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

POSTAL RATE AND FEE CHANGES, 1997) DOCKET NO. R97-1

OFFICE OF THE CONSUMER ADVOCATE

INITIAL BRIEF

SECOND SECTION

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PROCEDURAL HISTORY

On July 10, 1997, the United States Postal Service filed its Request with the Postal Rate Commission (herein "Commission") for a recommended decision on proposed changes in domestic rates and fees for all classes of mail and in certain mail classifications (herein "Request"). The Request was accompanied by 42 pieces of testimony sponsored by 40 witnesses. Most of the testimony was supported with exhibits, workpapers and extensive library references.

The Request maintained that "[w]ithout rate and fee changes, the Postal Service would incur a substantial revenue deficiency in the proposed test year" (1998) of $2.4 billion, in contravention of 39 USC § 3621.[1] With the proposed rates and fees, sufficient revenue would be generated to produce a surplus of approximately $41.9 million.

Under the Postal Service's Request, the price of a First-Class stamp would be increased by one cent, from 32 cents to 33 cents for letter mail, and from 20 to 21 cents for cards. A 30 cent rate, representing a 3 cent discount, is proposed for a new mail category referred to as Prepaid Reply Mail. The Postal Service states that the discount is intended to benefit the public who make bill payments using courtesy envelopes and cards provided by large-volume business mailers, such as utilities and credit card companies.[2] The discounted postage rate would be prepaid by the provider of the courtesy envelopes or cards, thus enabling customers to return payments without affixing postage. Rate increases for Periodicals would average 3.4 percent, 3.9 percent, 4.8 percent, and 3.5 percent for In County Periodicals, Nonprofit, Classroom, and Regular Rate publications, respectively. In Standard Mail (A), rate increases would average 4.1 percent, 3.2 percent and 15.1 percent for Commercial Regular, Commercial Enhanced and Nonprofit mail, respectively, while Nonprofit Enhanced mail would see a 4.8 percent decrease. In Standard Mail (B), rate increases would average 10.2 percent, 5.0 percent, and 13.1 percent for Parcel Post, Bound Printed Matter, and Library Rate, respectively. No rate increase was proposed for Special Rate.

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[1] Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, July 10, 1997, at 1.

[2] USPS-T-32 at 34.

The Postal Service's Request also proposed important classification changes. In addition to the new Prepaid Reply Mail category,[3] the Postal Service proposed a hazardous medical materials surcharge in First Class. The Postal Service also proposed elimination of the heavy-piece discount, which currently applies to First-Class presort mail weighing more than two ounces. In Periodicals, the Postal Service would split the existing 3/5-digit rate category in each of the subclasses (Regular, In County, Nonprofit and Classroom) into separate 3- and 5-digit categories, permitting all Periodicals subclasses to have 3-digit piece rates and 5-digit piece rates for both letters and flats for automation compatible mail. Standard Mail (A) would see elimination of the Single Piece subclass and introduction of a residual shape surcharge applicable to pieces that are not letter or flat shaped. In Standard Mail (B), the Postal Service proposed a number of new parcel discounts and expanded weight and size limits. Delivery confirmation service was also proposed for Priority Mail and for Standard Mail (B), which is now limited to Standard Mail (A).

A significant aspect of the Postal Service's Request was proposed changes in costing methodologies. Those changes represented a significant departure from the long-standing costing methodologies proposed by the Postal Service in previous Commission proceedings. According to the Commission, the proposed changes would affect, among other things, the analysis and attribution of mail processing costs, carrier costs, and transportation costs. "The overall effect of these changes is that the levels of attribution from which mark-ups are calculated are considerably lower than the Service proposed in Docket No. R94-1 or the Commission used in its recommendation in that proceeding."[4]

In Order No. 1186, issued July 11, 1997, the Commission set the Postal Service's Request for hearing as Docket No. R97-1. That "notice and order" also designated W. Gail Willette, Director of the Office of the Consumer Advocate (OCA), to represent the

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[3] The Postal Service also proposed a Qualified Business Reply Mail (QBRM) classification, which was essentially similar to the existing Business Reply Mail category. Rates for QBRM would be the same as Prepaid Reply Mail (PRM). "[T]his classification would differ from PRM in the method of postage accounting and auditing." USPS-T-32 at 7.

