

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

Annual Compliance Report, 2009

Docket No. ACR2009

**INITIAL COMMENTS OF
AMERICAN POSTAL WORKERS UNION, AFL-CIO
(February 1, 2010)**

On December 29, 2009, the United States Postal Service (USPS) filed its Annual Compliance Report (ACR) for Fiscal Year 2009 pursuant to Section 3652 of the Postal Accountability and Enhancement Act (PAEA). The Postal Regulatory Commission subsequently issued a Notice of Filing of Annual Compliance Report by the Postal Service and Solicitation of Public Comment (January 5, 2010) and established Docket No. ACR2009 in accordance with 39 U.S.C. § 3653.

In response to the Commission's Notice and Solicitation of Public Comment, the American Postal Workers Union, AFL-CIO (APWU) respectfully submits the following comments. These comments address our conclusion that the excessive and increasing workshare discounts for First-Class Mail Presort Letters/Cards reported by the Postal Service violate the workshare discount restrictions of 39 U.S.C. § 3622(e).

In Docket No. RM2009-3, which is pending before the Commission, we explained (1) that Congress, in the Postal Accountability and Enhancement Act (PAEA) has defined workshare discounts and has codified the requirement that workshare discounts not exceed costs avoided, unless one of four carefully-stated exceptions is met; (2) that

the Commission may not by rulemaking depart from these statutory requirements; (3) that the workshare discount restrictions serve a second fundamental statutory requirement stated in Section 404 (c) of the PRA, that there be at least one class of mail sealed against inspection, First Class Mail, for which the rate is uniform; and (4) that there remains no practical alternative to the use of the Bulk Metered Mail letter as the benchmark for calculating First Class letter workshare discounts. Initial Presentation of American Postal Workers Union, AFL-CIO (May 26, 2009), Docket No. RM2009-3.¹

We observe that, for the fourth year in a row, the Postal Service has departed from established methodologies for determining workshare discounts under Section 3622(e) of the Act without the approval of the Commission. This began in R2006-1 where the Postal Service sought to de-link workshared mail from single piece First Class mail by using separate cost categories. In rejecting that effort, the Commission reasoned “[d]elinking the rate design [between First Class single piece and presort mail] does not fairly and equitably balance the interests of all First-Class mailers.” PRC Op. R2006-1 at ¶ 5090. The Commission noted that abandoning the benchmark and de-linking single piece and presort mail “allows many costs that are not worksharing related to be avoided” by presort mailers.

The statutory requirement of a uniform rate for First Class mail has since been reiterated by Congress in the PAEA.² Thus, the central postal policy has been and remains to “bind the Nation together” and the requirement of a uniform rate for First Class remains unchanged. Nevertheless, in its first foray into ratemaking under the

¹ Our Initial Comments in RM2009-3 are attached and are hereby made a part of our Comments in this case by reference.

² This requirement is now in Section 404(c) of the PRA as amended by the PAEA.

PAEA, the Postal Service submitted rates for review by the Postal Regulatory Commission that asserted the authority to de-link single piece and workshared mail when calculating workshare discounts. Once again, the Commission rejected that effort, stating that

A decision to change the framework used for measuring worksharing cost avoidance should await a more complete airing of the pros and cons of the alternatives.

FY 2007 ACD at pp.63-64 (March 27, 2008). The Commission also observed that

The logic of restricting worksharing analysis to intra-subclass rates does not necessarily translate directly into restricting analysis to intra-product rates. Whereas subclasses under the PRA were defined as having distinct cost *and* demand characteristics, products are defined in the PAEA as having distinct cost *or* demand characteristics. Whether or not a rate differential is a worksharing discount may depend, in part, on whether the categories in question have substantially similar demand characteristics.

Id.

The Postal Service's third effort to abridge the requirement that workshare discounts not exceed costs avoided came in ACR2008 where it once again submitted rates that abandoned the Bulk Metered Mail benchmark and severed workshare discounts from a determination of the costs of processing non-workshared Bulk Metered Mail. Once again, the Commission admonished the Postal Service that it is required to use a single piece benchmark in setting workshare discounts. The Commission ruled:

For the mixed AADC letter discount, the Postal Service asserts that the decade-old established method of calculating avoided costs from the benchmark single-piece priced Bulk Metered Mail should be abandoned because the discounted rates and the benchmark are in different products. The Postal Service interpretation of the statute would exempt the

mixed AADC letter discount rate from the limitations of section 3622(e). The Commission has initiated a proceeding to resolve this issue. Upon completion of that proceeding, appropriate action will be taken. The Postal Service must discontinue the practice of changing established analytical methods in data filed with the Commission in support of price adjustments and Annual Compliance Reports.

