

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

**Consideration of Technical Methods to be
Applied in Workshare Discount Design**

Docket No. RM2010-13

REPLY COMMENTS OF PITNEY BOWES INC.

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I. INTRODUCTION AND SUMMARY OF POSITION

Pitney Bowes Inc. (Pitney Bowes) respectfully submits these reply comments pursuant to Order No. 537. These comments discuss: (1) the adoption of “Metered” mail as the base group for purposes of measuring First-Class Mail workshare discounts, (2) the proposals advanced by Stamps.com and Neopost to extend workshare discounts to PC Postage and postage meter users, (3) the Postal Service’s proposed methodology change to the Commission-approved cost pool classifications, and (4) the costing and pricing policy issues raised by the Greeting Card Association (GCA).

As discussed in detail below:

- The Commission should adopt “Metered” mail as the base group for purposes of measuring First-Class Mail workshare discounts. The consensus position of the initial comments, based on empirical data, confirms that the BMM benchmark is no longer valid and identifies “Metered” mail as the new base group. The empirical data also support the inclusion of collection costs in the “Metered” mail base group.
- Pitney Bowes supports the comments filed by Stamps.com and Neopost urging the Postal Service to extend the benefits of worksharing to small business and consumer mailers by providing channel-based discounts for more efficient, low cost, secure distribution and payment evidencing channels.
- The Commission should reject the Postal Service’s proposal to change the Commission-approved methodology for classifying First-Class Mail Presort Letters cost pools. The Commission-approved methodology is empirically-based and theoretically sound. The Postal Service presents no new costing studies to support the proposed changes, and the

qualitative analysis presented in its initial comments is incomplete and unsupported.

Accordingly, the Postal Service has failed to meet its burden to justify a change.

- Pitney Bowes supports GCA's proposal to directly measure the costs for Automation letters. Pitney Bowes disagrees with GCA's general criticism of the Postal Service's First-Class Mail Presort Letter cost models and its specific criticism of Pitney Bowes' proposal to adopt a 2-part CRA adjustment. Pitney Bowes also disagrees with GCA's discussion of the applicability of efficient component pricing (ECP) under the Commission's expanded conception of worksharing.

II. DISCUSSION

A. The Commission Should Adopt "Metered" Mail as the Base Group for Measuring First-Class Mail Workshare Discounts.

In Order No. 536, the Commission concluded that a worksharing relationship exists between First-Class Mail Presort Letters and Single-Piece First-Class Mail Letters, but that the BMM benchmark previously used to measure workshare discounts is no longer valid.¹ The Commission stated that a "factual inquiry to identify an appropriate base group" was required.²

Pitney Bowes and the Joint Commenters provided empirical data from a series of surveys collecting information from small business mailers, mail service providers, and large production mailers. The data confirm that BMM, a low-cost subset of Single-Piece First-Class Mail, is not representative of the mail at the margin of conversion. The data confirm that less than four percent of the mail converting to presort First-Class Mail is BMM. The typical mail piece at the margin of conversion is more like collection mail than BMM. Thus the Commission correctly determined that BMM was "obsolete."

¹ See Order No. 536, at 40.

² See *id.* at 21.

The data also confirm that “Metered” mail is an appropriate base group because its costs most closely approximate the identified cost characteristics of the mail most likely to convert to presort.³ The data show that an appropriate base group must have the specific cost characteristics of smaller mailings for which collection is frequently required. Moreover, the data show that the appropriate base group consists of letters that are not well organized (not trayed and faced) and not particularly “clean” (lacking address hygiene and design characteristics that facilitate efficient mail processing and delivery). The data confirm that the majority of this mail is metered, but some is stamped. “Metered” mail most closely reflects these characteristics. “Metered” mail is also a preferred base group because its costs are directly identifiable from the Postal Service’s existing cost system.

The data support the broad consensus among the initial comments, in which the majority of mailers and mailer groups identified a form of “Metered” mail as the appropriate base group. *See, e.g.*, Postal Service Comments at 8-10; GCA Comments at 13; PR Comments at 2; Joint Comments at 19-21. One area of disagreement is whether to include collection costs in determining the cost avoided by converting the “Metered” mail base group to presort. The Postal Service excludes collection costs. Based on the data submitted by the Joint Commenters the exclusion of collection costs is not justified and would result in a significant understatement of workshare-related costs avoided. Accordingly, as predicted by the Commission, collection costs should be included in a “Metered” mail base group.⁴

³ “Metered” mail as defined in the Postal Service’s existing cost systems includes metered mail, information based indicia mail (IBI mail) and PVI mail. *See* Dkt. No. RM2010-13, Response to CHIR No. 1 (Jan. 18, 2011) at 4 (IBI mail as discussed in the Postal Service’s response to CHIR No. 1 includes costs for digital meters and PC Postage solutions that use an information based indicia).

