

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

CONSIDERATION OF WORKSHARE DISCOUNT  
METHODOLOGIES

Docket No. RM2009-3

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE  
(September 11, 2009)

On July 10, 2009, the Commission issued Order No. 243, establishing further procedural steps for the above-captioned docket following the submission by the parties of initial comments on May 26, 2009. These further procedural steps consisted of a public forum held on August 11, 2009, and the opportunity to file reply comments by August 31, 2009. On August 27, 2009, the Commission issued Notice of Inquiry No. 1 in this docket, and simultaneously extended the due date for reply comments until September 11, 2009. The Postal Service hereby files its reply comments. A response to the questions posed in the Notice of Inquiry is simultaneously being filed as a separate pleading in this docket.

**I. Application of the “Just and Reasonable” Standard is the Appropriate Means to Protect the Interests of Single-piece First Class Mail Users Under the Statute**

Various alternatives have been suggested by which the Commission should determine, under the provisions of the PAEA, whether the rates for Single-piece and Presort First-Class Mail are appropriate. Several parties, including APWU, the Public Representative, and GCA, have argued that the prices for Presort mail should continue to be dictated by the estimated cost avoidance between the BMM benchmark and the “starting” price (Mixed AADC)

for one-ounce automation letters, pursuant to section 3622(e). As an alternative, the Public Representative has also argued that the two products should be placed into separate classes for purposes of applying the price cap.

Other parties, including the Postal Service, have argued that application of section 3622(e) to the relationship between Single-piece and Presort First-Class Mail is inappropriate. Rather, the Commission should review the Postal Service's pricing decisions with respect to these products through the "just and reasonable" rate schedule objective of section 3622(b)(8). This approach is required by the statute, as it is the approach that harmonizes the various elements of section 3622 and other provisions of the law into a coherent, workable regulatory scheme. On the other hand, the language and legislative history of the Act demonstrates that section 3622(e) was *not* considered to codify the rate relationship between Single-piece and Presort First-Class Mail that existed under the prior ratemaking regime.

**A. The just and reasonable standard best harmonizes the various provisions of section 3622**

The overarching question being addressed here is how to accommodate concerns about future rate increases for Single-piece First Class Mail in a manner that best effectuates the provisions of the Act. It is a basic principle of statutory interpretation that all provisions of a statute must be read as a harmonious, coherent whole. See FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 132-33 (2000) ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme. A court must therefore interpret a statute

as a symmetrical and coherent regulatory scheme, and fit, if possible, all parts into [a] harmonious whole.”) (internal quotation marks and citations omitted). As such, the Commission must interpret the various provisions of section 3622, which establishes the parameters of the new pricing regime for market-dominant products, in a way that ensures that the new system is a coherent whole (i.e., a system that is workable as a practical matter, and ensures the achievement of all of the policies underlying the provisions of section 3622).

In interpreting section 3622 as it relates to Single-piece and Presort First-Class Mail, it is important to keep two principles in mind. First, the Postal Service is entitled under the price cap established under section 3622(d)(1)(A) to raise its prices to the full extent of CPI-U, as a necessary corollary as its inability to raise its prices above inflation (as measured by the CPI-U) in normal circumstances. The authority to track inflation is, furthermore, important for the Postal Service to be able to acquire enough revenues in order to provide high quality universal service, pursuant to sections 3622(b)(3) and (b)(5).

Second, the language of the Act clearly states that the Postal Service should have *enhanced* pricing flexibility as compared to the prior pricing regime. See, e.g., 39 U.S.C. 3622(d)(4), (c)(7); SEN. REP. NO. 108-318 at 8, 10 (2004); Order No. 66 at 51; Order No. 43 at ¶ 2025; Order No. 26 at ¶ 3070. This emphasis on increased pricing flexibility is also evident from the fact that, as discussed below, Congress specifically chose to delete references to a “fair and equitable” rate schedule, which was the foundation for the Commission’s jurisprudence under the PRA. It is also evident from the fact that Congress

chose to replace the cost-of-service ratemaking system of the PRA with a system predicated on a price cap, a system of regulation that is generally designed to afford the regulated entity greater latitude to make pricing decisions under the cap, rather than having prices be dictated entirely by costs or economic theory.<sup>1</sup> Congress also chose to expand pricing flexibility by loosening the standards for mail classification – where the Commission in the past only applied the full range of ratemaking factors to “subclasses” with distinct cost and demand characteristics, Congress indicated that independent pricing was appropriate for “products” with distinct cost or market factors. Of course, section 3622 sets forth limitations on the Postal Service’s pricing flexibility, including section 3622(b)(8), which requires that section 3622(e) act as a limitation on the Postal Service’s pricing flexibility within the price cap. The question therefore becomes what is the best means by which to effectuate the various provisions of the statute with regard to First-Class Mail.

#### **1. Section 3622**

As the Postal Service discussed in its Initial Comments, the claim that the rate relationship between Single-piece and Presort First-Class Mail must be governed by the principles of section 3622(e) serves to undercut the achievement of several of the objectives of section 3622, due in part to the existence of the integer constraint on Single-piece First-Class Mail. Initial Comments at 21-28. In particular, the ultimate result of applying section 3622(e) to the relationship between Single-piece and Presort First-Class Mail would be a

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<sup>1</sup> As was commonly observed during the lengthy legislative process culminating in the PAEA, a basic goal of a price cap regime (as compared with a cost-of-service regulatory structure) is to “break the link” between costs and prices.

pricing system predicated not on the ability of the Postal Service to exercise judgment in the manner by which it sets prices for First-Class Mail, but a system in which pricing is dictated almost entirely by a single estimated cost avoidance figure.

