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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 THE ASSOCIATION FOR POSTAL COMMERCE

Pursuant to Commission Orders No. 537 and 568, the Association for Postal Commerce ("PostCom") hereby submits these reply comments to respond to the views expressed by other parties in this proceeding. These comments address Standard Mail only; PostCom takes no position with respect to other classes, and PostCom's discussion of comments submitted regarding other classes is meant to opine on those classes only as the issues raised bear on issues facing Standard Mail.

I. INTRODUCTION

In its initial comments, PostCom explained "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," and that consequently, "in most cases, there is no need to identify a 'benchmark' product from which workshare discounts can be calculated." Initial Comments of the Association for Postal Comments ("PostCom Initial Comments") at 1-2. The comments submitted by other parties to this proceeding testify to the truth of these statements. While many of the commenters dutifully engage in a search for some class of mail that represents a reasonable "benchmark" from which to construct First Class workshare discounts, in doing so, the parties demonstrate the practical difficulties of identifying this type of mail. The result is that each party selects what is essentially an arbitrary construction to serve as the benchmark for First Class Mail presort discounts, discounts that will inevitably be based on faulty cost data and outdated functional mail flows. In PostCom's view, these comments only serve to highlight the urgent need for the Commission to continue the strides it made in Order No. 536 toward revamping its entire approach to evaluating workshare discounts.

As PostCom indicated in its initial comments, much more goes into a decision to prepare mail to a particular presort and drop-entry level than simply looking at whether the discount for certain activities justifies the additional mail preparation steps. From the mail owner's perspective—and from the perspective of the mail service provider—what drives the decision making process are two elemental considerations: the total combined cost of using the mail,[1] and the return on investment that the mailing is expected to achieve. It is these considerations that the Commission must recognize in developing the technical methods to apply in workshare discount design, with the Postal Accountability and Enhancement Act ("PAEA") permitting the Commission to do so. While PostCom recognizes that the Commission may continue to insist on the identification of benchmark products,[2] it must use these benchmarks in a way that does not restrict the pricing flexibility the Postal Service needs to respond to the factors that truly drive mailers'

[1] Total cost includes, but is not limited to, costs stemming from postage, preparation requirements, mailpiece design, printing costs, and other factors.
[2] PostCom reiterates, however, that rather than engage in the essentially arbitrary task of identifying (or creating) benchmark products for each type of mail, the Commission, mailers, and the Postal Service would be better served by treating the various types of mail as completely distinct products serving different markets. *See* PostCom Initial Comments at 3-4.

decisions. If the Commission insists on a rigid, top-down, benchmark / avoided cost approach, it risks driving away volume.

The bottom-up costing approach that PostCom detailed in its Initial Comments, by contrast, can provide the Postal Service with needed pricing flexibility while still allowing the Commission to identify benchmark products and ensure that workshare discounts do not exceed avoided costs. Unlike the current top-down model, bottom-up costing provides the Postal Service with a more refined and more accurate estimate of actual costs associated with postal products. Decoupling price setting from costs enables the Postal Service to use the flexibility provided by the PAEA to tailor the apportionment of institutional costs and mark-ups to market realities. It also has the added benefit of allowing the Postal Service to measure avoided costs more precisely, as bottom-up costing directly measures the costs attributable to various activities, rather than extrapolating from a benchmark price that embodies outdated rate relationships dating from before the passage of the PAEA.

In these Reply Comments, PostCom first further explains the limited role workshare discounts play in determining mailer behavior and the difficulties this reality poses for identifying benchmark products. PostCom then explains in more detail how adopting a bottom-up costing approach fulfills the PAEA's goal of providing the Postal Service with pricing flexibility while respecting its directive to limit workshare discounts to avoided costs when doing so does not interfere with the efficient operation of the Postal Service.

