

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

**Priorities for Future Data Collection and
Analytical Work Relating to
Periodic Reporting**

Docket No. RM2011-3

INITIAL COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE

Pursuant to Commission Order No. 589, the Association for Postal Commerce ("PostCom") hereby submits these comments to express its belief that the Postal Service and the Commission should take advantage of data available through the Intelligent Mail barcode to create realistic mail flow models and improve the accuracy of the Postal Service's data collection and cost estimates. PostCom is submitting these comments in Docket No. RM2010-13 as well, as PostCom believes that workshare discount design and data collection for periodic reporting are necessarily intertwined—in setting priorities for data collection, one must be cognizant of the use to which that data will be put. These comments address Standard Mail only; PostCom takes no position with respect to other classes.

I. INTRODUCTION

In Order No. 536, the Commission took steps toward recognizing the fundamental change needed in the way the Postal Service prices its offerings. Although the Commission refused to recognize "products" as the unit of mail to which workshare discounts should apply, it developed a functional test for determining worksharing relationships that focuses on the markets served by types of mail and the use of mail by

postal customers. While PostCom still believes that, in most cases, there is no need to identify a “benchmark” product from which workshare discounts can be calculated, PostCom nevertheless applauds the Commission’s recognition that the identification of any benchmark must involve a detailed factual analysis. PostCom is also comforted by the Commission’s recognition that it must be willing “to re-evaluate facts or consider new facts when it is asked to modify the analytical principles that it accepts for modeling avoided costs.” Order No. 536 at 39.

Nevertheless, there is still significant work to do to ensure that the Postal Service’s prices—including workshare discounts—reflect the reality of how mailers make decisions regarding whether, and how, to mail. If the goal of Efficient Component Pricing—that each mail processing activity is performed by the lowest-cost provider—is to be achieved, changes to the Postal Service’s and the Commission’s approach to workshare discounts, and the data collection necessary to support those discounts, are necessary.

In these comments, PostCom suggest three modifications that will move the Postal Service toward more efficient pricing and allow it to increase volume and profitability by better serving the needs of its customers. First, PostCom urges the Commission to expand its sometimes narrow view of postal services and products and, through the factual inquiry it outlined in Order No. 536, recognize that most “workshared” postal products actually serve specific markets, meaning that changes in price alone do not dictate mailers’ decisions to choose one product over another. Second, the Postal Service and the Commission should develop product costs through a “bottom-up,” rather than “top-down,” process, beginning with the costs incurred for pieces of

mail that require the last work input from the USPS. Doing so will result in more accurate estimates of the costs incurred in processing different types of mail and allow for the development of more rational price relationships between different types of mail. Finally, to ensure that the Postal Service has accurate cost data on which to rely, the Postal Service should make greater use of Intelligent Mail barcode (“IMb”) data while phasing out its reliance on MODS and IOCS data.

II. THE COMMISSION AND THE POSTAL SERVICE NEED TO RECONSIDER ITS NARROW VIEW OF PRODUCTS

A. The PAEA Allows For a Flexible Approach

The Commission’s insistence on identifying benchmark products from which to calculate costs avoided by workshare discounts stems from the requirement in 39 U.S.C. § 3622(e)(2) that workshare “discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity.” While this mandate might appear to require the sort of rigid tying of workshared products to benchmark products the Commission imposes, the statute actually provides for a much greater degree of flexibility.

Specifically, 39 U.S.C. § 3622(e)(2)(D) essentially makes the issue of avoided costs irrelevant where “reduction or elimination of the discount would impede the efficient operation of the Postal Service.” This provision recognizes that the goal of providing workshare discounts—and the goal of the PAEA in general—is to create an environment where the Postal Service can operate in a more business-like manner, designing and pricing products suited to meet the needs of its customers, thereby resulting in a more efficient and profitable Postal Service. The section recognizes that doing so may result in prices that do not exactly track measured avoided costs for products which arguably have a worksharing relationship. Such prices nevertheless

might represent the most efficient prices given the realities of the mailing industry, especially when the tools available for measuring the costs incurred and avoided are imprecise.