First, the Postal Service would largely be foreclosed from ever raising the stamp price above inflation, for the simple fact that the integer constraint would almost always require a percentage increase that would result in a passthrough between Single-piece and Presort of greater than 100 percent. As such, the Postal Service would generally be required to raise Presort prices above the cap each year, while giving little or no increase (or even a decrease) to the Single-piece rate. As several parties noted in their Initial Comments, however, Presort First-Class Mail has a very high implicit cost coverage, and pays a much greater unit contribution, than does Single-piece (indeed, it pays a higher unit contribution than most of the market-dominant products). Nor is there any indication that Congress would have considered this an appropriate interpretation of the statute. As an alternative to raising Presort prices above the cap on a consistent basis, the Postal Service would have to foreclose raising prices for First-Class Mail to the full extent of the cap. Second, the pricing for First-Class Mail would become a mechanistic exercise, dictated almost entirely on a single estimated cost avoidance figure. For the bulk of First-Class Mail volume, represented by the Single-piece and Presort letters, the prices would derive entirely from the calculated benchmark. For the rest of the rates, pricing decisions would have to be based primarily on accommodating the percentage

changes for Single-piece and Presort dictated by ensuring adherence to a 100 percent passthrough of the estimated BMM cost avoidance. In other words, pricing for First-Class Mail would simply be a mechanistic exercise in which the Postal Service 1) establishes a whole-cent increase in the stamp price, usually *below* the CPI-cap level; 2) prices Presort letters in a way that adheres a 100 percent passthrough relative to the BMM benchmark; and 3) prices the other rates in First-Class Mail in a way that looks not at their unique characteristics and market needs, but on ensuring that the Postal Service gains sufficient revenue while adhering to section 3622(e).

The Public Representative attempts to argue that application of the BMM benchmark would “impose minimal (if any) constraints on the Postal Service’s ability to set automation presort letter rates that are lawful and reasonable.” PR Comments at 13. He attempts to prove this point by presenting a series of alternative rate designs that the Postal Service could have adopted in Docket No. R2009-2. In Alternative 1, the Public Representative notes that the Postal Service could have implemented a lower stamp price, along with an increase in Presort prices below the cap. However, two things are clear from this presentation. First, this alternative rate design would inevitably lead to an increase for Presort that is higher than the increase for Single-piece. Second, in order to keep the increase for Presort below the cap, while still leading to the percentage increase for the class as a whole similar to that proposed by the Postal Service, the Public Representative makes various changes to a number of smaller rates, especially larger increases in the additional ounce rates, and the

rates for all cards other than QBRM cards. PR Comments at 15. In Alternative 2, the Public Representative again proposes a smaller increase for the stamp price, and makes up the difference by setting forth larger increases for most of the other categories in Single-piece, by again raising the nonmachinable surcharges, and by requiring larger increases for business parcels and automation flats. As with Alternative 1, this would lead to an increase for Presort that is higher than the increase for Single-piece.

Rather than rebutting the Postal Service's position, the Public Representative instead underscores the perversity of basing First-Class Mail pricing on the BMM benchmark in the new pricing regime. In particular, the Public Representative simply demonstrates that it would have been possible to achieve a 100 percent passthrough in the prior rate case (at least with respect to Alternative 1; even his Alternative 2 had a passthrough greater than 100 percent) while still acquiring a percentage increase similar to that proposed by the Postal Service if 1) the prices for Presort were raised higher than the prices for Single-piece, and 2) other First-Class Mail rates were changed in order to accommodate the percentage changes for Single-piece and Presort letters dictated by applying the BMM benchmark pursuant to section 3622(e). Entirely missing from this discussion, however, is any statement as to why Single-piece should always increase less than Presort, or why the Public Representative's increases for First-Class Mail cards are appropriate, other than to ensure that the prices for Presort and Single-piece can be set in a way that adheres to the BMM benchmark. As the Postal Service noted in its Initial Comments, relegating the

pricing of these other, smaller, products within First-Class Mail to one in which pricing decisions are based primarily on ensuring adherence to the BMM benchmark is not rational as a matter of pricing policy.<sup>2</sup>

In his third alternative, the Public Representative abandons the integer constraint for the stamp price. PR Comments at 21; Tr. 28. While the Single-piece integer constraint looms particularly large in the context of the smaller, more frequent annual price-cap-based price changes under the PAEA, the Postal Service does not believe that abandoning the integer constraint is the proper answer to designing a system that harmonizes the various elements of section 3622 with regard to First-Class Mail.<sup>3</sup> Section 3622(d)(2)(B) expressly contemplates the use of whole integers. This reflects the more fundamental

