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COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these comments pursuant to Order No. 1510 (October 23, 2012). In them, we explain why we believe the Pitney Bowes alternative proposals to (i) establish the AADC rather than the 3-Digit cost level as the benchmark for 5-Digit First-Class Automation Letters, or (ii) create a "hybrid" benchmark using a volume-weighted blend of 3-Digit and AADC costs are neither legally feasible nor desirable as a matter of rate policy. Since in its Comments (December 7, 2012) Pitney Bowes (PB) appears to emphasize the hybrid proposal, perhaps to the exclusion of the first alternative, we focus largely though not exclusively on it.

I. INTRODUCTION

PB's basic argument, reduced to simplest terms, is that 3-Digit Automation Letters is, or is becoming, an obsolete category. PB adduces volume trends to support this contention, along with the proposition that since there is now no price difference between AADC and 3-Digit, mailers' choices of presort level are reduced to either AADC or 5-Digit. On that basis, PB urges that accurate reflection of costs in the 5-Digit benchmark requires that the present 3-Digit benchmark be dropped in favor of one of its proposed replacements.

This proposal, if adopted, would –

- Potentially imply rates violating 39 U.S.C. sec. 3622(e)(2);

- Run counter to the theory and structure of the established worksharing benchmark system;

- Make discounts for 5-Digit mail depend on changes in relative volume of AACD and 3-Digit letters, instead of actual 5-Digit cost savings;

- Distort the benchmark system for the benefit of one Presort rate category; and

- Cost the Postal Service up to $75 million annually in lost revenue, with, potentially, no improvement in 5-Digit worksharing cost savings.

GCA submits that, whatever might be true at some future time, the current profile of First-Class Automation Letters is such as to make the PB proposals legally infeasible, or at least pointless, under 39 U.S.C. sec. 3622(e). Three-digit mail has not disappeared from First-Class Presort; indeed, as PB's own statistics show, it is still a larger category than AADC. There is a significant, albeit fairly small, per-piece cost difference between 3-Digit and 5-Digit; data made available in the Postal Service's ACR2012 filing indicate that the difference is actually growing.[1] Under the established system of benchmarks for the calculation of worksharing discounts, this cost difference cannot be ignored. The larger cost difference between AADC and 5-Digit, were it reflected in rates[2], would cause the 5-Digit discount to exceed the costs avoided by conversion from 3-Digit to 5-Digit preparation, which would violate section 3622(e)(2).

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[1] The FY 2011 statistics cited by PB show a difference of 0.37 cent; in FY 2012 the Service's report shows a difference of 0.56 cent.

[2] It is true that (i) in both its Petition and its Comments, PB speaks of cost avoidances and does not take the further step of advocating rates strictly reflecting its proposed replacement benchmark, and (ii) the statute does not require a worksharing discount to equal the cost avoidance underpinning it. Nonetheless, the object of choosing a benchmark is, presumably, to base rates on it.

Quite apart from the legal difficulties inherent in the proposals, they imply rate policies which, GCA submits, would be unwise. The hybrid proposal, in particular, represents a significant departure from established worksharing rate policy. To attempt to apply established methods to a hybrid benchmark would entail estimating per-piece cost avoidance with respect to a mailpiece that does not exist in the real world. PB's proposed hybrid benchmark would make the cost avoidance, and potentially the discount, for 5-Digit letters increase solely because AADC volume had increased at the expense of 3-Digit. No reason is apparent why a change in the volume relationship between two other *categories* should imply an increased discount – and thus less Postal Service revenue – for a 5-Digit *piece.* The PB proposals would also create a hazardous precedent for future adjustments of benchmarks. And finally, the practice of "blending" costs from different sources to arrive at a cost estimate for a single product or function is considerably more problematic than PB's arguments would suggest.

In what follows, we deal first with the legal issues and subsequently (section III) with matters of rate policy.