⁴ Order 536 at 8 (“[a]mong the elements of avoided costs that will be considered for inclusion are collection costs.”).

B. Channel-based Discounts Would Promote Efficiency and Extend the Benefits of Worksharing to Small Business and Consumer Mailers.

Stamps.com and Neopost urge the Postal Service to implement channel-based discounts to incentivize efficient, low-cost, secure Single-Piece First-Class Mail. *See* Stamps.com Comments at 5-6; Neopost Comments at 2. Pitney Bowes has consistently advocated in favor of extending the benefits of worksharing to small business and consumer mailers by providing incentives for the use of more efficient, low cost, secure distribution channels.⁵

Selling stamps across a post office retail window is expensive. The Postal Service could realize significant cost savings and increased contribution by encouraging customers to use more efficient distribution and payment evidencing channels (e.g., postage meters, PC Postage, Kiosks, on-line stamp sales, etc.). Under the PAEA price cap, the Postal Service has the pricing flexibility to implement discounts for efficient distribution and payment evidencing channels. It should do so. Channel-based discounts would have the beneficial effects of improving the efficiency of the Postal Service, “democratizing” workshare discounts, and increasing the visibility and service performance of an information-rich Single-Piece First-Class Mail mail stream. For all these reasons, Pitney Bowes supports channel-based discounts.

⁵ *See* PRC Dkt. No. R2000-1, Direct Testimony of John Haldi (PB-T-2), Concerning Proposal to Institute a Discount for First-Class Single-Piece Metered Mail on Behalf of Pitney Bowes Inc., (May 22, 2000); PRC Dkt. No. R2006-1, Revised Direct Testimony of Lawrence G. Buc (PB-T-3) on Behalf of Pitney Bowes Inc. (Nov. 6, 2006).

C. The Commission Should Reject the Postal Service’s Proposed Methodology Change to the Cost Pool Classifications.

The Postal Service contends that the Commission’s decision in R2006-1 to classify certain First-Class Mail Presort Letters cost pools for allied and support activities as worksharing-related “proportional” was wrong. *See* Postal Service Comments at 12-13; PRC Op. R2006-1 at 5161. The Postal Service proposes to reverse this prior decision and classify only the MODS and non-MODS cost pools (representing piece distribution and bundle distribution operations) as “proportional”; all other cost pools would be reclassified as “fixed.” *See id.* at 21. This proposal has no merit and should be rejected. First, an analysis of the available CRA cost data, the costing methods, and postal operations confirm the Commission’s R2006-1 decision correctly held that indirect (e.g., “allied” and “support”) mail processing activities and costs vary by presort level because these activities and costs support direct operations (e.g., sorting) whose costs indisputably vary.⁶ Second, the Postal Service has failed to meet its burden to justify reclassifying the allied / support cost pools; the Postal Service presents no new costing studies to justify the proposed changes, and the analysis presented in its initial comments is incomplete and unsupported by the record evidence previously submitted to the Commission.

⁶ The Postal Service criticized this indirect, “piggyback” approach, but this criticism is misplaced. The Postal Service has no one to blame but itself for the failure to explicitly model or directly estimate (using IOCS) allied/support costs by presort level for First-Class Mail Presort Letters. The Postal Service certainly has the capability to do both and could have done so in the four years since the Commission declared them proportional in Docket No. R2006-1. In fact, as early as Docket No. MC95-1, USPS witness Smith noted that modeling these costs was a goal of the Postal Service. USPS-T-10 at 5. As discussed below, classification of the indirect costs as proportional is justified by the CRA cost and operational analyses discussed below and the “piggyback” approach for indirect costs is consistent with the Postal Service’s established approach for attributing and distributing costs to products. *See* FY 2009 Summary Description of USPS Development of Costs by Segments and Components (July 1, 2010) at H-4, H-6.

1. Background

The CRA disaggregates mail processing costs into cost pools. The cost pools represent specific operational tasks. In the Presort Letter cost model, these cost pools are classified as either “proportional” or “fixed.” “Proportional” cost pools represent mail processing costs that vary by presort level; “fixed” costs pools represent mail processing costs that do not. In Docket No. R2006-1 the Commission correctly held that all cost pools that include mail processing costs that *directly or indirectly* vary by presort level, including most costs in allied/support operations, should be classified as “proportional,” whether they have been modeled or not. PRC Op. R2006-1 at ¶ 5160.

In this proceeding, the Postal Service again suggests that all cost pools that are not directly modeled should be treated as “fixed” regardless of whether the cost for these activities vary with presort level. Based on this belief and based on no analysis, in Docket No. R2006-1, the Postal Service classified almost 78 percent of the cost pools in First-Class Letter Mail as “fixed” (this represented more than 35 percent of the total mail processing costs). Table 1 summarizes the Postal Service’s cost pool classifications as proposed in Docket No. R2006-1. The Commission rejected this proposal.