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<sup>2</sup> In Reply Comments filed early, GCA directly challenges the utility of the Postal Service's demonstration of the practical difficulties inherent in allowing the measured cost avoidance to dictate the major portion of all rate design issues within First-Class Mail. GCA Reply Comments (Aug. 31, 2009) at 18-23. Specifically, GCA claims that results in Table 2 on page 24 of the Postal Service's Initial Comments are driven by the failure of the workshare discount in Year 0 to reflect the target 100 percent passthrough, causing the need for an extraordinary percentage increase in Year 1 in order to achieve the target in that year. *Id.* at 21. GCA, however, is simply mistaken to characterize this as "an abrupt change in underlying rate theory." *What changed "abruptly" in the real world was the measured cost avoidance between FY 2007 and FY 2008, when the relevant figure dropped from 5.0 cents (FY07 ACD at 64) to 4.5 cents (FY08 ACD at 52).* GCA is correct to note that, under the passthrough constraint, a change of this magnitude creates substantial problems for rational rate design, but that is entirely the point of the Postal Service's exercise – to show that rigidly requiring one measured cost avoidance estimate to drive the entire First-Class Mail rate design can create a host of issues, and does not allow for reasonable application of pricing flexibility to finesse such practical difficulties. Costs are not static, and the circumstances highlighted by GCA are not an artifice of the Postal Service's hypothetical, but rather are a manifestation of the major drawbacks inherent in elevating one mechanical input to the role of the primary determinant of what instead should be one of the most carefully considered set of postal rate relationships in the price cap regime. Moreover, as shown by Table B on page 22 of the GCA Reply Comments, even if GCA in essence assumes away the consequences of the FY07 to FY08 change in the cost avoidance estimate, and furthermore abandons the whole-integer constraint, GCA still cannot squeeze out an overall price change within the cap. (The assumed cap is 1.0 percent, while GCA's Table B price change is 1.1 percent.) With the constraint of a 100 percent passthrough still in the mix, the dilemma of trying simultaneously to meet all of the competing pricing goals remains unresolved, GCA's gyrations notwithstanding.

<sup>3</sup> Furthermore, even here the proposal operates mechanistically to force a higher price increase for Presort than the increase for Single-piece, which does not further the goal of pricing flexibility.

point that Congress surely did not intend that the only way in which to coherently regulate First-Class Mail under section 3622 would be by having a stamp that is not a whole integer, for the first time in the history of this nation, and unique among postal administrations.

The Public Representative also proposes that Single-piece and Presort First-Class Mail be placed into separate classes for purposes of applying the price cap. PR Comments at 23-26. This proposal is, however, inconsistent with the plain language of section 3622(d)(2)(A), which states that the price cap established by section 3622(d)(1)(A) “shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule [DMCS] as in effect on the date of enactment of the Postal Accountability and Enhancement Act.” See also Tr. 35 (statement of Mr. Stover). Because Single-piece and Presort First-Class Mail are market-dominant products that were part of the same class of mail in the DMCS that was in effect on December 20, 2006, the Commission cannot place them in different classes for purposes of applying the price cap.

This language reflects Congress’ determination that a proliferation of the “baskets” to which the price cap is applied would ultimately strangle any pricing flexibility, as manifested in the extreme by a price cap regime applied at the level of each individual rate element or cell, which was considered by earlier versions of the postal reform legislation. The Public Representative’s proposal to establish Single-piece and Presort as separate price cap baskets would appear to be nothing short of the first steps down this path. The proposal runs directly counter to the intended thrust of the trade-off between pricing flexibility and a

*global* price restraint, explicitly set under the PAEA at the class level as defined by the DMCS that existed immediately prior to the enactment of the PAEA.

## **2. Just and Reasonable**

Application of section 3622(e) to the rate relationship between Single-piece and Presort First-Class Mail would therefore constitute an untenable interpretation of section 3622. On the other hand, application of the “just and reasonable” standard serves to harmonize the various elements of section 3622. That provision requires a consideration of whether the rate schedule as a whole falls within a “zone of reasonableness,” in which the rates are neither too low (not compensatory) or too high (excessive). In making this determination, the Postal Service and the Commission can take the totality of circumstances into account when pricing, including the entirety of the hierarchy of relevant objectives, factors, and policies of the Act. The just and reasonable standard thus allows the Postal Service to design, and the Commission to review, prices in a nuanced, market-based fashion, taking into account factors such as cost coverages, unit contributions, previous percentage rate increases, market differences, and similar trends in customer responses to price changes. This approach is faithful to the standards of the PAEA, which was designed to represent a break from the prior standards of the PRA. While this approach requires more from the Commission than mere application of a formula, as explained at the public forum (Tr. 18-20), that is what Congress had in mind.

In particular, under the current circumstances within First-Class Mail, in which the amount of cross-over between Presort and Single-piece is likely

minimal (e.g., Tr. 55), rigidly focusing on estimates of avoided costs between those products, which represent fundamentally different types of mail, to the exclusion of other relevant considerations, is inappropriate. Discarding such a rigid focus, however, would not make the estimated cost difference between Presort and Single-piece irrelevant. Rather, that difference can be taken into account when applying this standard, along with the rest of the relevant considerations that should be taken into account when pricing. Application of the just and reasonable standard would simply mean that the rate relationship between Single-piece and Presort would not be based *entirely* on one specific, quantitative standard.

**B. Application of the just and reasonable standard rather than section 3622(e) is consistent with the language of sections 102(6) and 3622(e), and with the legislative history of the PAEA**

APWU argues that the “primary and almost exclusive purpose” of section 3622(e) was to protect Single-piece First-Class Mail, by codifying the existing BMM-benchmark-based passthrough relationship between those rates. Tr. 12-13; APWU Comments at 4. However, this interpretation is not evident in the plain language of that provision. Indeed, the language of section 3622(e) makes no specific reference to First-Class Mail of any type. Instead, the only provision even remotely class-specific is seemingly directed at Periodicals (“mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value”). 39 U.S.C. § 3622(e)(2)(C). Conspicuously absent is any basis in the language of the section to support the APWU claim that its “primary and almost exclusive purpose” related to First-Class Mail.

