

ORDER NO. 1510

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;  
Nanci E. Langley, Vice Chairman;  
Mark Acton;  
Tony Hammond; and  
Robert G. Taub

Periodic Reporting

Docket No. RM2012-6

NOTICE OF PROPOSED RULEMAKING ON ANALYTICAL  
PRINCIPLE USED IN PERIODIC REPORTING  
(PITNEY BOWES INC. PROPOSAL ONE)

(Issued October 23, 2012)

I. BACKGROUND

On July 12, 2012, Pitney Bowes Inc. (Pitney Bowes) filed a petition to initiate an informal rulemaking to change the analytical principle that establishes the set of worksharing relationships that are presumed to exist between the various presort rate categories of presorted First-Class letter mail.<sup>1</sup> This set of relationships is described as the “presort tree.” The current presort tree uses a 3-Digit piece as the benchmark piece for calculating the costs that sorting to the 5-Digit level would avoid. The Petition notes that the Postal Service has eliminated the opportunity for a mailer of Mixed Automated Area Distribution Center (AADC) or AADC Presorted First-Class Mail to earn a larger

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<sup>1</sup> Petition of Pitney Bowes Inc. for the Initiation of a Proceeding to Consider Proposed Changes in Analytic Principle, July 12, 2012 (Petition).

discount for sorting further to the 3-Digit level. Petition at 2. Pitney Bowes argues that since there is no longer either a requirement or a reward for presorting First-Class letters to the 3-Digit level, the rationale for using 3-Digit presort as the benchmark for calculating the cost avoided by presorting to the 5-Digit level needs to be re-examined. *Id.* at 2-3. It suggests that the logical candidate for a new benchmark for the 5-Digit presorted Automated Letter category is an AADC Automation Letter piece, or a hybrid of an AADC Automation Letter and a 3-Digit piece. *Id.* at 3.

## II. POSTAL SERVICE RESPONSE

The Postal Service responded to the Petition by filing comments asserting that the Petition is not an authorized use of Periodic Reporting Rule 11 (39 CFR 3050.11).<sup>2</sup> Rule 11 authorizes the Postal Service, the Commission, or private parties to request that an informal rulemaking be initiated to change the analytical principles that the Postal Service applies when it estimates and reports the various dimensions of Postal Service performance that are the focus of the Postal Accountability and Enhancement Act (PAEA), Pub L. 109-435, 102 Stat. 3198 (2006), regulatory scheme— costs, volumes, revenues, rates, and service attainment. See 39 U.S.C. 3652(a)(1).

The Postal Service asserts that selecting benchmarks for calculating the avoided costs by which worksharing discounts are evaluated does not fit the definition of analytical principle. Postal Service Response at 2. It observes that 39 CFR 3050.1(c) defines an “analytical principle” as “a particular economic, mathematical, or statistical theory, precept, or assumption applied by the Postal Service in producing a periodic report to the Commission.” *Id.* It contends that this language confines analytical principles to mathematical models or formulae used to calculate costs. It notes that deciding what mail categories should serve as benchmarks for calculating the costs avoided by worksharing is not determined by a mathematical model or formula. *Id.*

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<sup>2</sup> Response of the United States Postal Service to Petition for Initiation of Proceeding, July 12, 2012 (Postal Service Response).

In addition, the Postal Service makes a policy argument that selecting benchmarks is a determination that should not be governed by the Commission's Periodic Reporting Rules or the procedures these rules prescribe for changing accepted analytical principles. The Postal Service explains that the purpose for identifying a benchmark is to establish a cost relationship between mail categories for pricing purposes. It contends that pricing issues are "the preserve of the Postal Service and, through its review functions, the Commission." *Id.* The Postal Service asserts that because the Commission exercises its review of prices in rate adjustment and Annual Compliance Determinations (ACDs), the selection of benchmarks should be confined to those proceedings. *Id.* at 2-3.

The Postal Service points out that it has the ability to create and abolish categories of workshared mail. *Id.* at 2, n.2. Because it exercises this influence over the pricing of workshared mail, it argues, it would be inappropriate for the Commission to entertain the Petition in a separate Rule 11 proceeding because it "could lead to pricing issues being reviewed and contested year-round rather than in the two types of proceedings established by the PAEA for price regulation." *Id.* at 3.