FY 2008 ACD at 6 (March 30, 2009).

In ACR2009, the Postal Service has, for a fourth time, departed from the Commission's requirements. Table 1 below shows the costs avoided available to support workshare discounts for four types of First Class mail: Mixed AADC, AADC, 3-digit, and 5-digit. This table shows that, as APWU predicted in R2008, costs avoided for some of these categories of mail have declined from 2008 to 2009. The key point, however, is that the workshare discount for Mixed AADC mail, which already exceeded costs avoided when compared to the BMM benchmark in 2008, increased from a discount of 5.1 cents to a discount of 5.8 cents, although the costs avoided by this workshare activity went down. See Table 1 below.

This anomaly alone would require remediation by the Postal Service to bring this discount back into compliance with the law. But it is also important to observe that, because the Postal Service builds the discounts for AADC, 3-digit and 5-digit worksharing from the rate base established by the Mixed AADC discount, the fact that the Mixed AADC discount is too large means that the AADC, 3-digit and 5-digit discounts are also too large. Accordingly, the Postal Service errs when it presents its data for workshared letters and cards in USPS FY09-3 as though the discounts for Automation 3-digit Letters are the result of a 100% passthrough, and the discount for Automation 5-digit Letters results from a passthrough of 84%. In fact, the Automation 5-

digit Letters discount of 10.5 cents exceeds the costs avoided by Automation 5-digit presort mail by more than 1.2 cents per letter, and the Automation 3-digit presort is more than 1.4 cents per letter too large. See Table 1.³ Thus, as a comparison of Table 1 with Table 2 below illustrates, the Postal Service's method of building successive discounts on an initial discount that is too large results in apparent, but misleading, "relative" costs avoided that mask the fact that the resultant discount significantly exceeds costs avoided.

Equally as troubling as the Postal Service's misuse of the BMM benchmark is its invocation of supposed policies and objectives of the Act as a counterpoint to the clear statutory requirements of Section 3622, and the Postal Service's rather cavalier assertion that reduction or elimination of the excessive discounts would "impede the efficient operation of the Postal Service" (referring to Section 3622(e)(2)(D)). ACR2009 at 60-61. The Objectives set by Section 3622(b)(1)-(9) are just that. The system of rates is to be designed to achieve them; but they are not firm requirements and each of them is to be "applied in conjunction with the others." In contrast, Section 3622(e) requires that 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, unless..." one of four specifically listed exceptions applies.

³ The 2008 discounts were set very close to the 2007 cost avoided numbers. However, they tend to be somewhat larger than the 2008 cost avoided numbers would support. See Table 1. Thus, when we compared to 2008 rates to the information available from the 2007 ACR, they seemed to be in line with the workshare language. One can see from this table that the discount for 2009 is higher than the costs avoided for all of the major automation groups. In 2007 they were all in the ballpark of their costs avoided by coincidence, despite the fact that the Postal Service did not apply the required methodology to set the discounts.

Table 1 Calculation of Costs Avoided for Each Category of Automation Letter Mail Using the Benchmark Piece as the Base						
	Costs avoided from benchmark piece ACR2009 (cents)	Costs avoided from the benchmark piece ACR2008 (cents)	Costs avoided from the benchmark piece ACR2007 (cents)	Discount from FC single ounce May '09 rates	Discount from FC single ounce May '08 rates	Discount from FC single ounce May '07 rates
Mixed AADC	4.569	4.526	5.065	5.8	5.1	5.0
AADC	6.606	6.689	6.901	8.0	6.9	6.9
3-digit	6.901	6.993	7.374	8.3	7.4	7.6
5-digit	9.471	9.429	9.503	10.5	9.6	9.8

Table 2. Calculation of Costs Avoided for Each Category of Automation Letter Mail Using a Relative Benchmark

	Costs avoided from relative benchmark ACR2009 (cents)	Costs avoided from relative benchmark ACR2008 (cents)	Discount from Preceding rate level May 2009 rates	Discount from Preceding May 2008 rates
Mixed AADC	4.569	4.526	5.8	5.1
AADC	2.037	2.163	2.2	1.8
3-digit	0.295	0.304	0.3	0.5
5-digit	2.569	2.436	2.2	2.2

The statute is clear and mandatory. The PRC “shall ensure” that workshare discounts do not exceed costs avoided unless one of the four exceptions is met. Accordingly, the Postal Service errs when it asserts that avoided cost that is lower than its related discount “does not itself trigger a requirement for an immediate price change.” ACR2009, at 61. The Postal Service asserts that when a discount violates the requirements of Section 3622(e) because it exceeds costs avoided, “it is an indication that a specific discount/cost avoidance relationship needs to be fully re-evaluated in the context of all of the statutory criteria.” In this fourth successive case in which the Postal

Service has thwarted the use of the BMM benchmark despite clear direction from the Commission to use it, the Postal Service asserts that “[t]his re-evaluation will be undertaken by the Postal Service when it prepares its next price adjustment, and will then be reviewed by the Commission.” ACR2009, at 61 (emphasis added here).