Nor is it evident when one considers section 3622(e) in the context of the statute as a whole. Rather, as discussed above, interpreting section 3622(e) as codifying the rate relationship that previously existed between Presort and Single-piece First-Class Mail creates perverse results. The result that is more faithful to the statute as a whole is to recognize that section 3622(e) does not apply to this relationship, a reading that not only serves to harmonize the elements of section 3622, but also serves to give effect to the language of section 3652(b).<sup>4</sup>

Moreover, attempting to perpetuate the previous interplay between Presort and Single-piece First-Class Mail rates would also contradict another significant new provision of the PAEA. The cornerstone of the old relationship between the two types of mail under the PRA was “subclass” status – both types of mail had to be priced within a unified subclass of First-Class Mail Letters and Sealed Parcels, and the factors recognized for intra-subclass pricing purposes were generally limited to workshare cost avoidances. The unified “subclass” status, in turn, was explicitly predicated on the Commission’s insistence that maintenance of a unitary subclass could only be overcome by the establishment of cost and demand differences between candidates for subclass bifurcation. See Opinion and Rec.Dec., Docket No. MC95-1 (January 26, 1996) at III-7 – III-10, V-14. Candidates not meeting the dual cost and demand test were relegated to “rate

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<sup>4</sup> In particular, section 3652(b) clearly specifies that the data necessary to determine adherence to section 3622(e) be presented on an intra-product, rather than inter-product, basis. GCA argues that nothing in section 3622, or section 3652, forbids the application of section 3622(e) to inter-product rate relationships. However, the language Congress specifically chose with respect to section 3652(b) (i.e., “the following information with respect to each market-dominant product for which a workshare discount was in effect”) indicates to the contrary.

category” status, and rate categories were “customarily priced as discounts from their subclass rates, based on savings from worksharing by mailers.” *Id.* at III-8.

In drafting the PAEA, however, Congress did not adopt the Commission’s conjunctive “cost and demand” test for subclasses. Rather, in defining products, Congress explicitly struck out in a different direction, using a disjunctive approach:

“product” means 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). In practical terms, the results for First-Class Mail are clear. What had been “rate categories” within a unified subclass under the old “cost and demand” test are now separate products under the new “cost or demand” test. The pricing approach advocated by APWU, however, would ignore the significant change in the standards for mail classification intended by the substitution of the word “or” for the word “and” in the new definition of “product,” and would require that pricing within First-Class Mail should continue exactly as if Single-piece and Presort were still rate categories with the same subclass, rather than independent products to which the full range of pricing standards and principles should be applied. Such an approach, at least with respect to First-Class Mail, would read the new definition of “product” out of the statute, and thus fails to provide the necessary harmony for a coherent interpretation of all aspects of the PAEA’s new regulatory scheme.<sup>5</sup>

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<sup>5</sup> Curiously, while acknowledging that the rate relationship it advocates predates the sea change from “subclass” to “product,” GCA argues that, notwithstanding, the reference in section 3652(b) to “product for which a workshare discount was in effect” should be read “to include the case where a discount was established to reflect workshare savings as between a non-workshared

Furthermore, APWU's position that section 3622(e) codified the rate relationship between Single-piece and Presort, in order to protect Single-piece users, is belied by the legislative history of the PAEA. Rather, the history shows that the concern about the rate relationship between Single-piece and Presort First-Class Mail was addressed in the "just and reasonable" objective, not in section 3622(e). In particular, during the 109<sup>th</sup> Congress, Hallmark proposed that the "fair and equitable" criterion be elevated to an objective, in order to preserve the existing rate relationship between these two products; Senator Bond put a hold on S. 662 based on this issue. John Fischer, Postal Reform Bill Vote Stalled in Senate, Multichannel Merchant, Nov. 2, 2005. This would have preserved avoided costs as the sole determinant of the relationship between Single-piece and Presort. Cf. PRC Op., Docket No. R2006-1, pg. 128 (¶ 5090). As noted in one commentary on this issue, "Hallmark fear[ed] that S. 662 would allow the [Postal Service] to shift postal overhead costs from automated and pre-sort first-class mail onto single-piece first class mail." See Defeat Bond Amendment and Support Vote on S. 662, e-NAPUS Legislative Newsletter, Nov. 4, 2005. Senator Collins, the Postal Service, and other parties opposed the Bond amendment, on the grounds that it would perpetuate the status quo PRA jurisprudence, and therefore be inconsistent with the goal of giving the Postal Service enhanced pricing flexibility.

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product and one that is, ... particularly [in] a case where when this relationship was established there was no question of separate 'products' ... ." GCA Reply Comments (Aug. 31, 2009) at 7. At bottom, therefore, GCA's position appears to be that the "modern system of rate regulation" built around "products" is a sham, and that the PAEA changed nothing.

The “just and reasonable” rate schedule objective of section 3622(b)(8) was specifically designed as a compromise on this issue. In February of 2006, Senators Bond and Collins jointly sponsored an amendment to S. 662 that 1) eliminated the “fair and equitable” provision from the list of factors; and 2) inserted the achievement of a “just and reasonable” rate schedule into the list of objectives. See 153 Cong. Rec. at S1033-34 (February 9, 2006). This amendment was adopted by the Senate when it passed S. 662, styled as an amendment to H.R. 22. The language of section 3622(b)(8) specifically noted that this standard “shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.”