II. LEGAL CONSIDERATIONS

Inconsistency of the PB proposal with statutory requirements

It seems clear that the PB proposal inescapably requires, as a precondition, that the 3-Digit category be eliminated, both as an element of the classification schedule and as an active Presort tier. This step, however – regardless of whether or not it would be desirable – is mail classification, and not a change in analytical principles. As such, it necessarily involves a change in Presort rates, one of which would be eliminated. Mail sorted to three digits, and previously paying the 3-Digit rate, would subsequently pay the AADC rate (itself potentially modified to reflect cost changes due to any continuing preparation of mail to three digits). Such changes are subject to Postal Service rate management authority, in the first instance, and to Commission review under sections 3622 and 3653.[3] Under those circumstances, it appears pointless to consider creating either an AADC or a "hybrid" benchmark.

GCA believes this to be true even though, in advocating its "hybrid" proposal, PB argues that 3-Digit has been effectively eliminated already:

> Equalizing the prices charged for 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.
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> 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

[3] Note that in so stating we are *not* reiterating the Postal Service's argument (Response of the United States Postal Service to Petition for Initiation of Proceeding, July 12, 2012, pp. 2-3), which the Commission rejected in Order No. 1510. The Service had argued that a benchmark is not an analytical principle, and hence is not a fit subject for the rulemaking PB requested. The Commission, however, concluded in Order No. 1510 that a benchmark is such a principle. Our present point is quite different. It is that for PB's proposal to be accepted, 3-Digit Automation Letters would have to disappear, as a category, from the classification schedule – an action which would clearly fall outside the "analytical principle" domain since it would necessarily affect rates directly – and from the real-world mailstream, where it exhibits a distinctive cost pattern which is the proper benchmark for 5-Digit. It is the (necessary) abolition of 3-Digit which, in GCA's view, is not a proper subject for an analytical principles rulemaking – but without it, consideration of a hybrid (or, for that matter, a "pure" AADC) benchmark would be no more than an academic exercise.

> mix of similar mail and the cost of each rate category represents an average typically developed from similarly, but not identically, prepared mail.[[4]]

If one considered *nothing* but the rates, PB's argument might appear plausible.[5] The fact is, however, that even though (current) 3-Digit and AADC rates are the same, 3-Digit and AADC costs are not the same. (If they were, there would be no point in proposing a hybrid or averaged benchmark.) Since the costs of the two categories are different, converting a piece of mail from AADC to 5-Digit will save a different quantum of cost than converting one from 3-Digit to 5-Digit.

In Order No. 1510, the Commission[6] explained that

> . . . 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.[7]

At present, according to Table 1 in PB's Comments, there is more 3-Digit than AADC volume in the system. In the first three quarters of FY 2012 there were approximately 8.8 billion 3-Digit Automation letters, and about half that number sorted to the AADC level.[8] There are, accordingly, two distinct, actively-used rate categories in the picture. The cost difference between them is not large – 0.37

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[4] PB Comments, pp. 5-6.

[5] That AADC and 3-Digit have the same weight and shape characteristics and the same service standard is of course irrelevant to whether they should be considered (or actually merged into) a single Presort category. They can share these characteristics and still exhibit different costs, as in fact they do.

[6] Citing, with approval, PB's formulation.

[7] Order No. 1510, p. 8.

[8] According to the Billing Determinants filed in Docket ACR2012, the FY 2012 figures are 10.5 billion (3-Digit) and 6.2 billion (AADC).

cents in FY 2011[9] and 0.56 cents in FY 2012[10] – but it is not zero. In particular, that the Postal Service does not reflect it in a rate difference does not make it unreal. (As the Commission pointed out in Order No. 1320, the statute departs from Efficient Component Pricing theory in that it sets a ceiling but no floor for worksharing discounts: "[u]nder section 3622(e), the Postal Service may offer as small a discount for worksharing as it sees fit."[11]) It follows that the cost avoided by presorting to five digits should be taken as that cost present in 3-Digit mail, but eliminated when presortation is carried to the 5-Digit level.

The simplest illustration of how these principles foreclose adoption of PB's proposal would be its original proposal to adopt AADC as the benchmark for 5-Digit mail.[12] Under this arrangement, conversion of a 3-Digit letter to 5-Digit would save \$0.0246; the potential incremental discount on that letter would be \$0.0246 + \$0.0037 = \$0.0283.[13] This would clearly violate section 3622(e), as to that and every other 3-Digit letter. Only the actual disappearance of 3-Digit mail – so that all non-5-Digit mail would have the worksharing and cost characteristics of AADC (or MAADC) letters – would remove the discrepancy.