[4] Notice of the U.S. Postal Service's Filing of Proposed Postal Rate, Fee and Classification Changes and Order Instituting Proceedings, PRC Order No. 1186, July 11, 1997, at 4.

interests of the general public, and scheduled a prehearing conference for July 30, 1997. Seventy-nine parties intervened in addition to the OCA. Chairman Edward J. Gleiman designated himself as Presiding Officer in a separate July 14, 1998, order.

The Commission sat *en banc* for 33 days of evidentiary hearings. Twelve days of hearings were allotted to the direct testimony of Postal Service during the period October 6-22, 1997. In response to motions practice concerning the evidentiary status of Postal Service library references under Commission rules, the Postal Service submitted supplemental direct testimony of 13 witnesses who sponsored 49 items initially filed as library references.[5] Four days of hearings on the Postal Service's supplemental direct testimony were held December 1-4, 1997.

OCA and participants other than the Postal Service filed their direct testimony on or before December 30, 1997, with nine days of hearings scheduled to receive this testimony, February 17-27, 1998. The OCA's direct case consisted of the testimony of seven witnesses: Thompson, Tr.20/10492 (OCA-T-100); O'Bannon, Tr. 25/13472 (OCA-T-200); Sherman, Tr. 26/13707 (OCA-T-300); Willette, Tr. 21/10679 (OCA-T-400); Callow, Tr. 23/12274 (OCA-T-500); Smith, Tr. 28/15818 (OCA-T-600); and Collins, Tr. 24/13082 (OCA-T-700). A total of 57 pieces of testimony were submitted by 50 witnesses.

Additional testimony was prompted from several participants in response to Notices of Inquiry (NOI) and Presiding Officer Information Requests (POIR). Testimony was provided from parties on the following: the Postal Service's treatment of load time, a component of carrier street time cost (NOI No. 3); and, the statistical validity of the "fixed-effects" model of mail processing labor cost variability proposed by the Postal Service (NOI No. 4). In Presiding Officer's Information Request Nos. 11 and 13, UPS and the Alliance of Nonprofit Mailers (ANM), respectively, were requested to supplement the testimony of two witnesses. As a result, six pieces of testimony were filed, including testimony from the Postal Service. In addition, LabOne, Inc., a participant granted late

[5] United States Postal Service Response to Presiding Officer's Ruling No. R97-1/42, October 14, 1997.

intervention, also filed direct testimony. This testimony was considered in hearings on March 2-3, 1998.

Rebuttal testimony of the parties and the Postal Service, filed March 9, 1998, was considered in five days of hearings, March 16-20, 1998. There were 35 rebuttal witnesses. The Commission subsequently scheduled a sixth day of hearings on rebuttal for March 30, 1998.[6] The purpose was to permit cross-examination on material produced by the Postal Service in response to a motion to compel from the Alliance of Nonprofit Mailers (ANM).[7]

The date for filing of initial briefs and reply briefs was set for April 1 and April 10, 1998, respectively. No date was set for oral argument as parties would be permitted to present oral argument only if requested.

In developing the evidentiary record, the Commission issued five Notices of Inquiry, and the Presiding Officer issued 17 Information Requests. In addition to the two Notice of Inquiry discussed above, NOI Nos. 1, 2 and 5 requested the views of all participants on, respectively, the interpretation of Commission rules authorizing the use of library references in Commission proceedings; several matters related to classification policy, and organization and editorial improvements in the Domestic Mail Classification Schedule (DMCS); and, whether the Commission should recognize actual 1997 Postal Service net income in developing its rate recommendations.