Thus, the legislative history shows that while Congress specifically chose to reject the perpetuation of status quo rate relationships manifested in the “fair and equitable” standard, in order to allow the Postal Service a true measure of enhanced pricing flexibility. Furthermore, during the disagreement between Senators Collins and Bond, there was never a suggestion that the language of section 3622(e) already accomplished the goal that Senator Bond was seeking. This is further evidence that the language of that section was not viewed by Congress as codifying the existing rate relationship between Single-piece and Presort mail and Presort.<sup>6</sup>

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<sup>6</sup> Put differently, if the intent of section 3622(e) was so clearly to perpetuate the existing relationship between Single-piece and Presort, as APWU and GCA now appear to be suggesting, then why did GCA-member Hallmark feel the need to go to such extraordinary lengths to seek other types of protection for that relationship, when 3622(e) was already in the Senate bill in question?

**C. Application of the Just and Reasonable Standard Would Also Fully Resolve the Strawman Arguments Raised by APWU and the Public Representative**

Both APWU and the Public Representative erroneously appear to suggest that confining the application of section 3622(e) to worksharing within products would be tantamount to abandoning some broader policy objective embedded in the statute. For example, the APWU raises the matter of uniform pricing for domestic First-Class Mail. That policy was commonly believed to have been the purpose of section 3623(d) under the old law, the salient provisions of which have now been transferred to section 404(c) of the new law. APWU argues that “Section 404(c) mandates the type of cross-subsidization within rate categories that the advocates of larger presort discounts are seeking so assiduously to avoid.” APWU Comments at 4. First of all, the Postal Service is advocating neither a larger price difference nor a smaller price difference between Presort and Single-piece First-Class Mail. Rather, the Postal Service is advocating that the size of the price differential should be determined by taking account of numerous factors, rather than mechanistically determined by the size of the estimated cost avoidance. Perhaps more to the point, nothing the Postal Service is proposing in its interpretation of section 3622(e) would even remotely jeopardize the continuation of uniform rates for First-Class Mail, under the established interpretation of section 404(c).

The Public Representative, meanwhile, asserts that the Postal Service’s approach on this matter would undermine the rationale behind the Private Express Statutes and the very existence of regulated postal prices. Public

Representative Comments at 22-23. Yet the Public Representative’s rhetoric, in which lower presort rates are objectionable because they would more closely resemble the rates that supposedly would prevail in a competitive market, is equally applicable to any amount of deaveraging on the basis of workshare savings. For example, with respect to lower presort rates, the Public Representative states that “[w]hile such rates may encourage more worksharing and presort mail, it does so at the expense of single-piece mailers.” *Id.* at 22. On that basis, of course, one could have opposed the creation of *any* presort discounts. Once again, however, the Postal Service is not necessarily seeking higher or lower presort rates, as opposed to the flexibility to take more factors into account in setting presort rates than the estimated cost avoidances. And where the Public Representative opines that the “monopoly exists to provide a reasonably priced universal service for all First-Class mailers,” and that “[i]t makes no sense to increase the burden of financing the universal service obligation solely on single-piece mailers” (*id.*), the Postal Service submits that its proposed application of the “just and reasonable standard” would be amply sufficient to safeguard the interests of single-piece mailers in these matters.

In addition, the assumption that higher rates for Presort First-Class Mail (and the presumed consequent protection for Single piece mailers) are necessary to protect universal service ignores the reality of the Postal Service’s customer base. Approximately 60 percent of First-Class Mail letters are Presort pieces, and ensuring that these customers do not seek nonmail alternatives that

could be driven by larger price increases (i.e., decreases in “discounts”) actually does serve to fund (and thus, ultimately, to protect) universal service.

## **II. Cost Differences Among Saturation and High Density Standard Mail Are Not Worksharing**

Within Standard Mail, density differences between Carrier Route Basic and High Density, and between High Density and Saturation are not the result of “presorting, prebarcoding, handling, or transportation” as worksharing is defined under 39 U.S.C. § 3622(e)(1).

### **A. Workshare discounts are defined clearly and unambiguously in the statute (3622(e)(1)), explicitly limiting the application of section 3622(e) to discounts provided for four specified activities: presorting, prebarcoding, handling, or transportation of mail**

The plain language and plain meaning of the law are very clear. Section 3622(e)(1) defines worksharing as four distinct activities that, as an option, mailers may perform themselves and therefore qualify for workshare discounts. These activities, when performed by mailers, allow the Postal Service to avoid work the Postal Service would otherwise have done on that mail.

Workshare discounts reflect costs that the Postal Service avoids when the mailer performs a specified activity prior to entering mail in the mailstream. Alternatively, mailers can choose a simpler path: they can tender mail to the Postal Service without taking on any presorting, prebarcoding, handling, or transportation activity beyond those of the simplest mail preparation requirements. In this latter case, the Postal Service would perform the specified activity or activities necessary for efficient operations in one or more of the

following areas: sorting, barcoding, handling, or transportation. Consequently, a workshare discount would not apply.

As discussed in the Postal Service's Initial Comments, other activities undertaken by mailers may impact mail characteristics. The fact that some of these activities can reduce costs and/or increase postal efficiency may be reflected in the prices and price differences between mail with a given characteristic and mail without that characteristic (e.g., letter-shaped vs. non-letter, or flat-shaped). However, price and cost differences that do not arise from specific mailer activity in presorting, prebarcoding, handling, or transportation do not fall within the scope of the precisely drawn definition of worksharing. Under the law and current postal pricing policy, the marginal costs are taken into account, but in a non-formulaic way. Sometimes a cost difference is just a cost difference, not an avoided worksharing cost or cost passthrough that is subject to evaluation under section 3622(e).

