediate good), not advertiser demand for print advertising. In this case, Carrier Route, High Density and Saturation mailers are the market consumers of the Postal Service; they each require different products from the Postal Service and therefore respond differently to the set of postal product rates.

Carrier Route mail and a portion of High Density mail consists of advertising that is targeted to a higher-value, demographically-selective audience; whereas the remaining portion of High Density and all of Saturation Flat mail is designed for mass distribution to a general audience, although differing in the means of achieving saturation distribution (full-saturation mail versus newspaper “total market coverage” programs that use a mix of newspaper and mail distribution).⁴ This saturation-distribution market is geared to advertisers that need to reach all potential customers within their local market areas, typically within a few-miles radius of their business locations. These advertisers -- such as groceries, drug stores, automotive services, fast food and restaurants, and similar retail and service businesses, large and small -- offer goods and services of general interest to a broad swath of consumers. Because the

⁴ Thus, the High Density mail product actually has two main components, including not just newspapers that use it in conjunction with newspaper-subscriber distribution to reach all households, but also other mailers that want to target a higher-value demographically-selective audience of as few as 25-percent of households, often in conjunction with lower-density Carrier Route distribution. That latter portion of demographically-targeted advertising in the High Density grouping is far more akin to selective Carrier Route product mailings in market/demand characteristics than it is to Saturation mail, with a lower price elasticity.

advertising promotes general goods and services (as opposed to high-end or specialty products with narrow interest) and is designed for mass distribution to reach all potential consumers (as opposed to just existing customers or demographically-targeted affinity consumers), it has a relatively low-value with a corresponding higher price sensitivity than targeted nonsaturation distribution. Although full-saturation and newspaper TMC mailers both participate in this market, they do so in their own individual ways which require different postal products.

It is not unusual to have multiple mailer types that serve the same end market but each having its own distinctive *postal* demand characteristics. Saturation Flat mailers, for example, compete with Saturation Letter mailers for many of the same advertising customers, yet no one has opposed their treatment as separate postal products. In the case of Saturation Flat mailers that mail at full-saturation levels and High-Density Flat mailers such as newspaper TMC mailers, both serve the same end market: delivery of general-interest print advertising to all addresses in a particular local geographic area. However, High-Density newspaper TMC mailers serve that end market through a combination of two delivery modes: hand delivery of newspapers to subscribers and mailings to non-subscribers on each route. Because they target their mailings only to non-subscribers, their prices to their customers need to cover their mix of low newspaper-delivery and higher postal-delivery cost, resulting in a lower blended cost. In contrast, full-saturation mailers (including a number of newspapers that mail full-

saturation programs) send their mailings to all addresses on a route, and their prices to their customers need to cover the full postal delivery cost.⁵

Full-saturation and newspaper TMC mailers have different requirements and plans to serve the same market, different sensitivities to newspaper subscribership, different percentages of total delivery expense represented by postage, and different susceptibilities to diversion to alternate delivery. Moreover, the overall demand characteristics of High Density mail reflect a mixture of higher-value demographically-selective mail and lower-value mass-distribution mail. Thus, it would be extremely unlikely for Saturation and High Density mail to have the same postal demand characteristics. Through its rate category selection, each mailer (and mailing) reveals its market and demand characteristics, even if they have not yet been measured.

For a full-saturation mailer, postal rates (and rate changes) affect the entirety of its distribution; whereas for a newspaper that uses the mail for only the nonsubscriber-portion of its distribution, the privately-delivered portion of its volume is unaffected by postal rate changes. Moreover, the cost of subscriber delivery by newspaper carriers is generally well below the cost of saturation mail, producing a blended distribution cost that is lower than that for full-saturation mailings. Thus, postal prices have a proportionately greater impact on the total distribution costs of full-saturation mailers.

⁵ Even the characteristics of their Saturation-rate mailings differ. Full-saturation mailers typically mail to well more than 90 percent of total households on a carrier route, whereas TMC mailers can qualify for Saturation rates by mailing to as few as 75 percent of households on carrier routes that are predominately residential. Thus, the density-related cost efficiencies of the latter are likely less than in the case of full-saturation mailings.