As the Commission and the Postal Service construct the presort tree, 3-Digit is identified as "the portion of the less workshared mail category that is most likely to convert" to 5-Digit. As the Commission noted in Order No. 1510,

> 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

[9] PB Comments, Table 4.

[10] Docket No. ACR2012, USPS-FY12-10 (rounded to 0.6 cents in USPS-FY12-3).

[11] Order No. 1320, p. 3, fn. 2.

[12] PB Petition, pp. 3 et seq. We recognize that in its Comments of December 7 PB may have dropped, or at least ceased to emphasize, this proposal.

[13] See PB Comments, Table 4.

> at the 3-Digit level, the validity of this economic assumption needs to be re-examined. [[14]]

Taken literally, PB's position, as summarized here by the Commission, is close to a truism. If there were *in fact* no more 3-Digit mail, because no mailer ever prepared a mailing to that level, then there would no longer be any distinctive 3-Digit cost profile, and hence nothing which could constitute a 3-Digit benchmark. But, as PB's own statistics show, and as its advocacy of a hybrid benchmark necessarily acknowledges, 3-Digit mail has not disappeared. As long as it exists, and continues to exhibit a cost difference in relation to AADC, the established structure of the presort tree entails retention of 3-Digit as the benchmark for 5-Digit.

<u>The necessary precondition for PB's proposal does not (yet) exist</u>

PB argues in considerable detail that 3-Digit has "effectively" been combined with AADC and that it "exists in name only," and hence should be disregarded, or at least diluted, in arriving at a benchmark for 5-Digit. One basis for this view is that there is no more rate distinction between 3-Digit and AADC. As PB's original Petition expressed the idea,

> . . . 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.[[15]]

This proposition appears to confuse two distinct notions: (i) the (presumed) behavior of a mailer once the additional discount for 3-Digit preparation has disappeared, and (ii) the cost characteristics of (in particular) 3-Digit and AADC letters. It does not follow that because, in the exercise of its statutory pricing flexibility[16],

[14] Order No. 1510, p. 4.

[15] PB Petition, p. 2, reproduced at PB Comments, p. 1.

[16] See, again, the discussion of this point in Order No. 1320, cited at p. 6 above. PB's inference from the absence of a price distinction to the "absence" of 3-Digit as a usable preparation level

the Postal Service has equalized the 3-Digit and AADC rates, the costs of those two categories have also become equal.

It follows from this that PB's basic idea, though it might some day be justified as a matter of mail classification and – subsequently – the calculation of a new 5-Digit benchmark to reflect the abolition of the 3-Digit category, involves creation of a benchmark which is legally infeasible as matters now stand. And since the letters still being entered as 3-Digit mail would obtain a discount in excess of avoided cost even under PB's hybrid benchmark, the same is true of that alternative proposal. Under a hybrid benchmark, a 3-Digit piece would be counted as having a (fictitious) avoidable cost somewhere between its own and that of an AADC piece, and thus a potential discount greater than 3-Digit cost avoided if it converted to 5-Digit. There is, in fact, a serious tension in PB's arguments between its quite appropriate insistence that "[a]ccurate reporting of cost avoidance and passthrough calculations is essential to ensure compliance with the statutory limitation on workshare discounts"[17] and the proposals it actually makes.

<u>Commission precedent does not support the hybrid benchmark proposal</u>

To support its hybrid benchmark proposal, PB argues[18] that the Commission has in the past created or approved such hybrids. But (i) the examples PB provides are clearly distinguishable, and (ii) for them to be relevant, it would still

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may be an inference from a rigorous reading of the Efficient Component Pricing (ECP) rule, under which, as the Commission put it in a slightly different context, "[t]he mailer's decision to select one mail category over another then turns only on differences in cost to the mailer." Order No. 1320, p. 4, fn. 4. Strictly read, the ECP rule allows the analyst to ignore the customer's *internal* cost of choosing one rate category over another, and to focus on price alone. See id., p. 3, fn. 3. The continued presence of billions of 3-Digit pieces in the system indicates only that real-world mailer behavior reflects considerations which ECP – which is essentially a tool for price-setters, not for customers – does not (and perhaps need not) recognize. It is that real-world mailer behavior, however, which accounts for the costs to the Postal Service of the mail actually in the system, and hence also for the level of savings available through additional worksharing.

