

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

CONSIDERATION OF WORKSHARE DISCOUNT
METHODOLOGIES

Docket No. RM2009-3

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO NOTICE OF INQUIRY NO. 1
(September 11, 2009)

On August 27, 2009, the Commission issued Notice of Inquiry No. 1 in this docket. The Postal Service hereby files its response. Each question is stated verbatim, and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. When the “owner” of First-Class Single-Piece Mail decides to use the services of a consolidator, its single-piece mail becomes eligible for Presort First-Class Mail discounts. As the consolidator increases density in this manner, it becomes feasible to presort the mail at greater depth, qualifying the mail for a deeper discount on each piece. Some of that discount is typically shared with the owner of the mail, and some is retained by the consolidator as compensation for the value that he adds to the owner’s mail.

- a. If the consolidator did not aggregate mail to greater density prior to presortation, would the Postal Service perform a similar aggregation function “in house” prior to sorting?
- b. Should the aggregation done by the consolidator be considered worksharing?
- c. Does aggregating mail to achieve higher densities prior to entering it into the system affect the value of presortation to the Postal Service?
- d. If aggregation to higher densities affects the value of presortation, would it be economically efficient to offer a rate incentive to encourage it?

Response:

The discussion below assumes that the questions refer to First-Class Mail.

a. Aggregation (increasing the number of pieces for sortation or potential sortation) does not by itself create greater density – at least not density that is in any way related to the Postal Service cost of handling the pieces aggregated. Nor does aggregation alter the market characteristics of the pieces aggregated.

If the consolidator accepts only metered mail, and requires its clients to present this mail faced and in trays, the mail may avoid the facer/canceller operation, but it would have done so even it had not been aggregated by the consolidator.

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- b. No; aggregation is simply a precondition that typically allows a consolidator to presort deeply enough to cover its costs (including a normal return on investment) after payments to clients are deducted.
- c. To the extent that aggregation permits greater volume and/or depth of presort mail qualifying for discounts, both the consolidator and its clients benefit, but there is no significant benefit to the Postal Service beyond that already rewarded by the presort discounts.
- d. It does not, so the question of whether an incentive should be offered need not be addressed. Again, to the degree that aggregation permits the consolidator to qualify mail for finer depths of presortation, the Postal Service already “rewards” that finer depth of presortation with a higher presort discount.

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2. Assume there is a given set of mail addressed to a 3-digit area that can be entered into the mailstream four different ways:
- as two separate non-presorted mailings, neither of which has sufficient density to qualify for 5-digit presort rates;
 - as two separate mailings presorted to 5-digit despite lacking sufficient density to qualify for 5-digit presort rates;
 - consolidated into a single mailing (which creates sufficient density to satisfy the minimum piece requirements for 5-digit presort rates), but not presorted; or
 - consolidated into a single mailing and presorted to 5-digit.
 - a. How would the cost to the Postal Service of handling the mail vary between the four preparation scenarios?
 - b. Is the ability of the Postal Service to realize savings from increased density dependent on (or enhanced by) presortation? Why or why not?
 - c. Is the ability of the Postal Service to realize savings from presortation dependent on (or enhanced by) some minimum level of density? Why or why not?
 - d. Are there synergies between the savings from density and presorting (*i.e.*, do the savings from the combination exceed the sum of each individually)?
 - e. If so, should the Postal Service try to estimate the cost-reducing effect of each separately and offer separate discounts?

Response:

To facilitate discussion, the four bullet-pointed ways of entering the mail have been numbered (i) – (iv) as follows:

- (i) as two separate non-presorted mailings, neither of which has sufficient density to qualify for 5-digit presort rates;
- (ii) as two separate mailings presorted to 5-digit despite lacking sufficient density to qualify for 5-digit presort rates;
- (iii) consolidated into a single mailing (which creates sufficient density to satisfy the minimum piece requirements for 5-digit presort rates), but not presorted; or
- (iv) consolidated into a single mailing and presorted to 5-digit.

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For concreteness, let us further assume that the 3-digit area under discussion contains 30 5-digit zones, and that there are a total of 200 pieces for each zone, or 6000 pieces for the 3-digit area. If this mail is entered as two mailings, each will have 100 pieces for each 5-digit zone, or 3000 pieces. Finally, assume that a 2-foot tray can comfortably hold 400 pieces.

