

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

Periodic Reporting

Docket No. RM2012-6

COMMENTS OF PITNEY BOWES INC.

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DATED: December 7, 2012

I. INTRODUCTION AND SUMMARY

Pursuant to Order No. 1510, Pitney Bowes Inc. (Pitney Bowes) respectfully submits these supplemental comments and materials in support of its Petition to change the benchmark for purposes of estimating workshare-related costs avoided within the presort tree for First-Class Mail Automation Letters.¹

Pitney Bowes framed the issue in its Petition as follows:

In May 2009, the Postal Service changed the mail preparation requirements for First-Class Mail Automation Letters to make 3-Digit tray preparation optional (although required to qualify for the 3-Digit Automation Letter rate). In January 2012, the Postal Service eliminated the price difference between First-Class Mail Automated Area Distribution Center (AADC) Letters and 3-Digit Automation Letters.

Although both the AADC and 3-Digit tiers were maintained in the rate schedule, the prices for both now are the same: 37.4 cents. Because there is no longer a price advantage nor any mail preparation requirement, for a mailer to perform the additional work to presort First-Class Mail Automation Letters into 3-Digit trays (as opposed to AADC trays), the choice facing the mailer is now among the Mixed AADC, AADC and 5-Digit preparation. For these reasons, there is no need to calculate a workshare cost avoidance or passthrough for 3-Digit Automation Letters. Additionally, 3-Digit Automation Letters is no longer the correct reference point for the purpose of estimating the 5-Digit Automation Letter cost avoidance and passthrough calculation.

The obsolescence of the 3-Digit Automation Letters tier in the presort tree is intuitive; the selection of a new intermediate tier in the presort tree is less obvious.

See Petition at 1-2 (Petition)(citations omitted).²

In its initial Petition, Pitney Bowes suggested two reasonable candidates for a new benchmark. The first was AADC Automation Letters (an existing rate category within the

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

² The AADC rate and the 3-Digit rate remain the same under the most recently proposed (and approved) price adjustment which will take effect on January 27, 2012.

presort tree). The second was a “blended” AADC / 3-Digit Automation Letters tier that reflects a mix of AADC and 3-Digit Automation Letter volume. *See* Petition at 3. Data from recent billing determinants now suggests that the use of a blended AADC / 3-Digit rate category would be most appropriate. That data shows a substantial shift in volume from 3-Digit to AADC has already occurred, and will likely continue. The use of a blended rate category will allow cost avoidance estimates to reflect this shift in mail volume over time and is consistent with the Commission’s past practice of using blended cost estimates for rate categories containing similar, but not identical, mail. *See infra* Section II.3.

The change to a blended rate category as a benchmark is illustrated in Figure 1 below. The blended approach would adjust costs avoided estimates as mailers change their behavior in response to the effective merger of the AADC and 3-Digit rate categories.

Figure 1. Proposed Change to First-Class Mail Automation Letters Presort Tree

Current		Proposed	
Type of Worksharing	Benchmark	Type of Worksharing	Benchmark
AADC Letters	Mixed AADC Letters	AADC/3-Digit Letters	Mixed AADC Letters
3-Digit Letters	AADC Letters	5-Digit Letters	AADC/3-Digit Letters
5-Digit Letters	3-Digit Letters		

The Petition requested a change in the analytic principle with respect to First-Class Mail Automation Letters. Since that Petition was filed the Postal Service has announced its plans to eliminate the 3-Digit rate for First-Class Mail Automation Cards and Standard Mail Automation Letters. Accordingly, the Commission should assess the need for a parallel change in analytic principle for these products. Although it is too early to assess the effect of the price changes for these products empirically, the theory and logic of using a blended AADC / 3-Digit benchmark would apply to these products as well. The use of a blended AADC / 3-Digit benchmark would also ensure that the benchmark appropriately captures any volume shift unique to these products

(e.g., preparation requirements for dropship discounts in Standard Mail Automation Letters may produce a different mail mix).

II. DISCUSSION

1. Selecting an Appropriate Benchmark is Essential for Compliance Purposes

The Commission has long recognized that the avoided cost standard for workshare discounts has as its practical basis the selection of an appropriate benchmark. *See* PRC Dkt. No. RM2009-3, Order No. 536 (Sept. 14, 2010) at 21. The task of selecting an appropriate benchmark takes on added significance under the Postal Accountability and Enhancement Act (PAEA).³ A principal requirement of the PAEA with respect to workshare discounts is the requirement that each discount not exceed its avoided cost. *See* 39 U.S.C. § 3622(e)(2). The Commission has recognized that to “implement that standard, it is necessary to identify a baseline, or reference category of mail from which avoided costs can be measured.” *See* PRC Dkt. No. RM2010-3, Order No. 1320 (Apr. 20, 2012) at 3. Accurate reporting of cost avoidance and passthrough calculations is, therefore, essential to ensure compliance with the statutory limitation on workshare discounts.