The notion that not all cost differences between various types of mailpieces reflect worksharing activity is basic and unambiguous. It is critical to understanding more abstract notions, such as the pricing flexibility provided in the PAEA, as well as practical matters, such as how the Postal Service prices specific products. For example, while there may be some marginal cost differences between High Density mail and Saturation mail, and these marginal cost differences may have some relevance to appropriate price setting, they cannot be analyzed under section 3622(e). Marginal cost differences do not fall

into one or more of the specific four categories defined as worksharing: presorting, prebarcoding, handling, or transportation of the mail.

While it is true that, in the course of its mail processing and delivery operations, the Postal Service increases overall address density, this is not work that is done by any mailer as a direct substitute for Postal Service activity. A mailer using the Carrier Route product could conceivably increase his address density to use the High Density, or even Saturation pricing categories. But increasing address density in this way does not replicate or substitute for the kind of work the Postal Service does. It makes the mailer eligible for a different price category that is defined solely by the number of pieces with specific address characteristics on a given carrier route. The Postal Service increases address density as a by-product of consolidating the mail sent by many different mailers: that is a key Postal Service function along with delivering the mail. *The Postal Service, however, never takes the mail from a single mailer and performs some process on it to transform that customer's mailing from a lower density mailing to a higher density mailing.* The address density of the mailer's original mail is not changed by the Postal Service's consolidation work; nor does the level of address density avoid any of this consolidation work. For this reason, the notion that increasing the address density of a single mailing is somehow akin to what the Postal Service does when it consolidates mail from disparate mailers is incorrect, and confounds two distinct and separate ideas of increasing address density.

For a more detailed discussion of aggregation and density, see the Postal Service response to Notice of Inquiry No. 1, filed simultaneously with these Reply Comments.

**B. Mail characteristics that support or are otherwise associated with the four worksharing activities enumerated in section 3622(e) are not themselves worksharing, and should not be regulated as worksharing**

The Commission's Order No. 243 raises the issue of whether certain activities or mail characteristics that are not explicitly identified in section 3622(e) should be regulated as worksharing because they may "be facilitated by or naturally support" what the Commission refers to as "pure" worksharing activities. They should not.

The first reason for excluding these ancillary activities or characteristics (referred to in the Order and the Public Forum as the "pure plus" approach) is, as discussed above, the plain language of the statute nowhere suggests that ancillary or supporting activities or characteristics were or are to be included along with those specifically enumerated in section 3622(e).<sup>7</sup> In addition to failing to fall within the plain meaning of section 3622(e), the "pure plus" approach to worksharing also violates the intent of the law. "Pure plus" would extend worksharing to include "cost reducing characteristics that indirectly support the 'pure' worksharing activity." This stretches the worksharing umbrella into a tent that can cover almost any cost reducing mail piece characteristic,

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<sup>7</sup> In the Public Forum on August 11, 2009, Tom McLaughlin speaking for Valassis, said, "The question of a purer definition [of worksharing] or 'pure plus' puzzles me. Pure plus sounds to me like impure in a way. The statute talks about the four functions, and the question here is whether the rate differential between those two categories of mail is due to one of those worksharing activities or whether it's due to something else." Tr. 73.

undermining the intent of Congress to provide the Postal Service with a great deal of pricing flexibility, subject to specific factors and objectives, and a limited number of explicitly enumerated exceptions. Thus, the “pure plus” concept violates both the letter and the spirit of the law.

To illustrate this point, consider the following example. Prebarcoding is worksharing as defined in the statute. But a discount for prebarcoding of letters is only offered if the barcodes are applied to machinable letters, since the Postal Service does not typically apply barcodes to nonmachinable letters, which receive manual sorting. By the logic of the “pure plus” argument, machinability “naturally supports” prebarcoding, and machinability would therefore fall under the regulation of section 3622(e), despite the fact that the Commission has a precedent of recognizing characteristics such as weight, shape and machinability as other than worksharing. See Docket No. R2006-1, Opinion and Recommended Decision Vol. I, at ¶ 4030.

Similarly, a mailer can presort Standard Mail automation letters to 3-digit ZIP Codes (and receive a discounted price) if the mailer has 150 or more letters going to each 3-digit area. But if the mail pieces are flats, the mailer can presort the mail to 3-digits with only ten pieces going to each 3-digit area. In fact, with 150 flats going to the same 3-digit area, the mailer may even be able to make one or more 5-digit bundles. By the “pure plus” logic, the mail piece shape (i.e. flats vs. letters) “naturally supports” presorting in a way that is almost an exact cognate of the way address density supports presorting. Yet the Commission

has stated that mail piece shape is not worksharing, and has recognized that Congress intended to exclude shape from regulation under section 3622(e).

In Order No. 243, the Commission appears to try to connect address density and worksharing by associating address density with sequencing mail and observing that sequencing appears to fall within the statute's definition of worksharing. The Postal Service is not here disputing whether mail sequencing does or does not meet the definition of worksharing in section 3622(e). A hypothetical finding that sequencing is worksharing would not affect the Postal Service's contention that address density is not worksharing, however close company density and sequencing may keep in the Postal Service's mailing standards.