- a. From highest cost to lowest cost scenario, the hierarchy is as follows:
- (ii) The second preparation is not actually permissible, but if it were, there would be 60 below-minimum 5-digit trays, each with 100 pieces, for a total of 60 tray handlings. The required minimum of 150 pieces reflects Operations' judgment that it is necessary to avoid at least 150 piece-sorts to cover the cost of handling an additional tray.
 - (i) For the first preparation, each mailing will have 7 full 3-digit trays of 400 pieces each, plus one overflow tray with 200 pieces, for a total of 14 full trays and 2 overflow trays. Total cost will be 16 tray handlings and 6000 piece sorts from 3- to 5-digit.
 - (iii) The third preparation will be slightly lower than the first because the 2 overflow trays will be merged into a single full tray for a total of 15 tray handlings and the same 6000 piece sorts.
 - (iv) The fourth preparation will have 30 5-digit trays, each with 200 pieces; each tray pays for its handling by avoiding more than 150 piece sorts. A full answer to this question depends on whether the savings from

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avoiding 200 piece sorts exceeds the cost of a tray handling by more than $200 * (3\text{-digit price} - 5\text{ digit price})$.

b. Compare preparations (iii) and (iv). Both have the density to meet the 150-piece minimum for 5-digit presort, but only (iv) is actually presorted. The pieces in (iii) will be sorted to the 12 5-digit zones along with all other 3-digit or less finely presorted mail received that day for that 3-digit area. The result will be multiple full 400-piece 5-digit trays plus at most one overflow tray for each 5-digit zone. In contrast, the 5-digit trays generated by the fourth preparation contain 200 pieces only. For first-pass DPS processing, trays must be moved from some staging area to the DBCS. The fourth preparation requires moving two trays to move 400 pieces, while the pieces from the third preparation will usually be in 400 piece trays.

If massive aggregation permits the consolidator to generate multiple full trays for all 5-digits in a given 3-digit area, then presortation by the consolidator should be roughly on par with postal sortation. In the not-so-massive aggregation of the fourth preparation, a more detailed analysis would be needed to determine where the advantage lies.

c. Please see the response to part b. above. In general, the “minimum level of density” required for the Postal Service to realize savings is specified in its mail preparation requirements for different products and rate categories. When mail meets density, volume, and mail prep requirements (whether it is aggregated or not), the mailer is eligible for discounted rates.

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- d. No, for the reasons explained in parts b. and c. above.
- e. Not applicable. Even if one were to disagree with the Postal Service's premise that this question is not applicable, it cannot be answered with available data.

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3. Under the established method of estimating the costs avoided by the Postal Service as a result of worksharing, the savings from some (workshare-related) mail preparation functions performed by a mailer that are not a direct substitute for a Postal Service function are included. Examples include savings from electronic presorting, which avoids Postal Service physical sorting; address cleansing, which avoids Postal Service forwarding and return costs; and automation compatible mailpiece design, which reduces the likelihood of manual Postal Service sorting. Should “worksharing-related” functions like the ones described above be applied when defining “workshare discount” and estimating “the cost that the Postal Service avoids as a result of workshare activity” under the Postal Accountability and Enhancement Act? See 39 U.S.C. § 3622(e). Should only those activities performed by a mailer that replicate functions the Postal Service would otherwise perform in essentially the same manner be considered part of worksharing? Or should some other standard apply? Please explain.

Response:

The intent of section 3622(e) is to promote the establishment of appropriate price incentives for mailers in order to achieve efficient divisions of four specified functions between the Postal Service and the mailers. The functions specified are sortation, barcoding, handling, and transportation. The concept is clear. Mailers can present mail that has been presorted to the final sort, or the Postal Service can sort the same mail to that level itself. Mailers can present mail that has been correctly prebarcoded, or the Postal Service can apply barcodes to the mail itself. Mailers can undertake the handling and transportation necessary to dropship mail closer to its destination, or the Postal Service can undertake such handling and transportation itself. In each instance, the option exists for the function to be performed by either the mailer or the Postal Service, and the intended measure of worksharing cost avoidance is the cost avoided by the Postal Service by virtue of not having to perform the function already performed by the mailer.

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The manner in which a mailer performs “workshare activities” does not relate to worksharing cost avoidances. What matters is the result – i.e., how mail is presented when it enters the mailstream, and the postal costs thus avoided. The Postal Service is only capable of measuring its own costs, as incurred through its own operational methods. It is not possible for the Postal Service to take into consideration the costs or activities incurred by mailers in preparing their mail to postal specifications. If the costs of complying with postal worksharing preparation requirements are higher than the workshare discounts offered by the Postal Service, the presumption is that the customer would behave in a rational manner. Under such circumstances, the mailer could either choose not to engage in the activity of preparing the mail thusly, or recognize that there are other benefits beyond the workshare discount, such as faster mail delivery service, less damage to mailpieces, or higher probability of reaching the intended recipient. These types of considerations could potentially offset some discrepancy in workshare costs and discounts from the mailer’s standpoint.

Because the manner in which the mailer achieves the level of mail preparation selected does not affect the workshare cost avoidance, the implicit distinction in the question between electronic presortation and physical presortation is not relevant to the matter of the appropriate standards for cost avoidance measurement. That distinction may be relevant to demand side considerations, but has no bearing on the costs avoided by the Postal Service when the mail presented by the customer has been prepared to a given level of

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presortation, by whatever means. The established cost models appropriately do not take (and, indeed, *could* not take), this factor into account in estimating cost avoidances.