In addition to POIRs Nos. 11 and 13 discussed above, topics addressed in the other 15 POIRs include the treatment of purchased transportation related to Parcel Post and Bound Printed Matter; the reasons for rising costs associated with library rate mail; the use of relevant cross-price elasticities in Ramsey pricing; the relevance of short-run and long-run production capacity in developing a model of mail processing cost variability; clarification of the development of costs and volumes for several special services; and, changes in the treatment of mail processing labor costs for First-Class and Standard (A) Mail.

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[6] *See* Tr. 36/19643-49; *see also* P.O. Ruling No. R97-1/113, March 24, 1998.

[7] Motion of Alliance of Nonprofit Mailers to Compel Production of Mail Acceptance Logs Underlying USPS-RT-22 or, in the Alternative, to Strike Portions of That Testimony, March 17, 1998.

Procedural Issues. One issue having significant impact on the Commission's prosecution of this docket centered on the evidentiary status of library references as documentation to support the Postal Service's Request. This issue took on heightened importance given the nature of the Postal Service's Request. By general consensus, the Postal Service's Request was considered the most complicated and complex in Commission history.[8] Its proposed changes in long-standing costing methodologies, in addition to the volume of material introduced, and its fragmented and incomplete presentation, strained the ability of participants to comprehend the magnitude and ramification of the changes proposed. Moreover, the procedural wrangling occasioned by these features of the Postal Service's Request jeopardized the Commission's ability to meet the 10-month deadline.

The evidentiary status of library references initially filed with the Postal Service's Request came into focus with the filing of three motions by Nashua Photo Inc. (Nashua), District Photo Inc. (District), Mystic Color Lab (Mystic) and Seattle Filmworks Inc. (Seattle) (hereinafter "NDMS").[9] One asked the Commission to strike portions of witness Fronk's testimony that relied upon a cost study supporting proposed increases in First-Class nonstandard surcharges that was not sponsored or prepared by witness Fronk, while the other sought to compel Fronk's response to an interrogatory inquiring into the authorship of the supporting mail cost study. The third motion sought to compel a response from witness Crum to an interrogatory concerning the sponsorship and preparation of a cost study underlying the proposed residual shape surcharge for Standard Mail (A).

The Presiding Officer denied the NDMS motion to strike portions of witness Fronk's testimony without prejudice and, as an alternative, provided the Postal Service

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[8] *See*, for example, Office of the Consumer Advocate Reply in Support of Major Mailers Association's Motion to Compel Answers to Certain Interrogatories, September 10, 1997, at 1; *see also* Order on Certified Motions, PRC Order No. 1201, November 4, 1997, at 10-11; Pretrial Brief of Alliance of Nonprofit Mailers, February 10, 1998, at 1.

[9] NDMS Motion to Strike [Specified Portion of] Testimony of Postal Service Witness David R. Fronk (USPS-T32), August 29, 1997; NDMS Motion to Compel Response of United States Postal Service Witness David R. Fronk to NDMS/USPS-T32-16[a-c;], August 22, 1997; and, NDMS Motion to Compel Response of United States Postal Service Witness Charles L. Crum to NDMS/USPS-T28-1(a)-(d) and (f)-(g), August 29, 1997.

with an opportunity to identify a sponsoring witness for the supporting cost study.[10] Nevertheless, the Presiding Officer found that the Postal Service's "position on the sponsorship of the support for its proposals for certain proposed surcharges is at odds with the basic rules of evidence."[11] The Postal Service subsequently identified another witness in the proceeding as sponsor of the cost study.[12] With respect to the NDMS motions to compel responses from witnesses Fronk and Crum, the Presiding Officer concluded that, as a result of subsequent filings answering most of the questions initially objected to by the Postal Service, the NDMS motions were moot.

The potentially broad impact of the issues addressed in the Presiding Officer's ruling prompted the Commission to issue Notice of Inquiry No. 1 concurrently with the ruling.[13] All parties were asked to identify and comment on material filed as library references that the Postal Service should have properly designated as evidence. Five parties responded.[14] Their comments focused primarily on prospective rule changes, although five library references were identified that they contended should have been sponsored by the Postal Service.