[17] PB Comments, p. 3. This discussion (section II.1. of PB's Comments) provides a very useful summary of the underlying legal situation.

[18] PB Comments, pp. 5-7.

be necessary for 3-Digit to have been abolished as a category with mail actually traveling in it.

In its Comments (December 7, 2012), PB points to what it argues are two Commission precedents for its hybrid benchmark: (i) the cost averaging, which encompasses all presortation levels, needed to arrive at a cost avoidance figure for Nonautomation Presort Letters, and (ii) the Commission's treatment of collection cost in the development of the current metered letter mail benchmark (Order No. 1320). These examples do not support PB's desired conclusion, since neither involves "blending" or "hybridization" as between existing rate categories actually used[19] by mailers.

Nonautomation Presort Letters is a single rate category, with no rate difference corresponding to the difference in presort level. It is clear, therefore, that PB's first example is no more than the cost averaging necessary to arrive at a single rate for *any* category of mail.[20] That such cost averaging is necessary in pricing, or arriving at a benchmark to represent, any *one* rate category does not support the entirely different proposal to merge two distinct rate categories for purposes of establishing a benchmark.

Similarly, the Commission's decision to include in the metered letter benchmark 60 percent of the estimated collection cost, because the record appeared to show that 60 percent of the relevant mail required collection, bears no resemblance to PB's proposed hybrid benchmark. See Order No. 1320, pp. 28-30. The Commission's determination was in no sense a "hybridization" of rate categories; it was simply an empirical judgment of how much metered letter mail

[19] As noted earlier, PB's Table 1 shows that in the first three quarters of FY 2012 there were approximately 8.8 billion pieces of 3-Digit Automation letter mail, and about half that many AADC pieces.

[20] As PB acknowledges: "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." PB Comments, pp. 5-6.

requires collection, and an adjustment to the benchmark cost to reflect that judgment. Only one subtype of mail – metered letters – was involved.

These fairly routine exercises in computing an average cost for a single type of mail did not involve anything which one could reasonably call hybridization. Consequently, they are irrelevant to PB's proposal that two recognized, actively-used rate categories should be merged to create a benchmark for a third rate category.

PB's examples from Commission practice indeed seem to depend as completely as the rest of its case on the notion that the AADC/3-Digit distinction should be (or perhaps has been) done away with. After describing them, PB goes on to state:

> Consistent with the averaging approach, the presort tree for Automation Letters should include three tiers – Mixed AADC, AADC/3-Digit (averaged), and 5-Digit.[[21]]

Taken as a whole, however, this argument seems to be circular. First, PB argues that the Postal Service "has effectively combined the AADC/3-Digit rate categories[.]" Therefore, according to PB, the cost averaging approach it would have the Commission use within that "effectively combined" rate category would be a routine exercise, no different from the cost averaging already performed on Nonautomation Presort Letters and in creating the metered letter benchmark. Finally, therefore, "consistent with the averaging approach," AADC and 3-Digit *should be* combined. But the examples of Nonautomation Presort and the metered letter benchmark, since they involved averaging within a single mail category, would be relevant only if AADC and 3-Digit had already been merged into a single new Presort tier. Since they have not, the examples cannot logically be used to justify such a merger.

[21] Comments, p. 7.

Benchmarks should be chosen with due attention to piece characteristics

One reason that PB's proposal is difficult to square with the statute and the established scheme of worksharing rate construction is that its arguments are expressed essentially at the rate category level. In its original Petition, for example, PB speaks of the "obsolescence of the 3-Digit Automation Letters tier in the presort tree"[22] Figure 1 in the Petition compares existing and hypothetical presort trees. There is no discussion of the relationship, on a piece basis, between cost avoidances and potential discounts.[23] Instead, PB argues that the 3-Digit category – considered as a category – is obsolete since it no longer carries a price incentive. Essentially the same is true of PB's December 7 Comments.