Newspapers, of course, could choose to distribute their entire program as full-saturation mailings. The reason they don't is because the saturation postal rate is substantially higher than their cost of delivering to subscribers using their own newspaper carriers. That the postal rate for the High Density portion of their nonsubscriber mailing distribution is higher than the Saturation rate cannot be considered discriminatory, because they have the option to mail their entire distribution at the very same Saturation rate used by full-saturation mailers.

A mailer's decision to mail as either High Density or Saturation is not merely a function of the unit cost/rate differential between the two, but is instead predominantly driven by the mailer's particular chosen business model and market, based on its assessment of demand conditions, response rates, return on investment, and how best to meet customer/recipient needs. The mailer decides how much to mail and to whom, and the result of that decision is either a High Density or Saturation mailing.⁶

Clearly, this is not the same as a decision on whether or not to undertake worksharing (e.g., whether to dropship to an SCF or a DDU). Unlike worksharing activities where either the mailer or the Postal Service can perform the function, there is

⁶ Based on its individual characteristics, a newspaper TMC mailer can choose to mail some its advertising packages at the High Density rate and some at the Saturation rate, the latter occurring on carrier routes with low newspaper subscribership. This, however, does not negate the fact that the two types of postal products provide two separate solutions to two separate newspaper TMC requirements. Many newspapers, particularly smaller ones, use full-saturation mailing for advertising distribution, as documented in Docket R2000-1 by a survey presented by the National Newspaper Association, whose members consist primarily of smaller daily and weekly newspapers. Its survey data showed that 70 percent of their ECR volumes were mailed at the saturation rate. As NAA's witness Max Heath testified, "Saturation mail is very important to NNA members." Tr. 46-B/20562, Docket R2000-1. See, generally, *id.* at 20559-63, and Docket R97-1, Tr. 14778-82.

no Postal Service function that can convert a lower-density mailing into a higher-density one – just as there is no Postal Service function that can convert a parcel shape to a letter shape or convert a heavy-weight piece to a lighter weight one. Moreover, the risks to the Postal Service of being constrained to a fixed rate differential are far higher. Unlike the ECP workshare scenario, mail-volume shifts between High Density and Saturation could have a large impact on total postal contribution, such that the Postal Service would not be indifferent to the outcome.

Because High Density and Saturation are distinct postal products, their rates should be developed on the basis of both cost and market/demand characteristics. They should not be inefficiently tied together as so-called “worksharing” variants of the same product based on historic misnomers, artificial subclass aggregations, and a strained interpretation of the PAEA. To do so would cause serious inefficiencies and unnecessary loss of postal revenue and contribution. Instead, the Postal Service should have full flexibility to set those rates and rate differentials based on its assessment and judgment of marketplace conditions and their impact on its financial viability.⁷

With respect to concerns about impact on competition, the Postal Service, in fact, has a powerful incentive to promote vigorous and healthy competition in the

⁷ The fact that there are overlaps at the margin in the usage of High Density and Saturation rates (i.e., some selective-distribution High Density mailings being part of a larger mailing that includes Carrier Route, and some Saturation mailings being part of a larger TMC distribution that includes High Density) does not undermine their classification as separate products. Any proposed grouping of mail products will inevitably include overlaps at the margin. In the case of the old ECR subclass, for example, a portion of Carrier Route-level mailings were part of larger mailings that include 5-Digit mail.

marketplace. The more mailers there are competing in these advertising sectors – including full-saturation mailers and newspapers that mail TMC or full-saturation programs -- the greater the Postal Service's mail volumes and revenues will be. Its interest in the end, far from favoring one group of mailers over another, is to maximize its profits over all its mail products.

Although saturation and high density mailers compete in the same general advertising market, the Saturation and High Density postal products they use have distinct postal demand and market characteristics that must be taken into account by the Postal Service in setting the rate differential between them. For example, a narrower rate differential (producing relatively higher Saturation rates) could cause loss of volumes due to full-saturation mailers being unable to compete in the marketplace or shifting to private delivery or merging their mailing programs into newspaper TMCs. A wider differential (relatively lower Saturation rates) could generate more saturation volumes, lessen the incentive to convert into TMCs, and encourage some TMCs to shift to full-saturation, but at the risk of diversion of some TMC programs to full private delivery. Because the optimum spread that maximizes Postal Service profit can and will change over time due to changes in the marketplace, the Postal Service must have pricing flexibility to respond and adjust its rates to those market conditions.