Subsequently, with the commencement of evidentiary hearings on October 6, 1997, the Postal Service began offering library references for admission into evidence. This action raised objections from interested participants that they had not had adequate time to prepare for full cross-examination of the proffered documents. The Presiding

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[10] P.O. Ruling R97-1/20, September 17, 1997, at 6.

[11] *Id.*

[12] Notice of the United States Postal Service in Response to Presiding Officer's Ruling No. R97-1/20 and Motion for Late Acceptance, September 25, 1997.

[13] Notice of Inquiry No. 1 on Interpretation of Commission Rules Authorizing the Use of Library References, September 17, 1997.

[14] Response of Alliance of Nonprofit Mailers to Notice of Inquiry No. 1, October 3, 1997; Nashua Photo Inc., District Photo Inc., Mystic Color Lab and Seattle Filmworks, Inc. Response to Notice of Inquiry No. 1 on Interpretation of Commission Rules Authorizing the Use of Library References, October 3, 1997; Newspaper Association of America Comments in Response to Notice of Inquiry No. 1, October 3, 1997; Office of the Consumer Advocate Response to Notice of Inquiry No. 1 on Interpretation of Commission Rules Authorizing the Use of Library References, October 3, 1997; Parcel Shippers Association (PSA) Response to Notice of Inquiry No. 1 (NOI No. 1) on Interpretation of Commission Rules Authorizing the Use of Library References, October 2, 1997; and Response of United States Postal Service to Notice of Inquiry No. 1 (USPS Response), October 6, 1997.

Officer, while admitting sponsored library references into the record, permitted participants to request procedural relief by October 16, 1997.

Three motions were submitted in response.[15] Collectively, the motions opposed admission into evidence of certain library references and supplemental testimony; requested that the Commission stay the proceedings; and, that the Commission strike portions of various Postal Service testimony and certain library references, in addition to other relief.

In Order No. 1201, issued November 4, 1997, the Commission denied the procedural relief requested.[16] After reviewing the origin of its rules concerning the submission of evidence and the history and proper role of library references in Commission proceedings, the Commission concluded that "staying the proceeding, or refusing to consider evidence premised on these library references, is unwarranted." [17] The Commission pointed to the Postal Service's willingness to sponsor as evidence 49 items previously provided as library references.[18] It also noted that the availability of library references since July "tends to support a finding that participants have had adequate opportunity to review the materials in question."[19] Nevertheless, the Commission granted participants additional time for further inquiry.

Order No. 1201 also directed that the Presiding Officer issue a revised procedural schedule.[20] The Commission, in ordering this procedural change, did so with the following pointed remarks:

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[15] Motion of Alliance of Nonprofit Mailers and American Library Association to Stay Proceedings; Nashua Photo Inc., District Photo Inc., Mystic Color Lab and Seattle Filmworks, Inc. Motion to Strike Specific Portions of the Testimony of Various Postal Service Witnesses and Certain Library References and For Other Relief; and, Newspaper Association of America Motion in Opposition to Admission Into Evidence of Certain Library Reference Materials and Supplemental Testimony USPS-ST-44; filed October 16, 1997.

[16] Order on Certified Motions, PRC Order No. 1201, November 4, 1997.

[17] *Id.* at 12.

[18] USPS Response, *supra* note 5.

[19] *Id.* at 13.

[20] *See* P.O. Ruling No. R97-1/54, November 4, 1997.

> In order to allow participants to prepare to cross-examine on this newly designated evidence, additional time must be allowed for discovery and additional hearing dates must be scheduled. These additional procedural steps will delay subsequent stages of the case, such as dates for submission of intervenor and rebuttal testimony. The Postal Service has thereby caused delay that will jeopardize the Commission's ability to issue a recommended decision within 10 months. Such a risk is obviously undesirable, but it is necessary to ensure that due process rights have been accorded to all participants.

Accordingly, the schedule delayed the filing of the participants' case-in-chief by six weeks, and permitted slightly shorter periods for oral cross-examination on intervenor and rebuttal witnesses.