Circumstances like those PB points to as supporting its "obsolescence" argument are certainly relevant in mail classification – in deciding, for example, whether or not a particular rate category, as a whole, is still useful. But as long as that worksharing category exists, with material amounts of mail using it, rate construction (including the choice of benchmarks) must take account of the cost avoidance/discount relationship, and must do so on a piece basis, just as First-Class rates themselves are expressed. Addressing the problem only at the rate category level, as PB does, obscures this important consideration. Focusing on the problem at the piece level, as we attempt to do at pp. 4-7 above, shows clearly that both of PB's proposals imply potential[24] 5-Digit rates which would contravene sec. 3622(e) and the Commission's carefully-evolved benchmarking system.

[22] PB Petition, p. 3.

[23] These statistics are presented in PB's Tables 1, 2, and 3 – but only to illustrate the quantitative effects of its alternative proposed benchmarks.

[24] There is, as noted earlier, no statutory requirement that a worksharing discount equal (though it may not exceed) the relevant per-piece cost avoidance. (It is this feature of the governing legislation which makes it possible for the Service to offer a zero discount for mail which saves 0.37 cents (FY 2011) or 0.56 cents (FY 2012) per piece.) Still, the Commission does require an explanation for discounts substantially smaller than the avoided cost. 39 CFR sec. 3010.14(b)(6).

III. CONSIDERATIONS OF RATE POLICY

<u>PB's hybrid proposal could make 5-Digit rates depend on volume trends in other categories, rather than on costs avoided</u>

The category-wide focus just criticized as a prominent characteristic of PB's proposals has another serious consequence. The established benchmark system examines costs avoided by further worksharing, and does so on a piece basis. If, as the statute requires, discounts are not to exceed avoided cost, this piece basis is a necessity: the costs affected by presortation are piece-related costs. Avoided cost for a particular presort tier may appropriately change from year to year if the piece costs of either the subject tier or its benchmark have changed. There is, however, no reason why it should change because the volume in one other presort tier has declined and that in still a third has grown. If the respective costs of a 3-Digit piece and a 5-Digit piece have not changed from one year to the next, but the total volume of (relatively less costly) 3-Digit mail has declined compared to that of (relatively more costly) AADC mail, the PB hybrid would imply an increase in the per-piece cost avoided by 5-Digit preparation even though no such increase had taken place.

Quite apart from the section 3622(e) problems which would ensue if rates were to reflect the fictitious avoided cost just described, the hybrid benchmark itself conflicts with the basis of the established benchmarking system.

That system, as developed by the Commission and as largely reflected in sec. 3622(e), has a solid basis in the economics of ratemaking, including, particularly, Efficient Component Pricing (ECP). There is no economic reason to allow the 5-Digit discount to increase just because AADC volume is growing at the expense of 3-Digit volume as a result of mailer decisions since the Postal Service made the AADC rate and the Automation 3-Digit rate the same.

Yet periodic increases in the 5-Digit discount above current levels would be the presumptive effect of PB's hybrid proposal. As the percentage of AADC mail to the total of AADC and 3-Digit moves from its FY2011 20/80 mix to the current 50/50 mix and, foreseeably, beyond to at least an 80/20 mix in the short run, with the change in its benchmark, PB can quickly realize the appearance of increases in the costs avoided by sorting to the 5-Digit level. These are shown below in TABLE ONE, column 4. The current costs avoided for 5-Digit Automation letters is 2.46 cents. The current discount is 2.4 cents and the first ounce rate is 35 cents, 10 cents less than a single piece stamp. Under the PB proposal, costs avoided could easily grow to 2.76 cents as more and more mail is sorted only to the AADC level, not the 3-Digit level because of the lack of any rate or discount incentive.