Table 1. USPS Classification of Proportional and Fixed Cost Pools (As proposed in R2006-1)

Pool Classification	Number of Pools	Percent of Pools	Unit Cost	Percent of Unit Cost
Proportional	14	22.2%	3.234	64.7%
Fixed	49	77.8%	1.766	35.3%
Total	63	100.0%	5.000	100.0%

Source: USPS-LR-L-110, PRC FCM.xls, Tab CRA - Presort Letters

Table 2 presents the same information from the Postal Service’s current proposal. The Postal Service proposes to classify approximately 60 percent of the cost pools in First-Class

Letter Mail as “fixed” (representing slightly more than 29 percent of the total mail processing costs). The main difference in the Postal Service’s current proposal and the Postal Service’s position in Docket No. R2006-1, is that the Postal Service no longer opposes the classification of “anomalous” cost pools as “proportional.”⁷

Table 2. USPS Classification of Proportional and Fixed Cost Pools (Current Proposal)

Pool Classification	Number of Pools	Percent of Pools	Unit Cost	Percent of Unit Cost
Proportional	25	40.3%	4.062	70.8%
Fixed	37	59.7%	1.672	29.2%
Total	62	100.0%	5.733	100.0%

Source: Docket No. RM2010-13, RM10.13.Intl.Commnts.xlsx, "CRA - PRESORT LETTERS"

Accurate classification of the cost pools is important because it directly affects measurement of avoided costs which in turn affect prices. The failure to classify cost pools that vary with presort level as proportional will result in understated workshare cost avoidance estimates and inefficient price signals. These classifications should be done with care, not by guess. Notwithstanding the importance of these classifications, in Docket No. R2006-1 the Postal Service conceded that it had no econometric, operational, or other studies to corroborate classification of certain cost pools as “fixed.” Rather that the determination was made based on whether the Postal Service had studied or modeled the costs involved: “[a]nything that’s in the fixed cost pool is what I have not modeled.” Docket No. R2006-1, Tr. 4/619 (PB/USPS-T-22-4 (Abdirahman)). The Postal Service further conceded that “its possible that some costs would in those cost pools [classified as “fixed”] vary for mail of different presort levels.” *See id.* at Tr. 4/670; Tr. 4/618; Tr. 35/12048. In effect, the Postal Service guessed.

⁷ “Anomalous” cost pools are those in which costs for First-Class Mail letters are unexpected. For example, IOCS tallies that reflect First-Class Mail letter mail processing costs in a manual parcel sorting operation.

In Docket No. R2006-1 the Commission chose not to guess, and relied instead on its own analysis and that of Pitney Bowes witness Buc. Witness Buc presented four separate analyses of the relevant cost pools: (1) an analysis based on the Postal Service's CRA cost data, (2) a review of the Postal Service's attribution and distribution costing methods, (3) a review of the classification of "anomalous" cost pools, and (4) an operational analysis. Docket No. R2006-1, PB-T-2 (Buc) at 13-28.

Application of these same analyses in this case confirms the Postal Service's current proposal would improperly classify as "fixed" cost pools which are properly classified as "proportional" because the activities and costs in those pools are affected by worksharing. Reversing the Commission-approved cost pool classifications would, thus, degrade rather than improve the quality of the workshare cost avoidance estimates for First-Class Mail Presort letters.

2. CRA Cost Data Analysis Supports the Commission-approved Methodology

The cost data analysis compares unit CRA costs for Single-Piece and Presort First-Class Mail letters in cost pools that the Postal Service defines as "fixed," primarily allied and support pools, and those it defines as proportional, primarily piece and bundle sorting pools. If the Postal Service is correct that allied / support costs do not vary with presort level, one would expect allied / support costs for less-workshared letters (for illustrative purposes, Single-Piece letters) to be similar to those for more-workshared letters (Presort letters) – after all, these costs are supposedly fixed with respect to presort level. Alternatively, if the Commission is correct that allied / support costs do vary with presort level, one would expect allied / support costs for Single-Piece letter to be substantially higher than those for Presort letters. In Docket No. R2006-1, the data revealed that the Single-Piece letter fixed unit cost was more than three times the

fixed unit cost for Presort letters. *See* Docket No. R2006-1, PB-T-2 (Buc) at 15. This showed that the costs the Postal Service classified as “fixed” in fact varied with presort level. Thus, the CRA data established that costs defined as “fixed” by the Postal Service were improperly classified. *See id.* at 14-17.

Table 3, below, shows the Postal Service’s current proposal suffers from the same infirmity.