### III. PITNEY BOWES REPLY

Pitney Bowes replies that the Postal Service's view of what qualifies as an analytical principle under the Commission's Periodic Reporting Rules is flawed.<sup>3</sup> It argues that the structure of the presort tree is an analytical principle, and therefore proposals to change that structure must be publicly vetted and accepted by the Commission prior to their use by the Postal Service in a rate adjustment proceeding or an Annual Compliance Report (ACR). Pitney Bowes Response at 2; see *also* 39 CFR 3050.11. It emphasizes that this interpretation of the Commission's Periodic Reporting Rules is consistent with the language of sections 3050.1 and 3050.11, the

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<sup>3</sup> Pitney Bowes Inc. Reply to USPS Response to Petition for Initiation of Proceeding to Consider Proposed Changes in Analytic Principle, July 17, 2012 (Pitney Bowes Response).

Commission's own interpretation of that language, and with Commission precedent applying those rules. Pitney Bowes Response at 3.

As the Postal Service did, Pitney Bowes focuses on the definition of analytical principle in 39 CFR 3050.1(c), but it interprets it more broadly. Pitney Bowes cites the Commission's definition of an analytical principle as "a particular economic, mathematical, or statistical theory, precept, or assumption." *Id.* at 2; see also 39 CFR 3050.1(c). While this definition includes mathematical models and formulas, it notes, it extends to theories, precepts, and assumptions as well. On a general level, it says that the selection of benchmarks is based on the economic assumption that the

cost avoided by workshared mail ought to be calculated by comparing its costs to the costs of a benchmark, which is that portion of the less workshared category that is most likely to convert to the next workshare category in response to price differentials (incentives) or preparation requirements.

Pitney Bowes Response at 3.

At the most specific level, Pitney Bowes argues that the presort tree incorporates the economic assumption that 3-Digit presort mail is the most likely to convert to 5-Digit mail. It notes that if mailers no longer prepare mail at the 3-Digit level, the validity of this economic assumption needs to be re-examined. *Id.*

Pitney Bowes observes that the Commission has specifically found that selection of an appropriate benchmark constitutes adoption of an analytical principle. Docket No. RM2008-4 established the definition of analytical principle and the procedures to be followed when there are proposals to change accepted analytical principles.<sup>4</sup> There, Pitney Bowes points out that the Commission directly addressed the question of how its analytical principles relate to the methods used by the Postal Service to calculate the avoided costs by which workshare discounts are evaluated. In Order No. 104, Pitney Bowes observes, the Commission expressly states that "[c]hanging the classification of

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<sup>4</sup> Docket No. RM2008-4, Notice of Proposed Rulemaking Prescribing Form and Content of Periodic Reports, August 22, 2008 (Order No. 104).

cost pools, **or the rate categories used as benchmarks or proxies**, would constitute a change in accepted analytical principles.” *Id.* at 29 (emphasis added). Pitney Bowes emphasizes that the Commission’s two major reviews of the issue regarding selection of appropriate benchmarks for calculating discounts for presorted First-Class letter mail took the form of Rule 11 proceedings, similar to the one that Pitney Bowes now asks the Commission to initiate. Pitney Bowes Response at 3.

With respect to the Postal Service’s policy arguments, Pitney Bowes concludes that however the Postal Service wishes to characterize its pricing prerogatives under the PAEA, they do not negate the Commission’s express authority under section 3652 to determine what data and methods will be used to measure the costs avoided by worksharing. Pitney Bowes says that if the statutory limit on workshare discounts established in 39 U.S.C. 3622(e) is to be properly enforced, avoided costs and passthroughs must be accurately estimated and reported. It emphasizes that the Commission has found that the complex issues that are typically raised by benchmark selection cannot be meaningfully explored or effectively resolved under the tight schedule of a rate adjustment proceeding. For that reason, it notes the Commission has told the Postal Service and the parties that the analytical principles that the Postal Service uses to estimate avoided costs must be evaluated and approved in an informal Rule 11 rulemaking devoted to that purpose before they are relied on in a highly compressed rate adjustment proceeding. *Id.* at 4.