TABLE ONE

FCLM Costs Avoided, Current and Hybrid
(Cents Per Piece)

	Mixed AADC	AADC	Auto 3-D	Auto 5-D
	(1)	(2)	(3)	(4)
Current Benchmark Costs (FY2010):	13.54	11.40	11.03	8.57
Current incremental costs avoided	---	2.14[25]	0.37[26]	2.46[27]
Hybrid FY 2011 mix 20/80	---	2.44[28]	---	2.53
Hybrid current 50/50 mix	---	2.33[29]	---	2.64
Hybrid Future mix 80/20	---	2.21[30]	---	2.76
Hybrid 100% AADC mix	---	2.14[31]	---	2.83

[25] Column 1 – Column 2

[26] Column 2 – Column 3

[27] Column 3 – Column 4

[28] (0.2 x Column 2 + 0.8 x Column 3) – Column 4

[29] (0.5 x Column 2 + 0.5 x Column 3) – Column 4

[30] (0.8 x Column 2 + 0.2 x Column 3) – Column 4

It is not superior “analytical principles” that would result from PB’s proposal, but simply higher possible discounts. With current annual volumes of Automation 5-Digit letter mail of 20.3 billion pieces in FY2012[32], each one-tenth of a cent increase in the incremental discount for Automation 5-Digit mail costs the Postal Service a little over $20.3 million. The Automation 5-Digit discount could ultimately be raised $0.0037 per piece if all Automation 3-Digit letter mail shifts to AADC mail. The negative impact on Postal Service revenues would then be about $75 million annually. Yet this decline in revenue could come about without any improvement in the cost savings per piece attributable to 5-Digit preparation.

The proposed change to a hybrid benchmark would have other negative consequences. Referring to TABLE ONE, column 2, the proposal would create confusing incentives for those now using an AADC rate. Hybrid costs avoided would increase relative to the current AADC level of 2.14 cents, and would continue above that level until, or unless, all Automation 3-Digit Level mail disappeared. Because these hybrid costs would be substituted for the actual costs of AADC mail[33], discounts for those sorting to AADC could be increased for a while under the PAEA rule that discounts not exceed costs avoided, but the additional discount would shrink over time as the lower-cost 3-Digit component faded away, and would ultimately return to the original 2.14 cents. If the discount were temporarily increased, it would represent a further loss to the Postal Service as a result of the proposed hybrid benchmark. Table Two, below, shows the potential levels of discount if PB’s hybrid proposal were adopted and the cost avoidances it generated were fully passed through in rates.

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[31] (1.0 x Column 2 + 0.0 x Column 3) – Column 4

[32] Docket No. ACR2012, Postal Service Library Reference USPS-FY12-4, First-Class Mail Billing Determinants File.

[33] See PB Comments, Figure 2, which shows the AADC/3-Digit as a worksharing level as well as a benchmark for 5-Digit.

TABLE TWO

FCLM Discounts, Current and Blended
(Cents Per Piece)

	Mixed AADC	AADC	Auto 3-D	Auto 5-D
	(1)	(2)	(3)	(4)
Current incremental costs avoided	---	2.14	0.37	2.46
Current discounts	2.0	3.0	0.0	2.4
Blended discounts 20/80 mix	---	3.3	---	2.5
Blended discounts 50/50 mix	---	3.2	---	2.6
Blended discounts mix 80/20	---	3.1	---	2.7
Blended discounts AADC mix	---	3.0	---	2.8

PB's proposed change in analytical principles, if accepted by the Commission, would set a precedent for another such petition once the ratio of AADC to AADC and 3-Digit approached 100 percent or flattened out at something less than that, at which point PB would receive no further benefit from the blended benchmark proposed in this proceeding. For Automation 5-Digit letter mail, the process described above could repeat itself. Costs avoided for Automation 5-Digit would begin to increase again, allowing further increases in the discount for Automation 5-Digit, and associated revenue losses to the Postal Service.

For example, one could proffer an"analytic principles" rationale as to why Mixed AADC or a blend of that and some other rate category would be a better benchmark. First-Class bulk mailers have argued ever since Docket MC95-1 that the Postal Service has overestimated the value of prebarcoding and underestimated the value of presorting. A second effort at a blending benchmark might therefore be a weighted average between Mixed AADC and machinable Nonautomation Presort.

The broader point is that the Commission’s actions on any so-called analytical principles have direct consequences for worksharing rates via the mechanics of how costs avoided and discounts are calculated.

<u>The benchmarking system should not be distorted to achieve larger discounts for a particular presort category</u>

PB presents its proposals almost exclusively in terms of rate categories and avoided costs, and does not extend the discussion to rates. In view of the nature of the proposals, this is understandable. It is worth noting, nevertheless, that the potential effect of the AADC or hybrid benchmark proposals would be to increase the 5-Digit discount. This is a goal which PB has consistently pursued.