B. Prices Should Reflect Products, Not Discounts for Specific Activities

Section 3622(e)(2)(D) provides the legal basis for a shift to a product-oriented approach to developing workshare discounts. In fact, it allows the Commission to shift away from the concept of “discounts” altogether to focus on the products actually being provided, the costs of providing those products, and the value of those products to mailers. In other words, where the Commission currently sees one product at a single level of worksharing, it should instead see numerous products serving separate markets. Workshare discounts are nothing more than pricing of products that entail and require certain functions to be performed by a mailer.

PostCom’s differences with the Commission on this score may be more theoretical than practical. PostCom believes that if the Commission engages in the type of factual inquiry that led it to conclude in Order No. 536 that High Density and Saturation Standard Mail do not have a worksharing relationship, it will likely find that there are few postal products that can reliably be benchmarked to another rate level that undergoes less worksharing activity. The process by which mailers choose postal products is focused on the most profitable ways to reach target audiences, not on whether it is worth the cost to engage in additional workshare activity. Nevertheless, PostCom believes that the more efficient route to this result is to abandon the focus on benchmarks and avoided costs in favor of a product-and-market oriented view of the postal industry.

The justification for this approach begins with the simple fact that there are a number of factors a mailer considers when developing a mailing. The primary factors, and the driving force behind the design of the mailing, are business factors independent of worksharing, such as the target market of the mailing and its anticipated response rate to different types of mail. A mailer cannot simply dropship a mailpiece into the system. There are rules and regulation around dropship requirements and the mailpieces that are entered.

That is, workshare and presort activities are not done in isolation, but together to meet postal rules and regulations. The Postal Service defines the presort process (DMM 245.1.0) as:

the process by which a mailer prepares mail so that it is sorted to at least the finest extent required by standards for the price claimed. Generally, presort is performed sequentially, from the lowest (finest) level to the highest level, to those destinations specified by standard and is completed at each level before the next level is prepared.

For example, to meet the 3-digit presort requirement, the ZIP code in the delivery address on all pieces in a mailing must begin with the same three digits. For dropship eligibility to a Destination Network Distribution Center (DNDC), a mailer must deposit pieces at a NDC, ASF (Area Sectional Facility), or SCF (Sectional Center Facility). Pieces must be addressed to one of the 3-digit ZIP codes served by the NDC or ASF, and pieces must be properly trayed or palletized. In the case of certain types of mail, there are further restrictions and requirements. Thus, machinable Standard Mail parcels may be entered at the DSCF if, but only if, they are presorted to 5 digits.

Although a mailer preparing mail to the level of a 3-digit presort has the option of not dropshipping this mailing, few choose that course. The USPS 2010 Standard Mail

piece-rated billing determinant shows that only roughly 22 percent¹ of all Standard Mail 3-digit automation letters are sent No Destination Entry. By contrast, 78 percent of 3-digit letters are destination entered at either the NDC or SCF.² The billing determinants also show for all piece-rated Standard Mail automation letters, 81 percent are dropship entered.³

It makes little sense to distinguish between the presort and drop-entry activities. In fact, what this data shows is that, where the Commission and the Postal Service see multiple products—*e.g.*, the 3-digit automation presort product and the DNDC-entered product, each with their own workshare discounts—there is, in fact only one product: mail sorted to the 3-digit automation standards and drop-entered. When evaluating whether a price complies with the Efficient Component Pricing, it is important to identify the proper component. In the example above, the component is the full product—presorting plus drop-entry—and not just one activity in isolation. In short, Efficient Component Pricing is a valuable tool for the recognizing the value of worksharing but only if the “component” is properly defined.

III. COST SYSTEMS ARE IN DIRE NEED OF A RENOVATION

Properly pricing the components of mail service, defined as products representing a bundle of services as described above, demands an ability to measure costs at the whole-product level. In PostCom’s view, the best way to develop such costs is through a “bottom-up” approach to costing. With this approach, rather than identifying a heavily

¹ See Library Reference USPS-FY10-4, FY2010 Market Dominant Billing Determinants at G-1, p.2 (22% = 3-digit automation letters No Destination Entry (2.816 billion pieces) / Total 3-digit automation letters (13.022 billion))

² *Id.* (78% = [NDC (5.309 billion) + SCF (4.897 billion)] / Total 3-digit automation letters (13.022 billion)).