#### IV. COMMISSION ANALYSIS

##### A. The Statutory Basis for the Commission’s Periodic Reporting Rules

When it adopted its Periodic Reporting Rules, the Commission explained that they are designed to carry out the functions assigned to the Commission by 39 U.S.C. 3651 through 3653. Section 3652(a) states that the Postal Service shall submit a report to the Commission each year

which shall analyze the costs, revenues, rates and quality of service, **using such methodologies as the Commission shall by regulation prescribe**, and in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title. (emphasis added).

39 U.S.C. 3652(a).

Section 3652(b) states that each ACR that the Postal Service prepares shall include for every workshared market dominant product

- (1) The per-item cost avoided by the Postal Service by virtue of such discount.
- (2) The percentage of such per-item cost avoided that the per-item discount represents.
- (3) The per-item contribution made to institutional costs.

39 U.S.C. 3652(b).

Section 3652(e)(1) states that the Commission shall, by regulation prescribe the form and content of such reports. 39 U.S.C. 3652(e)(1). Section 3652(e)(2) states that it may

on its own motion, or at the request of an interested party, initiate proceedings (according to such regulations as the Commission shall prescribe) to improve the quality, accuracy, or completeness of Postal Service data required by the Commission under this subsection whenever it shall appear that—

(A) the attribution of costs or revenues to products has become significantly inaccurate or can be significantly improved;

. . . . .

(C) such revisions are, in the judgment of the Commission, otherwise necessitated by the public interest. (emphasis added).

39 U.S.C. 3652(e)(2).

It is clear from these provisions that the PAEA assigns to the Commission the duty to determine what data and what analytical methods the Postal Service will use to prepare its ACR, including that part of its ACR that demonstrates that the Postal Service's workshare discounts comply with the PAEA.

B. Applying the Periodic Reporting Rules to the Methods Used to Estimate Avoided Costs

The principal requirement of the PAEA with respect to workshare discounts is the section 3622(e) requirement that each discount not exceed its avoided cost. The language of section 3652(e) quoted above clearly states that when the methodologies used in an ACR to estimate the cost avoided by a workshare discount category can be made "more accurate," "interested parties" (such as Pitney Bowes) may request that those methods be revised. The Petition follows that statutory option and the Periodic Reporting Rules which the Commission has adopted to implement it. Nevertheless, the Postal Service asks the Commission to reject the Petition.

The Postal Service first asserts that the selection of a benchmark does not qualify as an analytical principle because it is not "a particular economic, mathematical, or statistical theory, precept, or assumption" as 39 CFR 3050.1(c) requires. Postal Service Response at 1-2. The Postal Service Response says

Put simply, analytical principles are the models and formulae used to calculate the costs of each product and of each sortation level within a product, and Pitney Bowes's proposal does not implicate any such principles.

*Id.* at 2.

This interpretation, however, disregards the text of 39 CFR 3050.1(c). The terms "model" and "formula" do not appear in the text. The text uses the much broader terms "theory, precept, or assumption." As Pitney Bowes points out, at a general level, the First-Class Automation letter presort tree is based on the following general *economic*

*assumption*: the proper approach to calculating the costs avoided by worksharing is to identify the portion of the less workshared mail category that is most likely to convert to the more workshared category given a sufficient price incentive, then use that portion of the less workshared category as the benchmark for calculating the cost avoided by the more workshared category. In its Petition, Pitney Bowes proposes to re-examine the specific economic assumption that the current benchmark for 5-Digit presort mail is a viable benchmark. Accordingly, its Petition properly proposes to change that analytical principle.

When it introduced the concept of an analytical principle and the role it plays in periodic reporting, the Commission made it clear that proposals to change benchmarks are proposals to change analytical principles. Order No. 104 lists various examples of analytical principles, including the following:

6. Cost Avoidance

Changing the classification of cost pools, or *the rate categories used as benchmarks* or proxies, would constitute a change in accepted analytical principles. (emphasis added).