Considerable motions practice with procedural consequences surrounded the availability and use of Postal Service data related to nonprofit mail. Under the Postal Service's Request, rates for nonprofit Standard Mail (A) Regular Rate were proposed to increase sharply, in comparison to a small overall increase for the corresponding commercial Regular Rate.

The Alliance of Nonprofit Mailers (ANM) served discovery requests on the Postal Service. It suspected that the disproportionate rate increases were driven by disproportionate increases in the costs attributed by the Postal Service to nonprofit mail. The Postal Service objected to the discovery requests as untimely, and on the grounds of burden.[21] ANM, in turn, filed a motion to compel answers to the interrogatories filed.[22]

The Presiding Officer denied the ANM's motion to compel.[23] In doing so, he relied in significant part on Postal Service representations that the discovery and other data requests sought "new information requiring extensive research and analysis of data available only from 'the Field,' rather than existing data or operating procedures."[24] In

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[21] Objection of United States Postal Service to Interrogatories of the Alliance of Nonprofit Mailers (ANM/USPS-20-23, and 25-26), December 19, 1997.

[22] Motion of The Alliance of Nonprofit Mailers to Compel Answers to Interrogatories and for Permission to File Supplemental Testimony within Two Weeks of Receipt of Answers from the USPS (ANM/USPS-20-23 and 25-26), December 22, 1997.

[23] P.O. Ruling No. R97-1/86, January 9, 1998.

Order No. 1207, issued February 9, 1998, the Commission subsequently upheld the Presiding Officer's decision on appeal by ANM.[25]

On March 9, 1998, the Postal Service filed rebuttal testimony of witness Schenk that relied on data drawn from existing Postal Service records and a newly commissioned study. Using that data, witness Schenk attempted to quantify "the degree to which nonprofit IOCS costs are overstated because volumes and costs are inconsistent."[26] ANM filed a motion to compel production of "acceptance logs" or "disqualification logs"—the business records containing the data—underlying witness Schenk's estimates but not filed with the rebuttal testimony.[27] ANM's motion also requested that it be permitted to conduct supplemental cross examination on those documents or to file surrebuttal testimony. In the alternative, ANM asked the Commission to strike the relevant portions of witness Schenk's testimony.

During the hearing on March 20, 1998, to accept the rebuttal testimony of witness Schenk, the Presiding Officer announced his intention to compel disclosure, or strike relevant portions of witness Schenk's testimony, unless the Postal Service decided to produce the disputed documentation.[28] The Postal Service agreed to provide the available acceptance logs. The Presiding Officer subsequently scheduled a hearing on March 30, 1998, to conclude cross-examination on the testimony of witness Schenk and material provided.[29]

The Postal Service's resistance to providing critical information during discovery concerning proposed changes in costing methodologies prompted additional motions practice. The Major Mailers Association (MMA) filed interrogatories that asked the Postal Service to show what effect attributing costs according to Commission-approved methods would have on 1) unit mail processing costs, which served as the basis for

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24 *Id.* at 5

25 Order Affirming Presiding Officer's Ruling R97-1/86, PRC Order No. 1207, February 9, 1998.

26 USPS-RT-22 at 11-20, 25-29.

27 ANM Motion, *supra* note 7.

28 Tr. 36/19643-46.

29 P.O. Ruling R97-1/113, March 24, 198.

worksharing discounts for the various categories of First-Class letters, and 2) cost coverages for various subclasses and rate categories at the Postal Service's proposed rates.

The Postal Service objected to the interrogatories posed, maintaining that Rule 54(a) is intended to preempt discovery concerning the impact of proposed rate changes if measured by established methods.[30] MMA responded with a motion to compel.[31]

In Order No. 1197, issued October 1, 1997, the Commission granted MMA's motion to compel.[32] In its order, the Commission rejected the Postal Service's view of Rule 54(a), stating that one of the Postal Service's obligations is "to provide timely notice, in a process that is subject to severe time restrictions, of the impact of its proposed changes in rates so that the parties and the Commission can know what is at stake in time to respond appropriately."[33] With respect to the first matter, the Commission directed that responses be provided.