³ *Id.* (81% = Mixed AADC NDC auto letters + AADC NDC auto letters + AADC SCF auto letters + 3-digit NDC auto letters + 3-digit SCF auto letters + 5-digit NDC auto letters + 5-digit SCF auto letters).

worked, benchmark product, then estimating the costs avoided when a mailer chooses a less-worked product, the Postal Service would instead begin by determining the costs of the least-worked product.

This approach would assist the Postal Service in developing products and prices that reflect the lowest combined cost for the service. It would provide mailers with rational incentives to prepare and enter mail in the most efficient manner. Thus, rationalizing the Commission and Postal Service's approach to recognizing workshare-type activities in this manner will reward mailers for their investments and encourage mail growth through the provision of products that meet the business needs of postal customers.

The Postal Service and Commission must start by determining the cost of the product that requires the least USPS handling, measure the work performed for the next upstream operation, and then add this unit cost to determine the cost of the next product. As applied to products currently offered by the Postal Service, if the Postal Service identified Standard Mail Enhanced Carrier Route (ECR) Saturation Destination Delivery Unit (DDU) as its least worked product, it could use bottom-up costing to calculate not only the cost of this product, but also to calculate the additional cost associated with any next product operation. This would create an end-to-end cost for each product or sub-product within a class, instead of connecting products to one another as is done using the current top-down approach. Under this approach, workshare “discounts” would no longer be relevant as the actual cost of the end-to-end operation would be used instead of work avoided for costing purposes. This approach also moots the difficult and often contentious question of defining the proper benchmark.

Although this approach does not rely on discounts and benchmark products, it nevertheless ensures, better than the current system, that products will be priced at levels that accurately recognize the work performed by both mailers and the Postal Service. By determining costs from the bottom up, the Postal Service will ensure that each product it offers reflects the costs incurred by the Postal Service in providing that product while excluding the costs incurred by mailers engaging in workshare activities. With prices that accurately reflect only the Postal Service's costs, mailers will be able to make rational decisions as to whether they can perform particular activities more efficiently themselves, or whether the more efficient course would be to purchase a more heavily worked product from the Postal Service. Thus, the requirement of 39 U.S.C. § 3622(e)(2) that workshare "discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" will be upheld even without a formal analysis of avoided costs. Further, the Postal Service will be less likely to shift costs to mailers under this approach. Because it will have more accurate estimates of the costs incurred for particular processing activities, the Postal Service will be better able to price its products to reflect its own costs and less inclined to shift costs to mailers through mandatory preparation requirements.

IV. INVESTMENT IS NEEDED IN INTELLIGENT MAIL

To effectively implement bottom-up costing, however, the Postal Service will need to improve its ability to measure costs. The current system of measuring costs is inadequate. As the Office of Inspector General ("OIG") determined, "Postal Service cost avoidance estimates may not accurately reflect avoided costs for workshare mail." Office of Inspector General, Audit Report – Workshare Discounts Exceeding Avoided Costs, Report No. MS-AR-11-001 at 6 (December 23, 2010). The OIG explained that "accuracy

of cost avoidance estimates is critical.” *Id.* at 7. Improperly estimating costs can lead to discounts that do not properly apportion costs between the services performed by mailers and the Postal Service, leading to improperly set discounts that “conflict[] with the efficient component pricing theory.” *Id.*

Likewise, in its comments on the Postal Service’s Annual Compliance Report for Fiscal Year 2010, the Public Representative recognized that Management Operational Data System (“MODS”) data, which is used to develop the estimates of costs and avoided costs currently used in developing workshare discounts, “suffers from certain flaws,” including small sample sizes for certain data sets and anomalous results from a large percentage of facilities in which the data is collected. Public Representative Comments in Docket No. ACR2010 at 22-24. Similarly, sampling and non-sampling problems associated with the IOCS, particularly as it relates to small volumes of mail, are so well known as to require no citation.