Order No. 104 at 29.

The understanding that benchmarks constitute analytical principles is confirmed in the Commission's Annual Compliance Determinations. Its FY 2009 ACD makes this observation:

As the Commission stated in the 2008 ACD and consistent with its rules, the accepted methodology (which uses BMM as the benchmark for mixed AADC presort letters and non-automation presort letters) is to be retained unless and until "a different analytical principle [is] accepted by the Commission in a final rule."<sup>5</sup>

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<sup>5</sup> 2009 Annual Compliance Determination, March 29, 2010, at 71.



C. Benchmark Selection is a Necessary Component of the Analytical Method for Estimating Avoided Costs

As part of its argument that a proposal to change a benchmark is not a proposal to change an analytical principle, the Postal Service Response, asserts that

regardless of whether the benchmark is changed, the Postal Service's Annual Compliance Report will report the same costs for 5-digit Automation letters, 3-digit Automation letters, AADC letters, and so on.

Postal Service Response at 2.

This attempt to sever the link between the methodology by which costs are measured, and reporting the results of the application of that methodology implies that it is only the reporting function that is within the Commission's statutory mandate, and only the reporting function that is properly addressed by the Commission's Periodic Reporting Rules. This interpretation is incorrect.

The role that benchmark selection plays in the statutory scheme is described in the Commission's first rulemaking addressing the issues of benchmark selection. In Docket No. RM2009-3, the Commission stated:

4. Selecting a Base Group or "Benchmark" is Necessary to Measure Cost Avoidance

The structure of the PAEA and the role assigned to the Commission in section 3652(a)(1) reflects a Congressional intent to allow the Commission to determine the methods to be used to measure its quantitative pricing requirements. The requirement that workshare discounts be no greater than the amount of costs avoided is prescribed by statute. The policy aspects of whether and what kind of discount limit should be applied are resolved in section 3622(e) itself. The task that falls to the Commission is to select an appropriate

base group or “benchmark” from which the “costs avoided” may be determined.<sup>6</sup>

The circumstance that prompts Pitney Bowes to file its Petition to re-examine the suitability of 3-Digit letters to continue to serve as the benchmark for 5-Digit letters is the Postal Service’s decision to discontinue offering a discount for 3-Digit letters while it reevaluates its operating plan in connection with its network rationalization program.<sup>7</sup>

As a general proposition, the Postal Service may decide not to require a particular level of worksharing and a corresponding discount. In this case, if the volume of 3-Digit letters were to be eliminated as a consequence of future operating plans, or if 3-Digit letters were no longer the mail most likely to convert to 5-Digit, the Postal Service will have removed the factual basis for treating 3-Digit letters as the benchmark for 5-Digit letters.<sup>8</sup> A replacement benchmark for 5-Digit letters will then have to be proposed in a Rule 11 proceeding, and a new analytical principle (benchmark) will need to be accepted by the Commission (a process that the Petition seeks to initiate now). The Postal Service would be required by the Commission’s rules to estimate and report a unit cost for the new benchmark in the ACR that the Postal Service files subsequent to the stabilization of its operating plan. That ACR will also have to demonstrate that the discount for 5-Digit mail does not exceed the avoided cost calculated with reference to that benchmark, unless one of the exceptions in section 3622(e) is applicable.

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<sup>6</sup> Docket No. RM2009-3, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010, at 38.

<sup>7</sup> See Docket No. R2012-3, United States Postal Service Notice of Market-Dominant Price Adjustment, October 18, 2011, at 13-14, 35.

<sup>8</sup> As a general matter, any change that results in benchmark mail no longer being the mail most likely to convert to the next level of worksharing, would require reexamination of that benchmark.

D. When to Establish Procedures Under Rule 3050.11(c) is a Matter Fully Within Commission Discretion

The remaining issue to be addressed is the Postal Service's suggestion that its authority to determine when to implement price changes should limit the Commission when it determines how to implement the explicit section 3652 grant of authority to determine the data and methods by which the various pricing standards of the Act are quantified.