**Table 3. FY 2010 CRA Cost Data Analysis – Total USPS Pools
(Current Proposal)**

Ratio Range	Number of “Fixed” Pools with Specified Ratio of Single-Piece Metered Letters to Presort Letters Unit Cost	Unit Costs	
		Single-Piece Metered Letters	Presort Letters
Less than 1	4	0.012	0.065
Between 1 and 2	8	0.727	0.507
Between 2 and 5	13	2.624	0.961
Over 5	9	1.207	0.138
Total Pools	34	4.569	1.672
Source: PB-LR-1, "1"			

Under the Postal Service’s current proposal, 30 out of 34 cost pools that the Postal Service classifies as “fixed” actually have unit costs that are greater for Single-Piece letters than for Presort letters. The costs vary with presort level on a cost-pool by cost-pool basis. In fact, the overall ratio of the “fixed” unit costs in Single-Piece letter cost is essentially the same today (2.73) as it was in Docket No. R2006-1 (3.06). Once again the Postal Service’s own CRA unit cost data shows that allied / support costs for single-piece letters are substantially higher than they are for Presort letters. This data provides no basis for changing the Commission-approved methodology.

An analysis of the four specific cost pools – MODS Platform; NonMODS Allied; MODS Presort; and MODS Mechanical Tray Sorter / Robotics – discussed by the Postal Service in its

current proposal reinforces the conclusion that these cost pools are properly classified as proportional. As above, a simple comparison of the “fixed” costs for Single-Piece and Presort letters in these cost pools provides a good starting point. Table 4, below, shows that Single-Piece unit costs for each cost pool is greater than the cost for Presort. In the aggregate, costs for these four pools that the Postal Service proposes to classify as “fixed” are 2.26 times greater than the Presort unit costs for the same four pools. If these cost were truly fixed with respect to presort level, one would expect them to be about the same. But, in fact, they vary with presort level. Moreover, they vary with presort level almost exactly to the same degree that the proportional costs vary with presort level: the ratio of Single-Piece piece handling costs (proportional costs) to Presort piece handling costs is 2.23 as compared to the 2.26 ratio for the “fixed” cost pools.

Finally, while the piece sorting unit costs are expected to be larger for Single-Piece than they are for Presort (and they are), if the “fixed” costs are actually fixed, they should be the same on a unit basis for both Single-Piece and for Presort. This means that the ratio of “proportional” costs to “fixed” costs should be smaller for Presort Letters than for Single Piece. As Table 4 show, however, they are actually about the same. This is yet another indication that the costs classified as fixed by the Postal Service actually vary with presort level.

**Table 4. FY 2010 CRA Cost Data Analysis – 4 Designated Cost Pools
FY2010 Cost Per SP Metered and Presort Letters (in Cents)**

Cost Pool Category	SP Metered Letters	Presort Letters	Ratio	
Piece Sorting (Proportional)	9.04	4.06	2.23	
4 Designated “Fixed” Cost Pools	2.05	0.91	2.26	
Ratio	4.41	4.46		
Source: RM10.13.Intl.Cmmnts.xlsx, worksheets “CRA-METERED LETTERS” and “CRA – PRESORT LETTERS”				

Indeed the costs for the Postal Service proposed “fixed” cost pools vary to a similar extent to those classified as “proportional,” i.e., those cost pools that support direct operations (e.g., piece-sorting). This further validates the correctness of the Commission’s decision in Docket No. R2006-1.

3. The Postal Service’s Attribution and Distribution Costing Methods Support the Commission-approved Methodology

The Commission’s conclusion that allied / support costs are at least indirectly affected by worksharing is also consistent with the Postal Service’s own attribution and distribution costing methods. Testimony submitted by the Postal Service’s attribution and distribution witnesses in Docket No. R2005-1 confirms that the Postal Service’s attribution and distribution methods for allied labor and for general support labor depend on the fact [assumption? Is it really a fact?] that the costs for these activities are proportional to piece sorting costs, which in turn depend on presort level. *See e.g.*, Docket No. R2005-1, USPS-T-12 (Bozzo) at 14; Tr. 10/2549-50 (PB/USPS-T12-2 (Bozzo)); USPS-T-11 (Van-Ty-Smith) at 18-19; Tr. 10/2460 (PB/USPS-T11-1 (Van-Ty-Smith)).

Witness Buc summarized the issue as follows:

Postal Service attribution and distribution methods show that container handling, allied labor, not handling, and general support costs vary with piece handling costs. And because piece handling costs vary with presort level, so too must the container handling, allied labor, and general support costs. Thus, according to both the attribution and distribution theory of the Postal Service, all of the cost pools that are classified as “fixed” actually vary with respect to presort level.

Docket No. R2006-1, PB-T-2 (Buc) at 20.