It must be emphasized that this needed pricing flexibility does not in any way dictate the *direction* that the Postal Service should move in its pricing of these two products – whether to set the rate differential *higher or lower than or equal to* the cost difference. The Postal Service needs to be free to move in either direction depending on its best judgment of marketplace and demand factors, and able to react to changes

in the marketplace over time, in order to maximize its profit and enhance its economic viability. Constraining it to a misapplied ECP-like 100-percent passthrough of the cost differential will not serve the interests of either the Postal Service or any groups of mailers over the long run.

V. THE SATURATION AND HIGH DENSITY PRODUCTS ARE SEPARATE AND DISTINCT FROM THE CARRIER ROUTE PRODUCT, AND MUST BE DE-LINKED FOR PRICING PURPOSES.

The Commission's suggestion that the rates for Saturation and High Density could be mathematically linked by retaining their individual worksharing-cost rate differences with Carrier Route mail (Order at 8) ignores that Carrier Route is clearly a separate and distinct postal product for which such linkages make no sense. At the time the Enhanced Carrier Route (ECR) subclass was established in the Docket MC95-1 Reclassification Case, these three types of mail were lumped together not because they were similar, but to gain broad support for the subclass proposal within the industry.

Prior to MC95-1, the first proposal to establish a carrier route subclass was presented by Donnelley Marketing in Docket R87-1. In that proceeding, the PRC rejected the proposal *precisely because* the proposed subclass mixed saturation mail (whose distinctive market and demand characteristics were the justification for subclass treatment) with lower density, demographically-targeted carrier route mail that did not exhibit the same characteristics. The PRC found that Donnelley's proposal rested on a "false equation of carrier route mail as a whole with saturation mail," (PRC Op. R87-1 at 596), stating that:

"the main error is that [Donnelley witness] Gertz's definition essentially equates saturation and high density, which he defines as 80-85

percent of the carrier route, while carrier route eligibility is, as he acknowledges, available to any otherwise-qualifying mailer with as few as 10 pieces per carrier route, which Gertz admits amounts to about 3-4 percent of the route.”

In effect, the PRC found that carrier route mail was a separate and distinct product from saturation mail.

Subsequently, in Dockets C89-3 and MC89-1, Advo proposed a saturation subclass that was folded into the Docket R90-1 general rate case. As an alternative to subclass treatment, the Postal Service proposed new drop-ship and walk-sequence discounts for saturation mail. The PRC approved the new discounts, and for that reason deferred on consideration of a saturation subclass:

“Our rejection of the Advo subclass proposal stems from the circumstances of this record, where important changes are being made in third class, rather than any deficiency in Advo’s presentation. For the most part, we find that Advo has responded to the Commission’s Docket R87-1 subclass discussion (presented there in connection with a carrier route proposal) with a comprehensive filing. At this point, however, we are reluctant to proceed with a saturation subclass in light of other major changes we are recommending in third class.” PRC Op. R90-1 at V-204. *See, generally, id.* at V-201-209.

Then, in Docket MC95-1, the Postal Service submitted its Enhanced Carrier Route subclass proposal that regrouped Carrier Route with Saturation and High Density, similar to Donnelley’s R87-1 proposal but with some additional “enhanced” mail preparation requirements. This grouping was done to obtain broad industry support for the proposal. The evidence demonstrating the distinctive market and demand characteristics of ECR mail, however, as in the case of Donnelley’s earlier proposal, related to saturation mail – not to carrier route mail. As the PRC noted in approving the ECR subclass:

“ ‘The choice of target density can be viewed as a market decision by mailers. Thus, Basic, High Density, and Saturation Mail can be viewed

as representing distinct markets for mail....' *Id.* at 5343. 'The mailer's decision to enter a mailing in the high density or saturation category is assumed to be determined primarily by the marketing strategy of the mailer and not by small changes in category volumes.' *Id.* at 5199." PRC Op. MC95-1 at V-179 (quoting USPS witness Tolley).

"Alternative advertising media are closer natural substitutes for untargeted than for targeted mail. ... Most major advertising media, such as newspapers, magazines, television and radio, are comparatively untargeted. Thus, they compete directly with saturation and other high density mail, a large component of carrier route mail." *Id.* at V-187.

"Carrier route mailers have higher own-price elasticities than noncarrier route mailers, *especially in the saturation categories.*" *Id.* at V-190 (emphasis added).