This is manifestly incorrect. It is the Commission’s obligation under Section 3622(e) to “ensure” that workshare discounts do not exceed costs avoided. Moreover, in the Annual Compliance Review process, the Commission is required to make a determination of non-compliance when, as here, rates in effect during the year reviewed “have not been in compliance with applicable provisions of” Chapter 36 of the Act. 39 U.S.C. § 3653(b)(1).

Through four successive proceedings, the Postal Service has demonstrated that it will neither calculate its workshare discounts in accordance with the methodology used by the Commission nor take steps on its own to correct discounts that are not justified by costs avoided. In this proceeding, the Postal Service has sought to invoke Section 3622(e)(2)(D), one of the exceptions to the requirement that discounts not exceed costs avoided. Repeatedly, without any explanation or evidence, the Postal Service asserts that reduction or elimination of the excessive discounts would “impede the efficient operation of the Postal Service.” By simply referring to this exception with no explication, the Postal Service has offered no excuse for its continuing violations of the law.⁴

⁴ An example of the type of specificity that would be required to invoke this exception to 3622(e) is provided by the Postal Service’s assertion that it would impede its efficient operations if it were required to correct the discount for Mixed ADC automation flats. Although the Postal Service has not provided evidence to support this assertion, as a conceptual matter, it is possible that the otherwise illegal passthrough

For these reasons, the Commission must make a written determination that the Postal Service's workshare discount rates for First Class letter mail are not in compliance with Section 3622(e) of the Act.

Respectfully submitted,

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could be justified by the need to support the installation of the FSS flat sorters. See ACR2009, at 67.

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

**Consideration of Workshare Discount
Methodologies**

Docket No. RM2009-3

**INITIAL PRESENTATION OF
AMERICAN POSTAL WORKERS UNION, AFL-CIO
(May 26, 2009)**

The American Postal Workers Union, AFL-CIO (APWU) hereby submits its Initial Presentation in response to the Commission's March 16, 2009, Notice of Proposed Rulemaking on Application of Workshare Discount Rate Design Principles. We observe (1) that Congress, in the Postal Accountability and Enhancement Act (PAEA) has defined workshare discounts and has codified the requirement that workshare discounts not exceed costs avoided, unless one of four carefully-stated exceptions is met; (2) that the Commission may not by rulemaking depart from these statutory requirements; (3) that the workshare discount restrictions serve a second fundamental statutory requirement, that there be at least one class of mail sealed against inspection, First Class Mail, for which the rate is uniform; and (4) that there remains no practical alternative to the use of the Bulk Metered Mail letter as the benchmark for calculating First Class letter workshare discounts.

1. The statutory definition of workshare discount, the requirement that such discounts not exceed costs avoided, and the four exceptions to this restriction on workshare discounts are stated in Section 3622(e) of the Act and are by now familiar ground to the Commission. We wish to emphasize here that, when the Senate Bill

was introduced, it included a fifth exception: “(E) the Postal Regulatory Commission determines that such discounts are reasonable and equitable and consistent with the objectives and factors taken into account under subsections (b) and (c).” This provision was deleted by the Senate Committee on Governmental Affairs, was not included in the House Bill, and is not included in the law.

2. We observe that the Commission has initiated this proceeding “pursuant to 39 U.S.C. 503, 3622(a), and 3652(e).” None of these provisions provides a basis for departure from the restrictions of Section 3622(e). Section 503 merely authorizes and requires that the Commission promulgate rules, regulations and procedures it deems necessary and proper to carry out its responsibilities. Such a general statement of authority has no bearing on the specific requirements of Section 3622(e).

Section 3622(a) requires that the Commission establish and maintain a “modern system for regulating rates and classes for market dominant products.” The central feature of that obligation is that it comply with the requirements of Section 3622(d)(1) and (2) that annual rate increases for any class of mail be no greater than increases in the Consumer Price Index. That requirement serves to emphasize the central importance of maintaining the linkage between single piece letters and workshared letters within each class of mail. Thus, Section 3622 sets forth (b) objectives, (c) factors, (d) requirements, and (e) workshare discount limitations for market dominant products within a class.

