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

Annual Compliance Report, 2009 **Docket No. ACR2009**

COMMENTS OF PITNEY BOWES INC.

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I. INTRODUCTION

Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments on the Annual Compliance Report (ACR) for Fiscal Year 2009 (FY 2009), filed by the Postal Service on December 29, 2009. *See* PRC Docket No. ACR2009, Annual Compliance Report, 2009; PRC Order No. 380, Notice of Filing of Annual Reports to the Commission by the Postal Service and Solicitation of Public Comment (issued January 5, 2010).

II. DISCUSSION

A. First-Class Mail Presort Letters / Cards is Highly Profitable Mail

The FY 2009 ACR data confirm the value of workshare. First-Class Mail Presort letters and cards continue to be highly profitable mail for the Postal Service. The unit contribution for First-Class Mail Presort letters and cards is 22.9 cents. *See* USPS-FY09-1. This per piece contribution continues to be almost five cents more than the unit contribution of Single-Piece First-Class Mail letters (18.0 cents). *See id*. This large difference in contribution – 4.9 cents – remains unchanged from the difference in contribution reported in last year's Annual Compliance Report. *See* FY 2008 Annual Compliance Determination (ACD) at 48.

Recent comments filed by the Direct Marketing Association demonstrate that optimizing the pricing of more profitable First-Class Mail (by lowering Presort letter prices) could increase the total contribution from First-Class Mail by nearly $400 million. *See* PRC Dkt. No. RM2009-3, Comments of the Direct Marketing Association (Sept. 11, 2009), at 5-6. New demand data recently filed by the Postal Service establish that First-Class Mail Presort letters are much more price sensitive than Single-Piece First-Class Mail letters. *See* Econometric Demand Equation Tables for Market Dominant Products as of January 2010, http://www.prc.gov/Docs/66/66502/MarketDominant.zip, (filed Jan. 20, 2010). At a time when mail volume declines continue to

threaten the financial stability of the Postal Service, it is critical that the Postal Service do everything possible to preserve mail volumes and increase contribution from its most profitable products. Accordingly, the Postal Service should exercise restraint in future pricing increases for First-Class Mail Presort letters.

B. Existing Workshare Discounts Do Not Adequately Recognize the Value of 5-Digit Presort First-Class Mail and Standard Mail Automation Letters

For the second year in a row, the ACR data show that the existing workshare discounts for the 5-Digit First-Class Mail and Standard Mail automation letters significantly understate the value of this presort level. In FY 2009, the 5-Digit automation letter discounts in both First-Class Mail and Standard Mail passed through substantially less than 100 percent of avoided cost – 84.6 percent in First-Class Mail and 90 percent in Standard Mail. USPS-FY09-3, Worksharing_Discount_Table-FY_2009_12_29_09.xls, "FCM Bulk Letters, Cards 1" and "Standard Mail Letters."

Of particular concern, the passthrough underlying the First-Class Mail 5-Digit automation letter discount continues to trend in the wrong direction. For FY 2009, the First-Class Mail 5-Digit automation letter discount experienced an effective decrease in value; the underlying cost avoidance increased 0.2 cents from FY 2008, but the discount remained unchanged. *See* FY 2008 ACD, at 52. Discounts that are substantially below avoided costs distort pricing signals to mailers and, thus, are inconsistent with the efficient component pricing rule (ECPR). While the Commission has not sought to impose strict compliance with ECPR, it has repeatedly observed that ECPR should be used as a "guiding principle in establishing and maintaining workshare discounts." PRC Order No. 26, at 21-23. This position finds strong

support in the Postal Accountability and Enhancement Act (PAEA).[1] *See* 39 U.S.C. §§ 3622(b) and 3622(c). Unfortunately, the narrative discussion in the ACR filing focuses exclusively on the workshare passthroughs that exceed 100 percent of the costs avoided. Justification for workshare discounts that are substantially below costs avoided should also be provided to allow the Commission to assess compliance with the PAEA. *Cf.* PRC Rule 3010.14(b)(6) (requiring that "[t]he Postal Service shall also identify and explain discounts that are set substantially below avoided costs and explain any relationship between discounts that are above and those that are below avoided costs" in the context of a notice of rate adjustment).