In sum, although the PRC approved the ECR subclass proposal that differed only marginally from the Donnelley proposal it previously rejected, it did so in full recognition of its earlier conclusion that Saturation and High Density were different products than Basic Carrier Route mail.

More recently under the PAEA in Docket RM2007-1, the Postal Service has submitted a new Mail Classification Schedule that formally remedies what the PRC had earlier called the "false equation of carrier route mail as a whole with saturation mail" by establishing Carrier Route as a separate and distinct product from Saturation and High Density.⁸ Of greater note, but hardly surprising, is the fact that no mailer party objected to this classification proposal to de-link Carrier Route from Saturation as a separate product, a change that merely codifies a marketplace reality that has been well understood for the last two decades.

⁸ See United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26, September 24, 2007, Docket RM2007-1.

As discussed in our initial comments, an artificial aggregation of Saturation, High Density and ECR products into the historic and out-dated ECR “subclass,” together with a strained and incorrect interpretation of the term “worksharing,” may lead to their incorrect treatment as tantamount to the same “product” so that their rates are deemed to be “linked together” and constrained by the “workshare discount” restriction of Section 3622(e). Our concern is heightened by language in Order No. 243 (at 6-8) that suggests the use of various benchmarks, including even 5-Digit mail, to calculate “worksharing” discounts for all products in the former ECR subclass. This would be counter to the PAEA objective of pricing flexibility, reverting back to the heavy-handed regulation of products and prices that existed prior to MC95-1, an outcome that would serve no economic purpose but would be harmful to the Postal Service, its mailers, and the viability of the postal system. These different types of mail should be treated as what they are: separate mail products delinked of the artificial workshare-discount distinction.

VI. UNDER THE PRICING FLEXIBILITY OBJECTIVES OF THE PAEA, RESPONSIBILITY FOR DEFINING AND DEVELOPING POSTAL PRODUCTS AND THEIR PRICING SHOULD REST PRIMARILY WITH THE POSTAL SERVICE, WITHOUT ONEROUS REGULATORY BARRIERS.

The Commission’s call for “empirical evidence” of product and demand differences could be read to suggest that it intends to impose a substantial evidentiary burden on the Postal Service to justify its choices of product groupings, including detailed information on price elasticities. The Commission should resist this regulatory impulse that harkens back to the cumbersome classification process under the old statute.

The history leading to the adoption of the ECR subclass in Docket MC95-1 is instructive of the onerous regulatory barriers that inhibited the Postal Service from managing and pricing its products. The entire process, starting with Donnelley Marketing's carrier route subclass in Docket R87-1, consumed nine years, including four full-blown litigated proceedings that delved deeply into every imaginable nuance of the issues. Yet in retrospect, the proposition of a separate subclass for this mail seems eminently reasonable and obvious.

In this case, the Postal Service does not need to have detailed econometric studies or price elasticity analyses to know that Saturation and High Density are separate postal products. That conclusion follows from the differing structure and approach that mailers have in choosing to use these postal products to serve their advertising markets, as described earlier. Nor does the Postal Service need to know at this time in which direction the postal marketplace factors might push its pricing decisions, as that will depend on market conditions and volume trends that can and undoubtedly will vary over time. What the Postal Service needs is the flexibility to respond to those conditions as they occur.

Moreover, price elasticities are likely to have less utility in delineating products and setting prices in today's environment. By their nature, price elasticities as developed by the Postal Service and Commission are "backward-looking," based on historical trends over a long period of time. Their accuracy in predicting future volume responses hinges on whether current and future market conditions are comparable to those in the historic period, an assumption that may no longer hold true. In these circumstances, even if the Postal Service had good historical elasticities for each of its

products, it would nevertheless have to give greater weight to its best assessment of current and future market conditions and trends rather than applying elasticities that may not accurately predict future volume response.

This, in fact, is what most businesses in the private sector do in segmenting and pricing their products. Although a few may undertake elaborate technical price-elasticity analyses, for all successful firms, final decisions on product grouping and pricing are made after they watch and listen to the market, taking into account the alternatives that their customers have and monitoring responses to price changes, constantly experimenting with and fine-tuning their offerings and pricing to achieve an optimal profit-maximizing balance that, inevitably, will fluctuate over time. The Postal Service needs to have that same kind of real-world business flexibility over its products and pricing.

Respectfully submitted,

/s/

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