The Postal Service’s attribution and distribution theory and methods have not changed since Docket No. R2006-1. The Postal Service did not rebut this testimony in that docket and it

does not address this issue in this one. So, there is no basis to alter Commission's prior finding that allied / support costs are at least indirectly affected by worksharing.⁸

4. An Operational Analysis Supports the Commission-approved Methodology

In Docket No. R2006-1 witness Buc performed extensive operational analysis of the mail processing cost pools for First-Class Mail letters. *See* Docket No. R2006-1, PB-T-2 (Buc) at 22-29 (attached as PB-4). Witness Buc examined the cost pools through the lens of both (1) the Postal Service's Summary Description of Cost Segments which provides an explanation of activities in the mail processing cost pools and (2) the detailed descriptions of mail processing activities for First-Class Mail letters provided by Postal Service operations witness. *See* Docket No. R2006-1, Tr. 11/2922(PB/USPS-T42-5 (McCrery)). Detailed operational analysis of the following cost pool Letter Tray Sorting Operations – Mechanical Tray Sorters/Robotics, Dispatch Operations, Opening Unit Manual Transport Operations, Scanning Mail Operations, Platform Operations, Allied Labor Operations, and Miscellaneous and General Support Operations – confirmed that cost pools that the Postal Service classified as “fixed” (then and now), include costs that are affected directly or indirectly by worksharing.

5. The Postal Service's Analysis is Incomplete and Internally Inconsistent and, Therefore, Should be Rejected

The Postal Service has had four years since Docket No. R2006-1, to develop and report new cost studies or other evidence to challenge the above analysis and the Commission-approved methodology. But, it provides none. Its only support of the proposal to change an established

⁸ The parallels between the Postal Service's attribution and distribution methods and the Commission's finding that allied / support cost pools are indirectly affected by worksharing stand independent of the econometric evidence on attribution; thus, the Commission's rejection of the Postal Service's attribution levels has no effect on this argument.

analytic principle, is an “operational discussion” that is incomplete, internally inconsistent, and inaccurate.

The Postal Service complains that the Commission’s approach arbitrarily reclassifies certain cost pools previously identified as “fixed.” Yet it seeks the reversal of the Commission-approved methodology for 26 cost pools on the basis of its qualitative analysis of only four cost pools. Moreover, as discussed above, a comparison of Single-Piece and Presort letter unit costs for these four cost pools confirms that the Commission correctly held that they should be classified as “proportional,” not “fixed.”

The Postal Service’s “operational discussion” is internally inconsistent. For example, the Postal Service’s discussion of the non-MODS ALLIED cost pool focuses exclusively on platform costs. *See* USPS Comments at 18-19. But the Summary Description⁹ makes clear that this cost pool also includes costs for “collection activities, moving mail to/from other operations, separating/breaking down mail, other allied labor activities.” Summary Description at 3-11. The Postal Service’s “operational discussion” fails to address a key basis for the Commission’s conclusion: that support operations (e.g., “moving mail to / from other operations”) vary by presort level because these costs generally support direct operations (e.g., piece sorting).

The Postal Service’s discussion of the MODS PRESORT cost pool is similarly deficient, focusing exclusively on only one activity, sorting letter trays from a given mailing into rolling stock containers. *See* USPS Comments at 20. The Summary Description makes clear that this is much more of a catch-all operation including “[a]ctivities related to handling of presort mail volumes, including traying or banding of presort mail.” Summary Description at 3-7. The Postal Service’s contention that this cost pool is focused on the handling of Presort Mail is clearly

⁹ Summary Description of Development of Costs by Segment and Component (July 1, 2010)(“Summary Description”)

inaccurate. The Postal Service data show unit costs for Single-Piece letters in this cost pool, indeed, the unit cost of Single-Piece letters in this cost pool is higher than the unit cost for Presort Letters. *See* RM10.13. Intl.Cmmnts.xlsx, worksheets “CRA-METERED LETTERS” and “CRA – PRESORT LETTERS.”

The Postal Service’s operational discussion can be reduced to the following argument: (1) platform costs (e.g., tray sortations) vary only with the number of facilities through which mail passes, *see* USPS Comments at 18, (2) presort level has no effect on the number of facilities through which mail passes, *see id.* at 18-19, (3) therefore, presort level has no effect on the number of times letter trays are sorted. *Id.* at 17. Each of these assertions is demonstrably false. All three assertions ignore the efficiencies that accompany the density of highly-presorted mailings.¹⁰ Due to their large volumes (*i.e.*, density), highly-presorted mailings are prepared and entered on pallets that are presorted by destination (“pallet separations”).¹¹ Furthermore, mailers of highly-presorted mailings assign postal transportation for their trays using the *PostalOne!* Transportation Management System.¹² For example, Pitney Bowes Presort Services (PBPS) facilities prepare pallet separations for distinct destinations. In some cases PBPS facilities may prepare over 100 separations. Every one of these facilities also assigns postal transportation using the *PostalOne!* Transportation Management system. These separations are a function of

¹⁰ In Docket No. RM2009-3, the Commission concluded that “the four workshare characteristics named in section 3622(e) include integral associated workshare characteristics. If mail with one of the four workshare characteristics named in section 3622(e) must also have an integrally-related characteristic in order to avoid all of the costs that the named workshare characteristic is designed to avoid, the associated characteristic will be included in the avoided cost calculation...[and that] density is sufficiently related to presorting to satisfy the guidelines, at least in the context of First-Class Mail.” PRC Order No. 536 at 4.