Section 3652(e)(2) provides authority for the Commission to initiate proceedings to “improve the quality, accuracy, or completeness of Postal Service data required by the Commission in reports to be filed by the Postal Service. Significantly,

Section 3652(b) requires that Postal Service to report for workshare discounts (1) the per-item cost avoided by the Postal Service, (2) the percentage of such per item cost avoided that the per-item workshare discount represents, and (3) the per-item contribution made to institutional costs. Thus, the purpose of Section 3652 is to make sure that the Postal Service provides the data necessary to ensure compliance with Section 3622, and more specifically in 3652(b), with section 3622(e).

3. Section 404(c) of the Postal Reorganization Act provides, in part:

The Postal Service shall maintain one or more classes of mail for the transmission of letters sealed against inspection. The rate for each such class shall be uniform throughout the United States, its territories, and possessions.

As the Commission observed in MC95-1, ¶ 2048, "...the first and most enduring objective of postal policy has been to bind the nation together. " Central to this purpose is the requirement of uniform First Class rates to serve every area of the country. "A class such as First Class is necessary to comply with the statutory command [of Section 404(c)] that ...[t]he rate for [First Class] shall be uniform throughout the United States, its territories, and possessions." Id., at ¶ 3005.¹

Of course the Congress did not provide taxpayer subsidies for First Class Mail service to rural and distant areas. Instead, Congress chose to support universal service at uniform rates by requiring that rates be kept uniform within each class of letter mail sealed against inspection. This provision has been described by one Court as follows:

[T]he only policy concern clearly implicated in the quest for the proper scope of the monopoly [is] the need to shield operations from competition so the Postal Service can adopt nonmarket solutions in its effort to further various national goals (fn 9 For example, the cross subsidization inherent in

¹ The Commission was discussing the identical requirement then found in 39 U.S.C. 3623(d).

establishment of uniform rates regardless of distance for each class of mail sealed against inspection pursuant to 39 USC [404(c)] is inconsistent with a fully competitive market, as is the decision to locate post offices in some out-of-the-way places)... .

Associated Third Class Mailers v. U.S. Postal Service, 600 F.2d 824, 826 n. 9 (D.C. Cir. 1979).² [footnote original.]

Thus, 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.

4. The Postal Service and the Postal Rate Commission for many years have used a standard concept and process for calculating First Class rates. Witness Taufique described that concept in his testimony in R2006-1.

Since classification reform in Docket No. MC95-1, the structure of and approach to the relationship between the Single-Piece and Workshare rate categories in First-Class Mail have remained relatively constant. Workshare rates are determined by applying discounts to Single-Piece rates. These rate differentials (discounts) are based on estimates of costs avoided through each type of worksharing activity (e.g. prebarcoding and/or various levels of presortation). The cost differentials are developed by estimating avoidance of postal mail processing and related operations costs in comparison to a representative benchmark for workshare mail generally.³

In calculating costs avoided, the bulk metered mail letter (BMM) has been used as the benchmark piece since R97-1. This is the concept that was embedded in practice and understanding of the participants when the worksharing language for the PAEA was crafted and passed into law.

² The Court was discussing the identical requirement then found in 39 U.S.C. 3623(d).

³ USPS T-32, p. 12.

From the inception of First Class workshare discounts, there has been an understanding by both the Postal Service and the Commission that discounts must be justified by costs avoided so that similar letters being provided First Class service bear the same amount of the institutional costs of the Postal network. The process is to set a single uniform rate for First Class letters and validate discounts provided to Presort letters by the determining cost savings due to worksharing activities that allow the Postal Service to skip certain steps in processing that mail. The costs associated with the wide array of characteristics in the First Class mail stream have been averaged among all the First Class letter mailers because everything has been tied back to the overall Single Piece first ounce rate. In its R2006-1 Opinion the Commission rejected the Postal Service's attempts to delink the single-piece and workshare pieces stating:

In First-Class, the Postal Service proposed to “de-link” single-piece from worksharing rates. This practice would abandon the principle that worksharing discounts should be based on the costs avoided by worksharing activities. As applied by the Postal Service in this case, it would expand discounts beyond avoided costs, and unfairly shift the burden of this rate increase on to single-piece mailers. The Commission believes that mailers who workshare should be rewarded, and recommends discounts that fully reflect the costs avoided by worksharing. Because the de-linking approach does not equitably balance the interests of all mailers within a subclass, and does not follow established principles of rate design including Efficient Component Pricing, the Commission does not adopt it.⁴