In Docket RM2009-3, PB maintained that the proper interpretation of PAEA was as follows:

> Under the PAEA, First-Class Mail Presort Letters are a distinct product from First-Class Mail Single Piece letters, not a workshare variant of Single-Piece letters.[[34]]

The result would have been to detach all Presort mail from a Single-Piece benchmark. GCA argued in response that under PAEA no less than previous law, Presort letters were not a distinct product from Single-Piece in the sense that no worksharing relation could exist between them. One proof of this is that a prominent feature of PAEA was the carefully constructed provision that worksharing discounts (including from a Single-Piece benchmark) could not exceed costs avoided, and that a formal annual review establishing that was required.

The Commission in Order No. 536 rejected the reasoning of PB and others that Presort and Single-Piece were distinct products outside the purview of worksharing relationships. A major reason was that

[34] Docket No. RM2009-3, PB Initial Comments, p. 3.

> . . . in terms of price elasticity, the two categories frequently swap places, and that their relative elasticity is essentially unpredictable from year to year. There is therefore no assurance that the demand elasticity of presort mail will be greater than that of single-piece mail going forward.[[35]]

In Docket RM2010-13, PB expanded upon a proposal it had first mentioned earlier in RM2009-3, namely that the Postal Service's mail processing cost models would more accurately reflect costs by developing a "two-part" CRA adjustment for incoming secondary and non-incoming secondary operations.[36]

In its response to the PB proposal, GCA stated that it was designed simply to increase the cost avoidance basis for discounts PB receives from presorting its mail to the 5-Digit level. It demonstrated that as an analytical method, the "two-part" CRA adjustment factor does not fully distribute all non-modeled CRA costs, and that at a minimum three CRA adjustment factors would be needed to distribute all such costs if one were to proceed down the road to disaggregating the overall CRA non-modeled costs adjustment factor. While purportedly improving the accuracy of allocating mail processing costs, it would introduce a new inaccuracy by failing to allocate all non-modeled CRA costs.

The Postal Service made similar arguments to those of GCA in its reaction to the PB proposal. In its Order, the Commission rejected PB's proposal for many of the same reasons articulated earlier by GCA. It argued that there was no reason cited by PB as to why one of the six basic sorting operations should be given "unique treatment" in the development of its own CRA adjustment factor. Further, in moving from one CRA adjustment factor to two, or three or even six separate

[35] Docket No. RM2009-3, Order No. 536, p. 13

[36] As the Commission stated, in its analysis PB supported this proposal by arguing that "the ratio of CRA-to-modeled costs is higher for non-incoming secondary sorting (sorting pieces by facility and 5-Digit ZIP Code), than for incoming secondary sorting (sorting pieces from 5-Digit ZIP Code to carrier route and delivery point sequence.)" Docket No. RM2010-13, Order No. 1320, p. 54.

CRA adjustment factors, the Commission questioned how statistically reliable the data would be since the data for the single adjustment factor is already based on sampled data, and the proposal would not increase the sample size, just use a much smaller portion of that sample for each of the six operations.

<u>“Blending” of costs is a more problematic undertaking than PB recognizes</u>

At pp. 8-10 above, we showed that PB’s examples of “blended” or “hybrid” cost manipulation are irrelevant to the proposals it is now making. It is also worth noting, however, the blending of costs from different sources to arrive at a benchmark or other value is not so problem-free a procedure as PB may be suggesting.

In this proceeding PB appears clearly to applaud “the Commission’s past practice of using blended cost estimates for rate categories containing similar, but not identical, mail.”[37] But the history of using blended costs to set certain rates, far from being an unmitigated success story for workshared mail, has in fact more often proven to be harmful. One need look no further than the history of using statistically insignificant microcosms of non-presort automation delivery cost data blended with other cost data to estimate over-all costs for Bulk Metered Mail (BMM). Or the long history of blended cost data producing plainly anomalous results with negative costs avoided.