II. RETURN ON INVESTMENT DRIVES MAILING DECISIONS

While PostCom takes no position with regard to the benchmarks for First-Class Mail discounts identified by various commenters, it does note that the views of these commenters highlight the wisdom of abandoning the entire benchmarking project. The consistent theme throughout the comments on the proper benchmark for First-Class Mail discounts is that there is no single product within First-Class that adequately captures the characteristics of mail that can be converted to workshared mail. That is, there is virtually no First-Class Mail in the system that would, if only the discount for workshared mail accurately reflected avoided costs, convert to workshared mail. The commenters are thus driven to choose benchmarks they believe share as many cost characteristics with mail likely to convert to workshare as possible, even though the relationship between the costs of the benchmark mail and any actual mail in the system is essentially coincidental. There is a fundamental reason that identifying a proper benchmark has proven so difficult. As PostCom argued in its initial comments, certainly in application to Standard Mail, the benchmark model does not reflect the reality of the postal industry and the myriad factors that drive mailing decisions.

The primary driver behind a mailer's choice of product is return on investment. That is, the mailer will evaluate the total cost of a mailing—including postage, preparation requirements, mailpiece design, printing costs, and other factors—against the anticipated response rate from the mailing. Most marketing efforts are executed within an established budget, so as the total mail costs increase, less mail will be entered into the system to reflect the financial realities facing the advertising campaign. In practical terms, this relationship means that mailers will reduce the size of their lists, mailing only to those customers most likely to respond (that is, who provide the greatest expected return on investment), as total mailing costs increase.

This relationship is not linear, however. Rather, it is better understood as an ecosystem, where changes in a rate or workshare discount can have volume impacts far beyond a proportionate reduction in a mailer's use of a type of mail. As an illustration of this principle, consider the hypothetical case of XYZ Pool Cleaners, a pool cleaning service looking for new customers. XYZ has chosen to use saturation mail to reach potential customers, as this type of mail allows it to blanket neighborhoods where homes are likely to have pools. By mailing to every address, XYZ saves the non-postal cost of identifying specific addresses with pools. The additional costs of presorting to the saturation level are thus outweighed by the money it saves by not developing a more targeted marketing campaign. In this case, using saturation mail allows XYZ to limit its total costs and potentially increase its return on investment.

If the cost of saturation mail increases, however, due to a reduction in the presort discount for saturation mailing, XYZ's ecosystem responds based on a number of factors including, but not limited to, return on investment, budget, and number of pieces mailed. For XYZ, the choice it faces is not simply whether it can continue to sort to the saturation level more efficiently than the Postal Service. Rather, moving to a higher presort level, such as 5-digit automation, entails significantly greater costs. At this level, XYZ must commit additional resources to identifying specific addresses in need of its services to meet the 5-digit automation requirements, increasing the total cost of its campaign. It must, therefore, receive a higher return on investment to justify these additional costs, or mail less to keep postage costs in line with previous campaigns. In evaluating these factors, XYZ may determine that other marketing channels, such as electronic communications, present a better expected return on investment than the mail. Thus, rather than simply reducing the number of campaigns or the total mailpieces XYZ sends, the reduction in the presort discount for saturation mail could drive XYZ from the mail altogether for reasons unrelated to whether the presort discount accurately reflects avoided costs.

This example highlights the disconnect between a narrow focus on avoided costs and the realities faced by mailers. To the mailer, the only metrics that matter are the total cost of conducting an advertising campaign and the expected return on investment in that campaign. A top-down costing approach concerned only with avoided mail processing costs cannot account for either of these factors.[3] This approach erroneously assumes that mailers make their presort and drop-entry decisions based solely on the pricing of the discounts available for performing those activities.

This faulty understanding of how companies use the mail and make mailing decisions is particularly apparent in the comments filed by the American Postal Workers Union, AFL-CIO ("APWU Comments"). APWU contends that in developing workshare discounts, "the comparison has always been to what the presort mailer would pay if that mailer was not worksharing." APWU Comments at 7. This statement illustrates APWU's fundamental misunderstanding of how mailing decisions are made. As described above, mailers do not base their decisions regarding worksharing and mailing campaigns on the discounts they receive specifically for workshare activities. Instead,