Similarly, the notion of automation compatible mailpiece design likewise has no bearing on workshare cost avoidance. If the mailer presents a mailpiece which cannot be run through the Postal Service's automation equipment, the Postal Service would not be incurring any costs to barcode that piece. It would make no sense, therefore, for the Postal Service to grant a discount for prebarcoding such a piece, as no costs would be avoided by the mailer engaging in that activity under those circumstances. The costs avoided by prebarcoding must presuppose that the mailpieces in question can be run through postal automation equipment, as it is such equipment that would print any Postal Service-applied barcode. If the option does not exist for the Postal Service to perform the function in question, the circumstances are not covered by the intended scope of section 3622(e).

Address cleansing is a different matter. Assuming automation compatibility, a mailing produced using an address list which has not been subjected to appropriate address cleansing procedures can still, at least mechanically speaking, be run through postal machines and thus barcoded by the Postal Service as easily as a mailing produced using an address list which has been subjected to such procedures. In that sense, therefore, the workshare costs avoided by prebarcoding might seem unaffected by this requirement. In reality, however, the Postal Service is not indifferent whether its own equipment

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barcodes an uncleaned mailing, or whether the mailer does. In the process of applying barcodes, the Postal Service's equipment would identify certain address discrepancies, and treat certain mailpieces differently on that basis.

In other words, in the case of mailings generated from uncleaned address lists, what results from prebarcoding by the mailer is not comparable to what results from barcoding by the Postal Service. This would violate an implicit objective of section 3622(e), which is that the quality of the potential workshare function (for which appropriate incentives are supposed to be established) should be equivalent whether performed by the mailer or the Postal Service. There is no point in setting discounts exactly equal to avoided costs if the quality of the work performed is likewise not equal. To make sure the trade-offs are conducted on a level playing field, therefore, it is necessary to ensure that mailers employ appropriate address cleansing procedures before they prebarode their mail. With that sensible requirement in place, the task of measuring the avoided costs associated with prebarcoding correctly remains focused on the operational steps which the Postal Service would otherwise need to conduct in order to barcode the mailpieces itself.

It is true, as suggested by the question, that the inefficiencies caused by the failure to cleanse address lists primarily manifest themselves in subsequent postal activities (i.e., forwarding and returning). While those activities clearly have cost consequences for the Postal Service, they likewise can have detrimental consequences to the mailers. Sending mailpieces to the wrong addresses delays delivery to the intended recipients, and/or delays notification to

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the mailer that the intended recipients are no longer at the printed address. Mailers thus often have their own incentives for engaging in address cleansing, and receive benefits above and beyond qualification for workshare discounts. More to the point, however, the Postal Service does not view any potential subsequent cost consequences as germane to the intrinsic cost avoidances associated with worksharing. Mailers presumably have the option of engaging in address cleansing while declining to participate in worksharing, and may choose to do so because of other perceived benefits. The Postal Service, on the other hand, does not have the option of cleansing the mailer's address list prior to introduction of the mailing into the mailstream, so address cleansing is not a Postal Service activity that can alternatively be performed by the mailer, and thus is not comparable to any of the four worksharing activities identified in the statute.

In broader terms, however, the Postal Service also recognizes that, since as far back as Docket Nos. R90-1 and MC95-1, the Commission and the Postal Service have employed a "hybrid" cost methodology that uses both Cost and Revenue Analysis (CRA) mail processing unit costs and model-based mail processing unit costs to estimate the worksharing related savings. For example, the Commission in Docket No. R2000-1 rejected attempts to include a separate estimate of Move Update savings, but acknowledged that "the cost pools that reflect return and forwarding costs are already in the worksharing related cost savings estimates." PRC Op. & Rec.Dec., R2000-1 (Nov. 13, 2000), Vol. 1 at 242. To some extent, aspects of this approach would appear as if they might

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conflict with the Postal Service's view that the intended measure of worksharing cost avoidance is the cost avoided by the Postal Service by virtue of not having to perform the function already performed by the mailer. Even if that is the case, the Postal Service would be disinclined to support any further extension of the standard for cost avoidance measurement beyond those cost savings directly related to the functions which the mailer performs and the Postal Service avoids.

Perhaps more importantly, as the Postal Service has stated repeatedly, section 3622(e) is intended to operate only with respect to workshare cost differences within products. Address cleansing standards, for example, tend to be uniform within products (at least for letter-shaped and card-shaped mail). Therefore, under the correct interpretation of the new statutory scheme, cost differences related to address cleansing are much less likely to even arguably be "workshare-related" than they were under the old statutory scheme, in which, for example, workshare and nonworkshare letters were within the same subclass of First-Class Mail. Enhanced ability to maintain focus directly on the four worksharing activities specified in the statute is yet another reason supporting the view that section 3622(e) applies only to workshare cost differences within products.

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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