PB also applauds the fact that yesteryear’s blended cost concepts for workshared mail have now been extended to metered mail, specifically the single piece metered cost data that is the basis of the new benchmark. It highlights the Commission’s decision in RM2010-13 to blend in collection costs for metered

[37] PB Comments, p. 2.

mail based on ABA surveys that 60 percent of that industry's metered mail involves collection.[38]

But the cost estimate provided by the Postal Service for collection of metered mail, 3.811 cents, was itself problematic. In and of itself, it is a blend of two *entirely different* collection cost profiles: metered mail requiring relatively few collection stops because each stop services numerous vertically stacked businesses in an urban skyscraper environment (New York City, Chicago, and San Francisco, for example); and metered mail requiring separate stops for each business or a relatively small number of businesses, in cities and towns that are built horizontally rather than vertically (for example, some presort bureaus serving the greater Tampa and Los Angeles areas, and suburbia generally). The per piece collection cost of metered mail in the skyscraper location would be substantially less than in business locales which developed horizontally because of the lower cost of land and greater availability of it. The Commission's discussion of the Postal Service estimate, and the various alternatives and critiques presented by others, is illuminating in this regard. See Order No. 1320, pp. 28-30.

In general, blended cost exercises stand in some direct relationship with ever finer parsing and de-averaging of costs. Such fragmentation carries with it the risk that heterogeneity of cost-affecting mail characteristics within a rate category will no longer be "ironed out" and, accordingly, will produce results anomalous in terms of the purpose for which the subdividing has been undertaken. Within First Class, this is as true for Presort as it is for Single-Piece. For example, credit card statements are the lowest cost mail to run through automated mail processing. The 7 ¾ inch by 4 inch size of the envelope maximizes the throughput per hour, and is faster and cheaper than full size business envelopes at 9 ½ inches by 4 inches.

[38] Order No. 1320, pp. 28-29.

Address hygiene has from the origin of worksharing been a problem for Presort and remains so, lending a highly diverse set of heterogeneous cost characteristics to workshared letter mail. For example, it is not entirely unusual for Presort mail with a window for the delivery address with barcode to be improperly sized relative to the envelope and/or the position of the window on the envelope, such that the barcode may not appear in the window.[39] Alternatively, the window may be made with a material that is hard for a barcode scanner to read even if the barcode appears in the window. The mail processing cost of such letters is today no less than a handwritten envelope with a correctly enumerated ZIP code. Both the Presort and single piece letter will have to have a barcode applied before they can be Delivery Point Sequenced.

We discuss these details in order to underline the potential problems in blending or "hybridizing" subdivisions of cost, which may themselves incorporate unrecognized peculiarities of the subtype(s) of mail concerned, in order to generate a statistic for use in setting rates for yet another subtype. As we pointed out in a different context (pp. 8-10 above), averaging the costs of different presort levels to arrive at a single rate for Nonautomation Presort letters, or adding in a percentage of the cost of a particular function in proportion to the percentage of pieces which require that function, are fairly straightforward exercises. Blending of costs of disparate origins to create a benchmark for a different mail type, as proposed by PB, is a very different, and much riskier, undertaking.

IV. CONCLUSION

To summarize:

PB's alternative proposals would make possible 5-Digit discounts too large to meet the clear requirements of sec. 3622(e). The Commission determinations

[39] This problem occurs more frequently with bill remittance envelopes that use windows rather than having the remittance address printed directly on the envelope.

which PB cites as precedent for its hybrid proposal are easily distinguishable, and both proposals, to be legally workable, would require the complete disappearance of billions of existing pieces of 3-Digit Automation mail and of the rate category in which they travel.

The proposals conflict with the benchmark system the Commission has carefully developed for fixing worksharing discounts. In particular, the hybrid benchmark would make the size of the 5-Digit discount depend on volume trends in 3-Digit and AADC – not, as it should, on the savings available from 5-Digit preparation. They are presented essentially on a rate-category level, even though avoided cost must be estimated, and discounts set, on a piece basis.

The proposals, moreover, would distort the benchmark structure essentially to provide larger discounts for a single Presort level, and, in the case of the hybrid proposal, would require complex and statistically dubious blending of costs from different sources.

For all of the reasons discussed above, GCA respectfully submits that the Commission should decline to adopt either of the alternative benchmark proposals offered by PB.

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Respectfully submitted,

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