[3] For instance, the Postal Service in its Initial Comments proposes to use "the total delivery costs of 'Metered' letters less the collection costs for those letters" as the benchmark delivery cost for First Class Mail. Initial Comments of the United States Postal Service at 10. Notice the absence of any reference to the non-postal costs that can drive mailing decisions.

they evaluate the total cost of the mailing against the expected return on investment from the campaign. If the question is truly "what the presort mailer would pay if that mailer was not worksharing," the answer is likely "nothing." That is, if not for the discounted rate, the mailer would not mail at all—regardless of whether the price of the mail it intended to use precisely reflected the avoided costs measured against a benchmark piece

III. BOTTOM-UP COSTING PROVIDES FLEXIBILITY WHILE HONORING THE PAEA

In its initial comments, PostCom proposed an alternative method of costing "workshared" products that avoids these difficulties. The bottom-up costing method, based on improved actual cost information from Intelligent Mail Barcode ("IMb") data, would allow the Postal Service to price its products in a manner that responds to real-world mailer behavior while still respecting the PAEA directive to limit workshare discounts to avoided costs when doing so does not interfere with the efficient operation of the Postal Service.[4]

The primary advantage of using bottom-up costing is that this approach tracks only those costs directly attributable to processing a piece of mail. Unlike the top-down approach, it does not start with a product that already has institutional costs and mark-ups built in, and from which the costs of each level of workshare activity must be abstracted. Bottom-up costing, when developed through the IMb data, allows for more direct measurement of the activities performed to move different types of mail through the

[4] The Greeting Card Association recognizes the value of IMb as well, explaining that "[t]he full service [IMb] will enable the Postal Service to identify exactly what mail going through its network is entered as 5 Digit (or 3 Digit) mail. Such direct costing would be preferable to the use of cost modeling for 5 Digit (or 3 Digit) mail." Initial Comments of Greeting Card Association ("GCA Comments") at 16. The Public Representative reached a similar conclusion in its comments in Docket No. RM2011-3, stating that it "is optimistic that the expected widespread adoption by mailers of the [IMb] will remedy many of these historical problems with modeling volume variability in mail processing." Initial Comments of the Public Representative at 9 (Docket No. RM2011-3).

system, from collection to delivery. This approach allows the Postal Service to determine the cost of the product that is least-worked by the Postal Service and build the costs of products that it works more heavily based on the additional processing steps those pieces actually require. The Postal Service can then price these products so that they cover their measured attributable costs.

Additionally, the bottom-up approach poses less risk than the current top-down process of entrenching rate relationships that are based more on historical mark-ups and contributions to institutional costs than actual cost data. Because it measures only attributable costs, bottom-up costing permits the development of prices that accurately reflect the processing costs avoided at each processing level—these avoided costs are simply the difference in attributable costs between the mail less worked by the Postal Service and that mail which the Postal Service processes more heavily. Pricing products based on the bottom-up costing approach therefore ensures that postal prices will not run afoul of the PAEA directive that workshare discounts not exceed avoided costs unless doing so would interfere with the efficient operation of the Postal Service. As PostCom explained in its initial comments, "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." PostCom Initial Comments at 7-8.

While bottom-up costing would allow the Postal Service to develop prices that cover avoided costs without any reference to benchmark products, this costing method is not incompatible with the benchmarking approach favored by the Commission. Rather, it simply provides a more accurate and reliable method of developing the benchmark product's processing costs, as well as the Postal Service costs avoided when mailers engage in workshare activities.[5] The Commission should therefore implement this reform regardless of the decision it reaches regarding benchmark products.

IV. CONCLUSION

If the Postal Service is to grow its revenue and volume and achieve profitability, it must be able to price its products in a way that accounts for the real-world decisions mailers face. By employing bottom-up costing developed through increased use of IMb data, the Commission can provide the Postal Service with necessary tools to re-engineer historical pricing relationships, thus providing the Postal Service pricing flexibility while respecting the requirements of the PAEA.

Respectfully submitted,

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[5] *See also* GCA Comments at 30-31, explaining how a bottom-up approach based on directly measured 5 Digit or 3 Digit costs would improve costing accuracy in tandem with a benchmark product.