The task of selecting “an appropriate base group or ‘benchmark’ from which the ‘costs avoided’ may be determined” is fundamentally a costing exercise that is reserved to the Commission. Order No. 1510, at 9-10 (citing Docket No. RM2009-3, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology (Sept. 14, 2010) at 38 (“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.”)); 39 U.S.C. §§ 3652(a) and 3652(b).

³ *See* Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

The Commission has historically adopted an incremental analysis in which the cost avoided by workshared mail is calculated by comparing the costs of the workshared mail 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. *See* Order No. 536 at 21. Relevant for present purposes the question is what is the mail most likely to convert to 5-Digit within a presort tree in which the AADC and 3-Digit rates have been combined.

2. Selecting an Appropriate Benchmark is Important Because the Affected Rate Categories Represent Substantial Revenue and Volume

As a practical matter, establishing an appropriate benchmark is critical because First-Class Mail and Standard Mail Automation Letters and Cards comprise a substantial portion of total Postal Service volume and revenue. Table 2 below shows that Automation Letters and Cards comprised 55 percent of the Postal Service’s FY2011 volume, and 37 percent of the Postal Service’s FY2011 revenue.

Table 2. FY 2011 Automation Letter/Card Volume and Revenue

Type of Mail	Volume (Millions)	Revenue (Millions)
First-Class Mail Automation Letters	40,743	\$14,469
First-Class Mail Automation Cards	2,554	\$547
Standard Mail Automation Letters	48,850	\$9,352
Total Automation Letters/Cards	92,147	\$24,368
USPS Totals	168,322	\$65,739
Percentage	54.7%	37.1%

Source: PB-LR-1 (Supplemental).xlsx, “Table 2”

Accurate costing is the goal for all products, but properly measuring cost avoidances is especially important where the affected products could have such a significant impact on the Postal Service’s finances and the prices that mailers pay. Without accurate cost measurement there is a risk that workshare discounts for a substantial volume of mail could mistakenly

appear as though they violated the statutory limitation on workshare discounts when, in fact, they do not.

3. A Blended AADC / 3-Digit Benchmark Is Consistent with the Accepted Practice of Blending Costs of Similar, But Not Identical, Mail

Equalizing the prices charged for two rate categories within the same presort tree – AADC and 3-Digit – is no different than combining them into a single rate category. The two rate categories within the same presort tree are for all practical purposes indistinguishable. They share identical prices. Despite the fact that one is sorted to AADC and the other to 3-Digit, they are handled very similarly from an operational perspective. *See* PRC Dkt. RM2011-5, Comments of Pitney Bowes (Jan. 28, 2011) at 3, n.1. They share the same weight and shape characteristics. They have the same service standards. We understand that price equality alone may not be sufficient, but where two rate categories within the same presort tree are combined and the mail from each rate category is treated exactly the same in virtually every other respect except for presort level, the two rate categories should be considered as one. The listing of AADC and 3-Digit as distinct categories within the First-Class Mail Automation Letters presort tree has no bearing on costing. The 3-Digit presort tier is now a rate category that exists in name only.

Because the Postal Service has effectively combined the AADC / 3-Digit rate categories, they must be treated as such for purposes of calculating workshare-related costs avoidances. Thus, a new benchmark is required to accurately measure the cost attributes of this combined rate category. The use of blended costs within a rate category from similar, but not identical, mail is an accepted practice. Few existing rate categories represent groupings of perfectly

homogeneous mail. Rather, they reflect a mix of similar mail and the cost of each rate category represents an average typically developed from similarly, but not identically, prepared mail.