The Postal Service and the PRC adopted this concept explicitly in the choice of BMM as the benchmark piece. In its R97-1 decision, the Commission states that it “accepts the Service’s proposed use of BMM as the benchmark for calculating First-Class worksharing discounts. Fronk’s use of BMM responds to the Commission’s

⁴ *Opinion and Recommended Decision R2006-1*, p. iii

concern that the current benchmark—all nonpresorted single-piece mail—captures more costs than warranted.” It then quotes witness Fronk’s testimony:

[n]onpresorted mail includes everything from ‘clean’ mail (uniform pieces featuring typewritten or pre-printed addresses and often mailed in bulk) to ‘dirty’ mail (pieces featuring handwritten and incorrect or incomplete addresses) and all the mail in between. Using all nonpresort letters as a benchmark results in a larger discount than using a benchmark which tends to have all the attributes of presort/automated mail, except for the actual presortation or application of the barcode.⁵

The PRC has continued to endorse the use of the benchmark BMM letter as the key to calculating costs avoided due to worksharing for First Class mail. In its Annual Compliance Report it explicitly stated that “[t]he Postal Service must discontinue the practice of changing established analytical methods in data filed with the Commission in support of price adjustments and Annual Compliance Reports.”⁶ The reason for the Commission to continue using this methodology was stated in its R2000-1 Opinion, “the contribution made by that mailer to institutional costs is the same as that mailer would have made without worksharing.”⁷ Once worksharing discounts are introduced and mailers pay different rates based on their worksharing activities, it is necessary to make the comparison to the benchmark piece in order to ascertain the letter rates are uniform across mailers.

In R2005-1 witness Abdirahman defined the benchmark piece “BMM letters are generally considered to be machinable, homogeneous, non-barcoded pieces with machine printed addresses that are properly faced and entered in trays.”⁸

The Postal Service has never directly calculated a cost for just this benchmark

⁵ *Opinion and Recommended Decision R97-1*, p.292 at 5092.

⁶ *Annual Compliance Determination, 2008*, p. 6.

⁷ *Opinion and Recommended Decision R2000-1*, p. 234 at 5060.

⁸ R2005-1, APWU/USPS-T21-8, R2005-1 Tr. Vol. 4 at 952.

piece. The unit costs for BMM letters must be approximated based on a broader category of letters, all First Class letter-shaped mail with metered postage. That category of costs contains several types of mail that do not conform to Mr. Abdirahman's definition of the benchmark piece.

In the past, several steps were followed to estimate the cost of the benchmark piece from the CRA analysis of First Class letters with metered postage. Some of those steps included determining which cost pools should be included in the calculations, because they could reasonably be expected to reflect BMM processing costs, and which of the cost pools should be excluded because it was not reasonable to assume that they reflected costs associated with BMM letters. We recommend that the cost pools for use in estimating the benchmark piece be re-evaluated and returned to something closer to those used in R2005-1.

One example is the decision in R2006-1 to include the flat sorting machine costs in the calculation of the costs associated with the bulk metered mail benchmark. This change was never fully explained and should be re-evaluated now that the Postal Service uses the flat sorters for Netflix-type materials and slim-jims.⁹ These clearly are not examples of what Mr. Abdirahman described as the benchmark piece and they do not represent what presorted mail would look like if it were to convert back to First Class or if it were to fail to meet the presort requirements and be assessed at single-piece rates. Other examples would be

⁹ The use of the bulk metered mail benchmark, which has a separate CRA cost estimate, leads the Commission to retain the system of classifying MODS pool costs into three groups (proportional, worksharing-related fixed, and non-worksharing related). The Commission employs an approach to assigning costs to the three groups that falls between the Postal Service proposal and the analysis proposed by Pitney Bowes. *Opinion R2006-1*, p. 147 at 5159.

including the costs associated with the small parcel and bundle sorters in the costs of the bulk metered mail letter. The Postal Service actively discourages any mailer from bundling their letters anymore and it is difficult to imagine how those machines could be used in the processing of the BMM piece. As technology progresses and the information collected from the intelligent barcode system improves, the Postal Service should have better data in the future to use in assessing these costs. In the mean time it is important to focus on calculating the costs as accurately as possible to reflect the mail piece in question. If extra costs are thrown in, then the costs avoided do not accurately reflect the principles of efficient component pricing and do not provide the market with the correct signals.

For the reasons stated above, we respectfully submit that there is no legal or factual warrant for departing from the use of the Bulk Metered Mail benchmark for determining workshare discounts. The Postal Service's efforts to de-link single piece and workshared mail must be rejected.

Respectfully submitted,

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