¹¹ Large mailers work with the Postal Service to determine the appropriate separations. Docket No. R2005-1, Tr. 5/1776. Needless to say, smaller mailers of Presort Letters are not prepared on pallets at all, let alone pallet separations. For example, the total weight of a 500-piece mailing of a typical-weight Presort Letter would be less than 25 pounds. Given the density of this mailing, it wouldn’t make sense to enter it on pallets.

¹² Docket No. R2006-1, Direct Testimony of Lawrence G. Buc (PB-T-2) at 23-24; Direct Testimony of Richard Bentley (MMA-T-1) at 23-24. These are not the only additional activities that large mailers typically perform for the Postal Service. Mr. Bentley provides a list of other typical activities performed by large Presort Letter mailers. *Ibid.*

both density *and presort level*. In some cases pallet separations are prepared of only 5-Digit Automation letters. Intuitively, these activities allow pallets of finely-presorted mail to bypass certain mail processing activities and, often, to bypass certain facilities altogether.

Contrary to its current position, the Postal Service has previously acknowledged that preparing mail in this manner reduces Postal Service's platform, tray-sorting, and other allied costs.¹³ In Docket No. R2005-1, the Postal Service's operations witness confirmed that:

“[P]allet separations” (i.e., pallets of First-Class Mail letter trays that destinate to different local/non-local postal facilities) prepared by mailers at the request of the Postal Service allow the Postal Service to either transport the pallets directly to the final local facility (e.g., local plant, air mail center, hub and spoke facility, or mail consolidation center), typically avoiding platform and other mail processing operations at an intermediate local facility, or crossdock the mail at an intermediate local facility, typically avoiding entering, staging, and breaking down the pallet, sorting the trays into rolling stock, and staging and loading the rolling stock at the intermediate local facility.

Docket No. R2005-1, Tr. 5/1682 (PB/USPS-T29-13 (McCrery Response)).¹⁴

In the same case the Postal Service operations witness stated that pallet separations reduce the number of facilities through which the mailing passes by allowing some origin facilities to be bypassed in their entirety, thereby reducing platform (and transportation) costs:

In some cases, the containers for specific facilities/destinations prepared by mailers are transported directly out of the mailer facility bypassing the pallet sort/cross-dock operation on the platform at the local plant, which in some cases may also result in the savings of one transportation leg.

¹³ As detailed by witness Buc, preparing mail in these ways is not the only reason why costs in these activities are affected by presort level. Docket No. R2006-1, PB-T-2 (Buc) at 22-23.

¹⁴ Similarly, MMA witness Bentley explained, “Consistent high volume mailings also serve to minimize postal transportation and related costs as well. Trucks can be filled at the mailer's location and sent directly to an airport or HASP and often directly to a destinating postal facility. Such mail bypasses intermediate processing locations and avoids operations such as cross docking and breakdown, re-sortation of trays onto pallets and shrinkwrapping the new pallets.” Docket No. R2006-1, MMA-T-1 (Bentley) at 24.

Docket No. R2005-1, Tr. 5/1645 (PB/USPS-T29-5 (McCrery Response)). The Postal Service operations witness also stated that pallet separations reduce allied costs in general (and tray sorting costs in particular) at origin facilities through which they pass:

When trays are placed on pallets by the mailer for specific facilities/destinations, *the process of sorting the trays at the origin plant can be avoided*. Instead of moving the unsorted trays to a staging area, then sorting the trays using one of the methods listed in response to PB/USPS-T29-3, then moving the sorted containers to the SWYB and/or dock for dispatch; the pallets/containers prepared for specific facilities/destinations can be directed to SWYB and/or to the platform for pallet sorting and placement on outbound transportation bypassing one tray breakdown operation.

Docket No. R2005-1, Tr. 5/1644 (PB/USPS-T29-5 (McCrery Response))(emphasis added).

In Docket No. R2006-1 the Commission held that the Postal Service's assumption that the cost of non-modeled operations are not affected by worksharing to be "insufficiently supported." PRC Op. R2006-1 at ¶ 5160. That decision was clearly correct. The Commission should likewise reject the Postal Service's current proposal to change to the Commission-approved methodology. The Postal Service presents no new costing studies to support the proposed changes and, for the reasons discussed above, the qualitative analysis presented in the Postal Service's initial comments is incomplete and unsupported.

D. The Commission Should Consider Improving the CRA Adjustment Process in the First-Class Mail Presort Letter and Standard Mail Regular Presort Letter Cost Models.