Cost avoidances are also calculated from these average costs. For example, the workshare-related cost for the First-Class Mail Nonautomation Presort Letter rate category is an average of the cost of all machinable, nonautomation presort letters across all presort levels. *See* ACR2011, PRC-ACR2011-LR-2, FCM_LTRS.FAST Revision_prc.xls, “SUMMARY,” cell B38 and “PRESORT LETTERS SUM,” cell G47. Workshare-related costs for 3-Digit Automation Letters have historically applied to letters in trays either for (1) a single 3-Digit ZIP, or (2) a combination (scheme) of 3-Digit ZIPs. *See* DMM 233.5.4. The same is true for 5-Digit Automation Letters. *See id.* This practice is not reserved to letter-shaped mail. *See* ACR2011, PRC-ACR2011-LR-2, FCM_Prsrc_Flats_prc.xls, “FY VOLUME AUTO.” The First-Class Mail 5-Digit Automation Flat rate includes mail with all of the following characteristics: (1) Full 5-Digit Trays, (2) 5-Digit Bundles in Mixed ADC Tubs, (3) 5-Digit Bundles in ADC Tubs, (4) 5-Digit Bundles in 3-Digit Tubs, and (5) 5-Digit Bundles in 5-Digit Tubs. *See id.*

The recent benchmark rulemaking for First-Class Mail letters provides another example. *See* PRC Dkt. No. RM2010-13. In that proceeding, the Commission found that some, but not all, of the Single-Piece metered mail that is likely to convert to presort requires collection. *See* PRC Dkt. No. RM2010-13, Order No. 1320 at 28. Thus, the collection cost of the new metered mail benchmark used to estimate the cost avoided by Nonautomation Presort and Mixed AADC Automation Letters is an *average* of metered mail requiring collection and metered mail not requiring collection:

Because the empirical data presented by ABA et al. indicates that approximately 60 percent of the mail that is likely to convert to presort requires collection, the Commission will incorporate 60 percent of the metered mail collection cost

estimate provided by the Postal Service in response to CHIR No. 1 as the best currently-available estimate of metered mail collection costs.

Id., at 28-29.

Consistent with the averaging approach, the presort tree for Automation Letters should include three tiers – Mixed AADC, AADC/3-Digit (averaged), and 5-Digit. As shown in Figure 2, the cost avoided by AADC/3-Digit mail should be calculated using a Mixed AADC benchmark and the cost avoided by 5-Digit should be calculated using an AADC/3-Digit benchmark.

Figure 2. Presort Tree for First-Class Mail Automation Letters

Type of Worksharing	Benchmark
Automation AADC/3-Digit Letters	Automation Mixed AADC Letters
Automation 5-Digit Letters	Automation AADC/3-Digit Letters

4. Mailer Behavior as Reflected in Recent Volume Trends Confirm that a Combined AADC/3-Digit Rate Category is the Appropriate Benchmark

Table 1 below shows how mailers responded to the elimination of price incentive and preparation requirement for 3-Digit mail. The data shows a substantial shift from 3-Digit mail to AADC mail. This is not surprising. In FY 2010, FY 2011, and the first quarter of FY2012, the last full quarter before the price equalization, AADC Automation Letters comprised approximately 20 percent of combined AADC and 3-Digit Automation Letters volume. This percentage increased to 36 percent in the second quarter of FY 2012 (the quarter in which the First-Class Mail AADC and 3-Digit Automation Rates were equalized) and 47 percent in the third quarter of FY 2012 (the first full quarter after the prices were equalized).⁴

⁴ Over the same period, the AADC percentage for Standard Mail Letters and First-Class Mail Automation Cards (where the equalization has not yet occurred) was stable. This corroborates that the increase in the AADC percentage in First-Class Mail Automation Letters and Cards was caused by the equalization of the First-Class Mail AADC and 3-Digit Automation Letter rates. See PB-LR-1 (Supplemental).xlsx, “FCM Card Vols” and “SM Letter Vols”.

**Table 1. First-Class Mail AADC Automation Letter Volume
(As Percentage of AADC + 3-Digit Automation Letter Volume)**

Fiscal Year	Quarter	Volume (000s)		AADC Percent
		AADC	3-Digit	
2010	1	854,413	3,960,854	17.7%
2010	2	860,476	4,021,101	17.6%
2010	3	781,162	3,734,754	17.3%
2010	4	758,957	3,650,738	17.2%
2011	1	785,450	3,787,012	17.2%
2011	2	976,947	3,818,598	20.4%
2011	3	1,025,821	3,531,094	22.5%
2011	4	840,552	3,629,710	18.8%
2012	1	836,171	3,717,837	18.4%
2012	2	1,621,386	2,929,375	35.6%
2012	3	1,989,098	2,241,189	47.0%

Source: PB-LR-1 (Supplemental).xlsx, “Table 1”

As shown in Table 1, since the Postal Service combined the AADC and 3-Digit rate categories, substantial volumes of First-Class Mail Automation Letters have shifted from the 3-Digit to the AADC presort level. The substantial increase in AADC volume (and corresponding decrease in 3-Digit) from the most recent quarters (Quarter 2 to Quarter 3 of FY2012) suggests that the shift toward AADC will likely continue.