Furthermore, the FY 2009 5-Digit automation letter cost avoidances likely understate the costs that will be avoided when the next ACR is filed and when price changes are next implemented. These cost avoidances will likely increase due to increases in postal compensation. Non-Remote Encoding Center (REC) mail processing hourly compensation increased by 7.7 percent from FY 2008 to FY 2009, enlarging cost avoidances. *Compare* USPS-FY09-10 FCM Letters Costs Final.xls and USPS-FY08-10 FCM Letters Costs Final.xls, worksheet "WAGE RATES - PIGGYBACK FACTORS", cell D5. While hourly compensation is not likely to continue increasing at such a rapid pace due to nonexistent inflation, it will likely be higher in FY 2010 than in FY 2009.[2] Quarter 1 clerk compensation was nearly four percent higher in FY 2010 than it was in FY 2009. *Compare* Page 27 (YTD Figures) of FY 2009 and FY 2010 Pay Period 26 National Payroll Hour Summary Report.

Finally, the question of whether the use of a single or two-part CRA adjustment factor in the letter cost avoidance models is pending in Docket No RM2009-3. *See* PRC Dkt. No. RM2009-3, Initial Comments of Pitney Bowes Inc., at 11-14 (Sept. 11, 2009). Consistent with

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[1] *See* Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.
[2] *See* www.prc.gov/PRC-DOCS/home/CPI.pdf.

the findings presented in our previous comments, use of a two-part CRA adjustment, rather than the Postal Service's use of a single proportional adjustment factor, substantially increases the FY 2009 5-Digit automation letter cost avoidance.[3]

For these reasons the Postal Service should revisit the rate design for 5-Digit presort First-Class Mail and Standard Mail letters when it makes its next pricing adjustment. Discounts for Presort letters should be increased.

C. The Alternate First-Class Mail Letter Cost Model is Flawed

The Postal Service again filed an alternate First-Class Mail letter cost avoidance model, USPS-FY09-29. As in the past, this alternate model differs in several important respects from the Commission-approved First-Class Mail letter cost avoidance model, filed in USPS-FY09-10. The Postal Service acknowledges that the alternate model is procedurally flawed because it relies on unapproved methodological changes. *See* USPS-FY09-29.doc at 1 (disclaiming the use of the model – "[it] is not used in other analyses"). The Commission could ignore the cost avoidance estimates produced by this model on this basis alone. The Commission should also ignore the alternate model because it is substantively flawed and inaccurate in two major respects, specifically:[4]

- USPS-FY09-29 uses the CRA cost pool classifications that have been approved for Standard Mail letters, rather than those that have been approved to estimate First-Class Mail letter cost avoidances (USPS-FY09-29.doc at 2); and

[3] *See* PRC Dkt. No. RM2009-3 (Sept. 11, 2009), at 11-14; PRC Dkt. No. ACR2008, PB Comments (Jan. 30, 2009), at 4-5; PRC Dkt. No. RM2009-1 PB Reply Comments (Dec. 10, 2008)

[4] USPS-FY09-29 does not include a cost estimate for bulk metered mail (BMM) letters. Importantly, this difference only affects which costs are estimated by the model, not the magnitude of costs that are estimated by and presented in the model. Excluding a cost estimate for BMM letters is why the Postal Service referred to this cost avoidance model in the FY 2008 ACR as the "Delinked" First-Class Mail Model. While the filing of unapproved cost models as part of the Annual Compliance Report only contributes to confusion, Pitney Bowes appreciates that the Postal Service titled this library reference "Alternate FCM Workshare Estimates" in FY 2009 to indicate that delinking is not the relevant difference between this cost model and the approved one. Cost avoidance estimates associated with a delinked rate design that are based upon the Commission-approved cost model (USPS-FY09-10) are presented in USPS-FY09-3. The delinked cost avoidance estimates within Automation Letters are exactly the same as under the linked cost avoidance estimates. *See* Worksharing_Discount_Table-FY_2009_12_29_09.xls, "FCM Bulk Letters, Cards 1" and "FCM Bulk Letters, Cards 2."