The Commission specifically invited comments on whether the use of two Cost and Revenue Analysis (CRA) adjustment factors to develop workshare discounts would be appropriate. *See* Order No. 537 at 2-3. Pitney Bowes has raised this issue previously and continues to believe that by using a single adjustment factor to tie modeled costs back to actual

costs reported in the CRA,¹⁵ the letter cost models filed in Docket No. ACR2010, USPS-FY10-10 may understate the cost avoided by improving the presort level of First-Class Mail and Standard Mail Regular letters. Accordingly, Pitney Bowes proposed that the Commission consider adopting First-Class Mail Presort and Standard Mail Regular Presort letter cost models that use separate CRA adjustment factors for incoming secondary (IS) and non-IS costs.

GCA disagrees. GCA's specific criticism of a 2-part CRA adjustment appears to be grounded in a general criticism of the Postal Service's First-Class Mail Presort Letter cost models.¹⁶ *See* GCA Comments at 38. Pitney Bowes does not share such a dim view of the accuracy of the cost models. Once an appropriate base group is identified and modeled costs appropriately adjusted for consistency with the CRA, the First-Class Mail Presort letter cost model will provide reasonable estimates of mail processing costs and cost avoidances.

In fact, the discrepancies identified by GCA between modeled costs and CRA costs provides evidence that (1) the PRC-approved cost pool classifications are appropriate; and (2) a deaveraged CRA adjustment is necessary. Modeled costs for Presort Letters are less than CRA costs for two main reasons. First, the cost model makes no attempt to model allied and support costs. *See* USPS Comments at 15. Not modeling these costs (approximately 1.3 cents per piece for Presort Letters)¹⁷ is not evidence of errors in the model, but rather that the model is under inclusive. The PRC's approach of classifying the majority of allied and support costs as "proportional" appropriately allows these costs, consistent with the discussion in other sections

¹⁵ Because the letter cost models serve only to deaverage the cost of presort letters by presort level, this problem does not affect the average cost avoidance between Single-Piece and Presort letters. Thus, adjusting the CRA adjustment process should have no effect on the average rate difference between Single-Piece and Presort letters.

¹⁶ GCA's assertion that further deaveraging of CRA adjustments would necessarily result in larger adjustments for less-workshared mail is completely unsupported. *See* GCA Comments at 30-31. There is no reason why this would have to be so.

¹⁷ The sum of CRA costs in cost pools identified as allied/support sorting in Docket No. ACR2010, USPS-FY10-10, USPS-FY-10_FCM_PRST_LETTERS_MPFinal.xlsx, "CRA - PRESORT LETTERS."

of these comments, to vary with presort level.¹⁸ Second, the Postal Service’s model understates letter sorting costs by approximately 20 percent,¹⁹ an amount that (given the complexity of the Postal Service’s mail processing network) is unsurprising and certainly not evidence of a fatal flaw in the model. Further analysis of the discrepancy strongly suggests that the degree by which the model understates actual costs is not uniform and, thus, the adjustment necessary to ensure consistency should not be uniform.

As Table 5 below shows, both the First-Class Mail and Standard Mail cost models have consistently understated the costs the Postal Service incurs to sort Presort Letters to 5-Digit ZIP (i.e., non-incoming secondary (non-IS) sorting costs) while overstating (slightly for First-Class Mail) costs to sort Presort Letters from 5-Digit ZIP to carrier route and delivery point sequence (i.e., incoming secondary (IS) sorting costs). To compensate for the nonuniformity of the discrepancy between CRA and modeled costs, the adjustment to non-IS sorting costs should be larger than that to IS sorting costs. The two-part CRA adjustment improves the models by making this correction.

Table 5. First-Class Mail and Standard Mail Presort Letter Ratio of CRA-to-Modeled Costs²⁰

		First-Class Mail		Standard Mail	
		IS	Non-IS	IS	Non-IS
2010	[1]	0.984	1.681	0.843	1.396
2009	[2]	0.969	1.611	0.802	1.498
2008	[3]	0.979	1.557	0.773	1.411
2007	[3]	0.986	1.449	0.815	1.308

¹⁸ Alternative ways to allow these costs to vary with presort level would be for the Postal Service to model these costs or directly estimate these costs by rate category using IOCS. The Postal Service has done neither.

¹⁹ The weighted average modeled cost of 3.0 cents is 20 percent less than the CRA cost in cost pools identified as piece-sorting. Docket No. ACR2010, USPS-FY10-10, USPS-FY-10_FCM_PRST_LETTERS_MPFinal.xlsx, “PRESORT LETTERS SUM” and “CRA - PRESORT LETTERS.”

²⁰ The ratios of CRA-to-modeled costs in Docket No. R2006-1 are consistently lower than in the 2007 to 2010 models are caused because the R2006-1 model relied on older and lower read / accept rates. Holding all else constant, these older read / accept rate data overstated the percentage of letters that are sorted manually and thus letter-sorting costs. More recent read / accept rate data were used in the more recent cost models.