The fact that a type of mail avoids certain operations, thereby lowering costs, does not mean that the characteristics that allow that type of mail to avoid the operations constitute worksharing as defined by section 3622(e).

Consider the following: machinable letters are put into delivery point sequence at the plant and avoid the carrier casing operation. Currently, flats and nonmachinable letters must be cased. Two mailpiece characteristics—having the right shape, and machinability—need to be present to avoid carrier casing. Yet neither of these characteristics (which, indeed, may well be more under the mailer's control than address density) is worksharing. See PRC Op., R2006-1, at ¶ 4030 (identifying non-worksharing mail characteristics to include “weight,

shape, and machinability” even under the less restrictive pricing regime of the PRA).<sup>8</sup>

In the same way, sufficient address density, another mail characteristic, may permit the Postal Service to avoid casing the mail. (Perhaps more importantly, as discussed below, highly geographically-targeted mail also serves a different marketing purpose and faces more and different types of competition than less highly geographically-targeted mail, or mail that is not geographically-targeted at all.) But, like machinability or shape, this characteristic is not, by this fact alone, worksharing. Simply put, the mailing can avoid casing because it has an intrinsic characteristic—high address density—that makes it lower cost to process and deliver. This characteristic is not itself the product of work that the Postal Service does and that can be avoided, so it is not worksharing. Rather, like machinability or shape, it enables a lower cost mail processing or delivery path to be used. As stated in the Postal Service's Initial Comments, a prerequisite for some activity is not the same as the activity itself. Because something is required for worksharing to take place does not make that characteristic or activity itself worksharing. In fact, within the Standard Mail Carrier Route and High Density/Saturation products, density is the *sine qua non*, a prerequisite for the products themselves and a reason for the products' existence.

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<sup>8</sup> See also Docket No. RM2007-1, Order No. 43, at ¶ 2118 (“workshare discounts, as defined in the PAEA, do not include shape-based differences”).

## **1. Density and sequencing are not identical**

In its Initial Comments at page 32, the Postal Service noted that High Density mail and Saturation mail both have the same sequencing requirement. Therefore, saying that sequencing is worksharing fails to establish the fact that the two categories are worksharing variants of each other. In fact, the relationship between High Density mail and Saturation mail is comparable to two groups of regular mail, presorted to the same level, but differing in number of pieces. For example, one mailer could tender one tray of 3-digit automation letters and a second mailer three trays of 3-digit automation letters, all going to the same 3-digit area. Both mailings would have the same level of presort and be eligible for the same discounted pricing. Although one would be denser than the other, these would never have been considered worksharing variants of each other.

## **2. Background of Carrier Route, High Density, and Saturation mail categories**

The background of the development of Carrier Route, High Density, and Saturation Mail is illuminating, because the underlying reasons for the Enhanced Carrier Route (ECR) subclass creation are still valid today, even though the ECR subclass has evolved into two different products: Carrier Route and High Density/Saturation mail, which both differentiate geographically-targeted mail groups from the rest of Standard Mail. Commission analysis from Docket No. MC95-1 provides support for keeping geographically-targeted mail such as High Density and Saturation mail separate from demographically-targeted regular Standard mail, including automation mail.

Bulk Regular Rate is overwhelmingly advertising mail. Advertising is often regarded as more-or-less targeted. Highly targeted advertising attempts to select only those recipients who are likely to respond to the advertiser's message. Less targeted advertising involves less sharply focused efforts to reach groups of recipients who have desirable economic or demographic characteristics. At the extreme, untargeted advertising makes no effort to select recipients of the message.

Based on the qualitative evidence, it appears that untargeted advertising mail is more price sensitive than targeted mail. Therefore, carrier route Standard Mail ought to be more own-price elastic than noncarrier route categories of Standard Mail.

Docket No. MC95-1, Opinion and Recommended Decision, (Jan. 26, 1996) at V-186.

The Commission broadly endorsed the concept of separate carrier route and noncarrier route markets, based both on quantitative and qualitative data, stating, "...separate rates and discounts for carrier route and noncarrier route mail should improve the equity and economic efficiency of the postal rate structure." *Id.* at V-189.

In that docket, Postal Service Witness Tolley (USPS-T-16) explained the Postal Service's view of density as it applied to the (then-proposed) ECR, which was accepted in the Opinion and Recommended Decision: "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 V-179. Prof. Tolley also dismissed the importance of marginal price differences, saying, "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 discounts." *Id.* The Postal Service's position today, as it has been for many years, is that target

density remains a decision by mailers made for marketing reasons, a position which mailers echoed in the Public Forum.

As a Postal Service representative stated in the Public Forum (Tr. 51), we need to consider that empirical evidence does not begin and end with estimating elasticities econometrically. It may not be feasible to prove by presenting separate elasticities that these categories serve separate markets, but that absence does not then mean that they do not. Generally, it is believed that the greater the address density of a mailing, the more alternatives exist, either for alternate delivery of hard copy advertising, or to reach intended customers by broadcast messaging methods. This was one of the Commission's key analytical findings in Docket No. MC95-1, based on econometric data as well as qualitative data supplied by the Postal Service and by mailers and mailing industry groups:

Alternative advertising media are closer natural substitutes for untargeted mail than for targeted mail. This fact can be inferred from the direct testimony of representatives of mailers in the current proceeding when they discuss the greater price sensitivity of saturation mail. See Postal Service brief at 234. 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.