In sum, the Postal Service’s current methods of collecting and evaluating cost data are entirely and indisputably inadequate. While the OIG and the Public Representative, in recommending that certain workshare discounts be revised to reduce passthroughs of greater than 100%, ignored their own analysis of the accuracy of Postal Service costing and its implications, the Commission should not make the same mistake.⁴ It must instead focus on developing more accurate costing methodologies before

⁴ The OIG report is internally inconsistent. Although it explains that the avoided cost data reported by the Postal Service is inaccurate, it relies on that very data to reach the conclusion that many discounts exceed the costs avoided by the Postal Service without justification. There is no basis for this conclusion if the data reported by the Postal Service is inaccurate—the OIG cannot know whether the discounts actually exceed avoided costs without reliable data. Moreover, the OIG, like the Commission historically, maintains an improper focus on discounts and avoided costs rather than approaching workshare activities from a functional, product-oriented perspective.

suggesting any radical revisions to current workshare discounts. Such estimates are necessary to the task of developing the bottom-up costs essential to efficient pricing.

Fortunately, The Postal Service, has a tool at its disposal that is capable of providing accurate cost data that does not suffer from the sampling errors inherent in the current systems: the Intelligent Mail barcode (“IMb”). The Intelligent Mail barcode (IMb) was first introduced as a service measurement tool. Over time, due to the interest of the industry and the need to create additional value in the mail stream, the IMb and its related services have become a viable vehicle for implementing and maintaining bottom-up costing.

With the introduction of the IMb, the Postal Service has opened the door to new products and services that can add value to the mail, provide more precise information to mailers, and offer customizable messages to the recipient. Currently, the IMb is falling short of the expectations first envisioned by the industry and Postal Service, becoming a burdensome task that has caused more costs than benefits for both the Postal Service and its customers. Nevertheless, proper implementation and use of the IMb could create sustainable benefits for all parties.

One of the largest benefits the IMb can offer is its track and trace ability to capture how mail actually travels through the postal network. This real-time information shows where a piece is accepted and entered based on the tray or pallet scan that connects to the electronic documentation submitted by the mailer. It then shows machine-codes of where the mail is processed and sorted. Once the piece is delivery-point sequenced, it receives an “out for delivery” scan.

As the Postal Service collects this information for service reporting, it can begin to model costs in real-time for automation pieces. It can begin to move away from sampling and use the intelligent mail to generate costs for products. It will also open the door to tracking costs and mail flows for different customer segments, different shapes, and specific customers. Giving the Postal Service the opportunity to capture true cost of doing business and begin to offer prices that reflect the accurate effort of the mailer.

By fully utilizing the IMb, the Postal Service can revise its mail flows, which currently bear little, if any, relation to how mail actually moves through the system, to better represent the services the Postal Service actually performs on specific products. It will then be better able to estimate these products' costs, allowing it to build the bottom-up costs necessary for efficient pricing. PostCom submits that the IMb should serve as the foundation of the Postal Service's data collection, costing, and periodic reporting activities, and urges the Commission to work with the Postal Service to realize the full benefits presented by IMb.

V. CONCLUSION

The Commission took important steps in Order No. 536 toward eliminating irrational benchmark relationships between certain products and toward developing workshare discounts that respond to the ways in which mailers actually use the services offered by the Postal Service. PostCom contends that the Commission and the Postal Service must go further, however, and adopt a product-oriented approach to pricing. The Intelligent Mail barcode provides the Postal Service with the tools necessary to track its mail flows and develop cost estimates that accurately reflect the reality of mail processing. These estimates can then be used in a bottom-up fashion to develop prices

for products that recognize the work actually performed by the Postal Service and provide mailers with the information they need to make rational mailing decisions. Doing so will result in more efficient mail processing, encourage volume growth, and serve as a beginning step toward returning the Postal Service to profitability.

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