R2006-1	[3]	0.804	1.205	0.639	1.098
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[1] PB Initial Comments at 5

[2] PB-2 (2009) and PB-3 (2009)

[3] RM2009-3, PB Initial Comments at 13

E. Direct Costing for Presort Letters Should be Explored.

Pitney Bowes supports GCA’s proposal to directly measure the costs for Automation Letters using the In-Office Cost System (IOCS). Directly estimating mail processing costs for Automation Letters would be an improvement over the current method.

GCA’s recommendation is limited to directly estimating the costs for 5-Digit Automation Letters. Pitney Bowes would extend this approach to all Automation Letter rate categories (Mixed Automated Area Distribution Center (MAADC), AADC, and 3-Digit). Extending this approach to all Automation Letter rate categories would allow cost avoidances within Automation Letters to be directly estimated, rather than modeled.

As a practical matter, there is sufficient volume to allow costs for these categories to be estimated with an acceptable level of sampling error. As Table 6 below shows, each First-Class Mail Automation Letter rate category has substantial volumes (even the smallest of these rate categories contains about the same volume as Presort Cards, a category containing about three billion pieces and for which the coefficient of variation (CV) for mail processing costs is approximately six percent). Docket No. ACR2010, USPS-FY2010-37, IOCS PRC CV Summary FY10 public.xls, “Mail Proc.”²¹

²¹ Due to their much larger volumes, the coefficient of variation for the largest Automation Letter rate categories – 3-Digit and 5-Digit – would be substantially less than six percent. A CV of six percent is about the same as those for the High Density and Saturation Letter and High Density and Saturation Flats/Parcels and compares favorably to CVs for Bound Printed Matter Flats, Periodicals In-County, and several special services.

Table 6. FY 2010 First-Class Mail Automation Letter Volumes (in Thousands)

Presort Level	Volume
Mixed AADC	2,540,785
AADC	3,255,007
3-Digit	15,367,447
5-Digit	20,967,385

Pitney Bowes recommends that the Postal Service explore direct costing for Automation Letters as an issue for consideration in Docket No. RM2011-3, Priorities for Future Data Collection and Analytical Work Relating to Periodic Reporting.

F. There is No Inherent Tension Between the Commission’s Expanded Workshare Definition and Efficient Component Pricing.

Pitney Bowes disagrees with GCA’s discussion of the applicability of efficient component pricing (ECP) under the Commission’s expanded conception of worksharing. *See* GCA Comments at 19. GCA contends that ECP is not well-suited to the Commission’s expanded workshare definition because it may be difficult to price mailer activities that reduce Postal Service costs, but for which there is no mirror-image activity that the Postal Service would otherwise perform. *See id.* at 21.

While Pitney Bowes is concerned that the expanded definition of worksharing activities could impair the Postal Service’s flexibility to price based on non-cost factors, it does not share GCA’s concerns regarding the applicability of ECP to a larger list of private sector activities that reduce Postal Service costs. This is not a new issue. This specific issue was addressed in testimony by Pitney Bowes witness Panzar in R2006-1. Witness Panzar discussed the applicability of ECP to an expansive theoretical conception of worksharing encompassing “any private sector *activity* which *reduces the costs* of the Postal Service.” Docket No. R2006-1, PB-T-1 (Panzar) at 7. The relevant inquiry in witness Panzar’s formulation is whether the mailer activity reduces Postal Service costs, not whether the specific activity is one that displaces the

very same activity at the Postal Service. Panzar then goes on to discuss how ECP promotes productive efficiency in the context of “multiple dimensions of worksharing”:

The discounts for these various activities must also be structured so as to induce efficient choices on the part of mailers. That is, when there are two or more levels of worksharing possible, efficient discount policy must not only induce efficient worksharing, but also induce mailers to select the most efficient worksharing option. Again, ECPR-based worksharing discounts based upon Postal Service unit avoided cost will accomplish this.

Id. at 26-27.

GCA cites to address quality as an example of a mailer activity for which “ECPR cannot be used to ground a discount.” GCA Comments at 23. But address quality was one of three specific examples that Panzar discussed in his R2006-1 testimony. Docket No. R2006-1, PB-T-1 (Panzar) at 15. Panzar concluded that ECP could be used to appropriately establish prices that incentivize mail that avoids the costs of forwarding / returns and discourage mail that incurs such costs, stating, “[i]f surcharges for forwards and returns were set at cost, those who could correct addresses for less than the Postal Service’s cost to do so would do so themselves. And those who could not, would not.” *Id.*

III. CONCLUSION

For the reasons set forth above and in Pitney Bowes initial comments, Pitney Bowes respectfully requests that the Commission: (1) establish “Metered” mail, including collection costs, as the base group for purposes of measuring First-Class Mail workshare discounts, (2) reject the Postal Service’s proposed methodology change to the Commission-approved cost pool classifications, and (3) adopt a two-part CRA adjustment for First-Class Mail Presort and Standard Mail Regular Letters to improve the accuracy of the reported mail processing costs.

Respectfully submitted:

/s/

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