The Commission also stated that the only outstanding issue, with respect to the second matter, was whether the Postal Service should make "a handful of minor, miscellaneous 'final adjustments' that correspond to the final adjustments that it makes to its own proposed attributable costs."[34] The Presiding officer concluded that it should so that parties might understand the effect of those changes on cost coverages.

Similar issues arose in a set of interrogatories posed by OCA. OCA/USPS-71 asked the Postal Service to list the "steps necessary to compute the test year mail processing unit cost . . . when mail processing costs are assumed to be 100 percent variable."[35] The requested information was similar in form to the list of four steps

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[30] Objection of United States Postal Service to Major Mailers Association Interrogatories MMA/USPS-T5-1 and 6(b), MMA/USPS-T25-1(B) and (C), MMA/USPS-T30-3(A) through (D), 4(A) through (D), 6, 7(A)(2) and 8(C)(1) through (3), and MMA/USPS-T32-15(B), August 25, 1997.

[31] Major Mailers Association's Motion to Compel Answers to Certain Interrogatories, September 8, 1997.

[32] Order Accepting Certification and Granting Major Mailers Association Motion to Compel, PRC Order No. 1197, October 1, 1997.

[33] *Id.* at 4.

[34] *Id.* at 10.

provided by the Postal Service in response to a question posed by MMA. Unlike MMA's interrogatory, however, which was limited to certain First-Class letter mail, OCA's interrogatories sought this information for "each rate element," and requested that the Postal Service identify the specific portions of its documentation that would need to be changed. The Postal Service objected to the interrogatories posed as irrelevant, burdensome to produce, and that the documentation already provided should permit OCA "in some instances" to produce the information itself. [36] OCA filed a motion to compel responses to these interrogatories.[37]

The Presiding Officer subsequently granted the OCA's motion to compel.[38] He observed that Order No. 1197 made it clear that "the Postal Service has the burden of demonstrating the impact that its proposed changes in attribution principles would have on the attributable costs and cost coverages of the various subclasses at the Postal Service's proposed rates."[39] The Presiding Officer concluded:

> The Commission and most participants share the OCA's need to be able to identify and understand these changes. This need justifies imposing a burden upon the Postal Service, even if it is substantial.[40]

However, rather than OCA's requested documentation for "each rate element," the Postal Service was ordered to "provide calculations for the worksharing categories and associated rate benchmarks within the First-Class, Periodicals, Standard A and Standard B subclasses."[41]

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35 OCA/USPS-71; Tr. 19-C/9140.

36 Objection of Untied States Postal Service to Office of the Consume Advocate Interrogatories (OCA/USPS-71-73, 74(a) and (b), 75(a) and (b), 76-78), September 26, 1997.

37 Office of the Consumer Advocate Motion to Compel Answers to Interrogatories OCA/USPS-71-73, 74(a) and (b), 75(a) and (b), 76-78, 84, 85, 86(i), and OCA/USPS-T5-42, October 10, 1997.

38 P.O. Ruling R97-1/61, November 13, 1997.

39 *Id.* at 7.

40 *Id.*

41 *Id.* at 8.

Another issue having potential procedural (and substantive) consequences involved the treatment of the Postal Service's actual financial results. At the time of its Request, the need for higher rates after the previous two years of favorable operating results was debatable. Moreover, the subsequent release of the Postal Service's 1997 Annual Report showed actual net income of $1.264 billion rather than the $636 million estimated by the Postal Service for FY 1997 in its Request.

In this context, the Commission issued Notice of Inquiry No. 5, concerning the recognition of interim year financial results.[42] Eight parties responded, plus the Postal Service.[43] The FY 1997 results also prompted the Commission, on February 24,1998, to communicate with the Postal Board of Governors concerning the inclusion of 1997 actual results in the upcoming recommended decision for Docket No. R97-1.[44]

In an unprecedented action, the Commission requested that the Board of Governors make available earlier than scheduled the data on actual results of operations for FY 1997. In making its request, the Commission noted that the operating results for FY 1997 were significantly better than projected at the time of filing. The Commission also observed that without such data, rates would be "flawed by the fact that they reflect pre-reclassification operating results rather than more representative, recent, fiscal and operating realities."[45] This, in turn, may cause many mailers to pay "inappropriate

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[42] Notice of Inquiry No. 5 on Recognizing Interim Year Results, January 28, 1998.