The empirical results confirm that for many mailers the lack of a price incentive results in the preparation of AADC rather than 3-Digit mail, i.e., what was 3-Digit mail has shifted to the next less finely presorted level, AADC. Pitney Bowes Presort Services’ (PBPS) experience is consistent with this trend. For First-Class Mail Automation Letters, PBPS prepares 3-Digit trays only for mail destinating in the service area of the local USPS facility at the request of the Postal Service. PBPS does not sort non-local mail to 3-Digit; rather, it sorts this mail to AADC or 5-Digits (with a very small percentage entered at the MAADC rate).

For many mailers, preparing 3-Digit mail is no longer a consideration - the presort option is either AADC or 5-Digit mail. Thus, any mail from these mailers that might convert to 5-Digit would come from AADC. But the data also show that some mailers continue to prepare 3-Digit mail. For this mail volume, conversion to 5-Digit might come from 3-Digit. Accordingly, a blended AADC / 3-Digit benchmark is the most appropriate benchmark going forward.

5. Timely Adoption of the New Benchmark

To ensure timely adoption, the new benchmark should be implemented as part of the Annual Compliance Report (ACR) for the fiscal year in which AADC and 3-Digit rates are equalized.⁵ Under this suggested approach, the new blended AADC / 3-Digit benchmark for First-Class Mail Automation Letters should be implemented in the FY2012 ACR. If parallel changes are made to Standard Mail Automation Letters and First-Class Mail Automation Cards, the new benchmark should be implemented in the FY2013 ACR.

As shown in Table 3, given the timing of the 2012 and 2013 price adjustments (the middle of the second quarter), the first-year weights should be Quarter 3 and 4 volumes.⁶ Thereafter, full-year volume weights can be used.

Table 3. Post-Rate-Equalization Volume Weights for Calculating Average Cost of AADC / 3-Digit Rate Category

Mail Class and Shape	FY 2012	FY 2013	FY 2014 and Thereafter
First-Class Mail Automation Letters	Q3 and Q4	Fiscal Year	
First-Class Mail Automation Cards	n/a	Q3 and Q4	Fiscal Year
Standard Mail Automation Letters	n/a		

⁵ We are hopeful that the Commission will formally address the issue of timely adoption of new Commission-approved costing methodologies in the near future. See PRC Order No. 1541, at 11 (“The Commission concurs with Pitney Bowes that the Commission’s rules may need to be revised to ensure that the most up to date methodologies are incorporated in price adjustment filings, and the Commission intends to explore this matter.”).

⁶ The use of partial-year volumes in estimating average costs need not be extended to other rate categories. We are not aware of other rate design changes that have resulted or are likely to result in such substantial and rapid changes in mail mix.

6. The Impact on Cost Estimates

Tables 4 and 5 below illustrate the impact of adopting a blended AADC / 3-Digit benchmark. Tables 4 and 5 present the cost estimates using FY2011 Automation Letter cost data. For illustrative purposes, Table 5 assumes that the distribution of AADC and 3-Digit Automation Letter volume is equal within the blended AADC / 3-Digit rate category.⁷

Table 4. FY 2011 First-Class Mail Automation Letters Cost Avoidance (Current Presort Tree)

Type of Worksharing	Benchmark	Cost Avoidance (in Cents)
AADC	Mixed AADC	2.15
3-Digit	AADC	0.37
5-Digit	3-Digit	2.46

Table 5. FY 2011 First-Class Mail Automation Letters Cost Avoidance (Proposed Presort Tree)

Type of Worksharing	Benchmark	Cost Avoidance (in Cents)
AADC/3-Digit	Mixed AADC	2.33
5-Digit	AADC/3-Digit	2.64

PB-LR-1 (Supplemental) shows the calculations underlying the proposed change in analytic principle under both alternatives. The calculations are performed and fully sourced in the worksheet entitled “FCM Letter Costs.”

⁷ This assumption is consistent with the billing determinants for First-Class Mail Automation Letters in FY2012, Quarter 3.

III. CONCLUSION

For the reasons discussed above and in its initial Petition, Pitney Bowes respectfully requests that the Commission adopt a blended AADC / 3-Digit benchmark for purposes of estimating workshare-related costs avoided within the presort tree for First-Class Mail Automation Letters.

Respectfully submitted:

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