To the extent that these categories of mail tend to have different non-postal alternatives, that fact would highlight that the categories serve different markets. However, there is some overlap among Carrier Route, High Density,

and Saturation, which is not surprising. It is a situation that the Commission has recognized in the past.<sup>9</sup>

For example, High Density and Saturation mail categories are often used by different customer types, but a customer who uses predominantly one category may, on some routes, use the other. Advertising consolidators offer Saturation mail as a product for reaching geographically concentrated targeted customers as an alternative to other marketing options. Both local and national newspapers often use High Density mail in their Total Market Coverage (TMC) programs to supplement newspaper inserts delivered to subscribers. However, advertising consolidators may also use High Density mail on occasion, just as newspapers may use Saturation mail. There is no set customer or market "boundary" between High Density and Saturation mail; the choice of which to use may vary by carrier route, driven by carrier route demographics.

**C. Current product and rate category groupings are appropriate.**

The five-digit price should not be used as a benchmark for Carrier Route, High Density or Saturation Mail, nor should Carrier Route be used as a benchmark for High Density or Saturation. Although the statute identifies products as groupings of mail having distinct cost or demand characteristics, neither the statute nor good business sense requires that every group that has distinct costs or demand be formally designated as a separate product.<sup>10</sup> In

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<sup>9</sup> The Commission added that, "It is not necessary to define Standard Mail subclasses in a way that completely avoids any overlap..." Docket No. MC95-1 at V-189.

<sup>10</sup> See, e.g., Docket No. RM2007-1, Order 26, at ¶ 3069 ("[T]he existence of a separate rate, implying a cost difference, does not require that the particular postal service, e.g, rate cell, be deemed a product. A rule of reason must be applied."), and at 3070, ("Disaggregating postal services into too many products would...serve no legitimate business or regulatory need.").

response to a query posed on Order No. 143, while the Postal Service has not reached the conclusion that Carrier Route and High Density mail serve the same market, a contrary conclusion (i.e., that these two products serve different markets) would not automatically compel the conclusion that Saturation and High Density serve the same market. If the Postal Service were to conclude that Saturation and High Density serve different markets, that factor would figure importantly in pricing decisions for both Saturation and High Density mail, whether or not the Postal Service were to take the further steps necessary to separate Saturation and High Density into separate products.

The notion that five-digit automation mail might become a benchmark for High Density or Saturation mail (either directly or using Carrier Route as an intermediary) is a "non-starter." The notion is destructive, in that it would undo the comprehensive findings of Docket No. MC95-1 that High Density/Saturation mail serves a different market than demographically targeted "regular" Standard mail. Not only would this be an enormous step backwards in terms of logical mail classification groupings long accepted by the mailing community, it would be likely to destroy both High Density and Saturation mail categories, since the High Density/Saturation mail market would not be likely to withstand the price increases that would ensue if the price differences between High Density/Saturation and regular Standard mail were only to reflect the provable cost differences due to presorting to carrier route and sequencing.

## 1. Line-of-Travel (LOT) and Walk Sequenced Mail

The Postal Service is aware that there are some mailers with sufficient address density to mail at High Density (or, possibly at Saturation) prices, but who choose to enter at the Carrier Route level, using line-of-travel rather than walk sequencing. Although there are some mailers for whom such a choice exists, the typical Carrier Route mailer does not have the address density to decide between using Carrier Route and using High Density or Saturation. The suggestion on page 7 of Order No. 243 oversimplifies a complex situation. The mailer takes the address density as a given characteristic. Nonetheless, even in the situation described therein, where the mailer has a choice, the mailer decides on which pricing category to use, based on the mailer's own costs compared to the price differential. Further, even if a mailer has a choice between Carrier Route and High Density or High Density and Saturation, that does not mean these products or price categories are not targeted Standard Mail offerings.

Neither the price differentials nor the cost differentials between Carrier Route mail on the one hand, and High Density or Saturation mail on the other, simply reflect the difference in Postal Service costs between identical batches of line-of-travel and walk sequenced mail. Rather, the cost differentials predominantly reflect other factors such as the average address density of High Density/Saturation mail (high) and Carrier Route mail (low). The Postal Service believes that the cost differences between the two allowed sequencing methodologies are *de minimis* for mail that is not to be taken directly to the street

as a third bundle. If any cost differences even exist, they are dwarfed by the cost differences produced by other factors such as average address density itself.

## **2. Automated vs. manual sequencing**

The issue of whether cost differences arising from address density differences are worksharing and subject to the 3622(e) does not depend on whether the mail receives automated or manual delivery point sequencing. Nor do the questions of whether these categories serve the same or different markets. *Both High Density and Saturation have the same level of worksharing, whether or not they receive manual or automated delivery point sequencing.* The issue of what kind of delivery point sequencing a piece receives is a (non-worksharing) cost issue, and is a factor that is taken into account in pricing, along with other factors, such as market factors. Cost differences, while important, are not the sole, or even the most important factor in pricing, particularly so under the pricing regime set by the PAEA.

## **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. Instead of the workshare provisions of section 3622(e), the Commission may rely on the “just and reasonable” standard of section 3622(b)(8) to preclude the Postal Service from unduly favoring Presort mailers to the detriment of Single-piece mailers while grappling with the myriad challenges presented by application of the CPI-U price cap to First-Class Mail. With respect to the Standard Mail question, differences in cost among the Saturation, High Density, and Basic price categories are not “workshare” differences within the meaning of section 3622(e). Pricing for those products should not be encumbered by striving to meet inapplicable requirements.

Respectfully submitted,

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## 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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