- USPS-FY09-29 excludes rate category-specific delivery cost estimates. *Id.*

As explained in our previous comments, using the Standard Mail CRA cost pool classification for First-Class Mail letters is inaccurate primarily because the Standard Mail cost avoidance model classifies platform costs as fixed. *See* PRC Dkt. No. ACR2008, PB Comments, at 8.[5] This classification may be reasonable in Standard Mail because these costs are included in the destination entry cost avoidance model. The treatment is inappropriate in First-Class Mail because there currently are no destination entry discounts.

Excluding rate-category specific delivery cost estimates directly contradicts the Commission's approved methodology,

> The Commission also finds it appropriate to continue the practice of including estimated delivery costs by rate category in the calculation of cost avoidances for discounted letter rates. Differences in delivery costs between letter categories arise from differences in the percentage of each category that are sorted in automated Delivery Point Sequencing (DPS) operations. The Postal Service asserts that the use of average acceptance rates in the mail flow models yields misleading DPS percentages by rate category because pieces are very likely to be successfully processed on downstream operations after they have been successfully processed once.
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> The validity of this argument is undermined by the existence of significant non-zero reject rates for the second pass of the two-pass automated incoming secondary sort which, by definition, consists of mail that has been successfully sorted on automation equipment at least once. Also, it would be inconsistent to find that the use of average acceptance rates produce reliable estimates of mail processing unit costs, but the same acceptance rates produce unreliable DPS percentages for use in calculating unit delivery costs. The two outputs of the models are both dependent on the same inputs, including acceptance rates.

PRC Dkt. No. R2006-1, para. 5155-6.

[5] Additionally, the cost estimates differ because several of the piggyback factors used in the alternate cost model conflict with those in USPS-FY09-10, have not been updated from the FY 2008 version of the cost model, and thus appear to be in error. USPS-FY09-29, USPS-FY09-29 Alternate FCM Model.xls, "WAGE RATES - PIGGYBACK FACTORS," cells D23, D25, D27, D31, D33, D35, D37, D38.

D. First-Class Mail Flats are a Profitable Flat-Shaped Mail Product

As the Commission observed in Order No. 380, the revenues for flat-shaped mail generally did not cover costs in FY 2009. *See* Order at 5-6. First-Class Mail Flats, however, contributed nearly 50 cents per piece to institutional costs. *See id*., at 22. Accordingly, the Postal Service must ensure that future pricing adjustments do not inadvertently cause a migration of commercial flats from First-Class Mail. For example, under the Postal Service's new method for estimating First-Class Mail flats cost avoidances, the FY 2009 ACR shows a significant reduction in the Area Distribution Center (ADC) Automation Flat cost avoidance. FY 2009 ACR at 65; USPS-FY08-11, Preface.doc at 3. The Postal Service should exercise caution when adjusting this discount to ensure that it preserves profitable First-Class Mail Flats volumes.

E. The Postal Service Must Continue to Exercise the Pricing Flexibility Afforded Under the PAEA to Stem Volume Declines and Increase Postal Revenues

Competitive products were a bright light for Postal Service finances in FY 2009: institutional cost contribution increased from $1.8 billion in FY 2008 to $2.0 billion in FY 2009. USPS-FY09-39, FY09-CP01-Comp_Product_Income_Statement-Distributed.xls, "PRC Form CP-01." The success of competitive products is likely due in significant part to the Postal Service's use of its increased pricing flexibility afforded under the PAEA. The Postal Service filed and the Commission approved 63 competitive contract pricing arrangements in FY 2009, more than three times the number in FY 2008. *See* PRC Annual Report, at 16.

The Postal Service must continue to exercise its pricing flexibility for both market dominant and competitive products in an effort to stem mail volume declines and increase revenues. The Postal Service should continue to offer promotional initiatives like the Summer and Fall Sales, and should seek to fully leverage its authority to offer new experimental products.

The Postal Service should also consider pursuing niche opportunities and new workshare discounts designed to stimulate new volumes and drive out costs. For example, the Postal Service should propose a distance-based pricing structure in First-Class Mail. First-Class Presort Mail is the only major class of mail without distance-related pricing. A destination entry discount for First-Class Presort Letter Mail would lower the total combined system costs for First-Class Mail, while increasing First-Class Mail volume and total contribution.

III. CONCLUSION

Pitney Bowes appreciates the Commission's consideration of these comments.

Respectfully submitted:

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