Section 3652(a) grants authority to the Commission to determine the methods by which all dimensions of Postal Service operating performance are to be measured— costs, volumes, revenues, and service. The dimensions of operating performance that are to be estimated and reported according to the methods prescribed by the Commission under section 3652(a) include the avoided cost, the passthrough, and the contribution to institutional cost associated with each workshared category. See 39 U.S.C. 3652(b).

Section 3652(e) explicitly grants to the Commission, rather than the Postal Service, the authority to decide how *changes* will be made to the data and methods used to estimate and report all dimensions of Postal Service performance, including all of the metrics related to worksharing. Whatever tension exists between the Postal Service's authority to offer discounts for workshared mail and the Commission's authority to decide how to measure the costs that worksharing avoids has been resolved by the PAEA itself. Section 3652 expressly grants to the Commission the authority to decide how avoided costs will be measured. It does not expressly grant any countervailing authority to the Postal Service.

To develop an objective view of the nature of the implied authority that may be validly inferred from the PAEA, it is helpful to recognize that the PAEA does not grant to the Postal Service pricing flexibility in the abstract. With respect to both competitive and market dominant products, it grants pricing flexibility of a specific kind, and limits that flexibility in specific ways.

With respect to market dominant products, the PAEA grants the Postal Service the flexibility to choose its prices as long as they satisfy applicable statutory requirements. The Postal Service has the flexibility to file for rate changes when it chooses, and to receive a decision from the Commission within 45 days of filing.<sup>9</sup> These are the essential types of pricing flexibility that the PAEA grants the Postal Service. The Commission's Periodic Reporting Rules provide the best means of preserving that flexibility and still affording meaningful due process to mailers and the public with respect to the quality of the data and the appropriateness of the analytical methods that the Postal Service employs. This is what Congress contemplated when it enacted section 3652.

Selecting appropriate worksharing benchmarks raises issues of fact and theory that are complex and controversial, as Docket Nos. RM2009-3 and RM2010-13 illustrate. If due process is to be afforded to affected mailers and the public, there must be a reasonable opportunity to investigate the factual issues and to contest the methodological issues that are raised. The Commission has concluded that it is not feasible to provide meaningful review of such issues in the context of highly compressed rate adjustment dockets or ACD dockets. It has concluded that they should be examined, instead, in informal rulemakings that can focus exclusively on those issues, and resolve them in advance of the time that the methodological changes would be relied on. Resolving such methodological issues before they are relied on in rate filings or compliance determinations does little, if any, damage to the essential kinds of pricing flexibility described above that the PAEA grants to the Postal Service. The Commission's Periodic Reporting Rules embody this approach, and the Petition follows those rules. Accordingly, the Commission grants the Petition.

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<sup>9</sup> The PAEA makes a similar grant to the Postal Service of flexible pricing authority over competitive products. It grants the Postal Service the flexibility to change any price it chooses after a brief notice period. Its flexibility, however, is limited by the requirement that no competitive product be priced below its attributable cost and the requirement that all competitive products collectively make at least an established minimum contribution to institutional costs. The PAEA gives the Commission the responsibility of deciding what data and methods will be used to quantify these pricing standards.

*It is ordered:*

1. The Petition of Pitney Bowes Inc. for the Initiation of a Proceeding to Consider Changes in Analytical Principle, filed July 12, 2012, is appropriately filed under 39 CFR 3050.11 of the Commission's Periodic Reporting Rules.
2. The Commission establishes Docket No. RM2012-6 to consider the matters raised by Pitney Bowes Petition.
3. Pitney Bowes shall file any additional material supporting its Petition by December 7, 2012.
4. Comments on the Petition are due no later than January 7, 2013.
5. Rand E. Costich is appointed to serve as the Public Representative to represent the interests of the general public in this proceeding.
6. The Pitney Bowes Inc. Motion for Leave to File Reply to USPS Response to Petition for Initiation of Proceeding to Consider Proposed Changes in Analytical Principle, filed July 17, 2012, is granted.
7. The Secretary shall arrange for publication of this Notice in the *Federal Register*.

By the Commission.

Shoshana M. Grove  
Secretary