[43] Joint Comments of Advertising Mail Marketing Association, ADVO, Inc., The Direct Marketing Association, Mail Order Association of America, and Parcel Shippers Association in Response to Notice of Inquiry No. 5 (on recognizing Interim Year Results); Memorandum of Alliance of Nonprofit Mailers on Recognition of Interim Year Results; Response of Major Mailers Association to Notice of Inquiry No. 5 on Recognizing Interim Year Results; Office of the Consumer Advocate Response to Notice of Inquiry No. 5 on Recognizing Interim Year Results; Response of United States Postal Service to Notice of Inquiry No. 5; filed February 13, 1998.

[44] Letter from Edward J. Gleiman, Chairman, George W. Haley, Vice Chairman, W.H. LeBlanc, III, and George A. Omas, Commissioners, U.S. Postal Rate Commission to the Honorable Sam Winters, Chairman, Board of Governors, United States Postal Service, February 24, 1998 (requesting FY 1997 actual financial results).

[45] *Id.* at 2.

rates."[46] The Commission concluded that it would take approximately three months to incorporate this data into a recommended decision.

The Board of Governors subsequently rejected the Commission's request, stating that "it should not comment at this time on the state of the evidentiary record currently being developed by the Commission."[47]

An unusual procedural issue involved a Postal Service "strategy" document that allegedly was inadvertently filed electronically with the Commission. Relating to rebuttal testimony concerning the revenue requirement, that document stated, *inter alia*, that the testimony should "[p]rovide updated test year cost changes for known, quantifiable, actual events that have been raised on the record"; "[p]rovide updated information on cost increases to offset the decreases . . ."; and, that "A complete revenue requirement update would be time consuming and would probably result in a further reduction in test year costs."[48] The document was marked for identification and entered into evidence by the Presiding Officer during the March 19, 1998, cross-examination of Postal Service rebuttal witness Porras.[49] The Postal Service subsequently filed a motion to strike the transcribed document and related questioning of witness Porras about the document from the record.[50] In its motion, the Postal Service maintained that no foundation had been laid for the document's admission, and that the document was subject to protection under the work product privilege.

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[46] *Id.* at 1.

[47] Letter from Sam Winters, Chairman, Board of Governors, United States Postal Service, to the Honorable Edward J. Gleiman, Chairman, U.S. Postal Rate Commission, March 3, 1998 (declining to comment on the state of the evidentiary record of the proceeding).

[48] Tr. 35/18730.

[49] *Id.*

[50] Restatement of Objection by the United States Postal Service and Motion to Strike the Transcription, Acceptance into Evidence, and Questioning of Witness Porras Concerning the Purported Strategy Document Found Within Electronic Version of Exhibits Voluntarily Provided to the Commission, March 24, 1998.

The Presiding Officer set March 30, 1998, as the date for responses to the Postal Service motion.[51] OCA and one other party opposed the Postal Service motion. The motion was not to be ruled upon before the time for filing initial briefs.

[51] P.O. Ruling No. R97-1/115, March 25, 1998.

SUMMARY OF ARGUMENT

I. REVENUE REQUIREMENT

The First Section of the Office of the Consumer Advocate's ("OCA") Initial Brief, filed March 16, 1998, argued that the Commission must reject the Postal Service's rate increase request because the Postal Service has not carried its burden of proof to demonstrate there will be revenue deficiency in the test year. A/P 6 earnings have become available since that filing. The continued favorable earnings reinforce OCA's contention, as discussed in the First Section of OCA's Brief.

Obtaining FY 1997 actuals to reflect the high unanticipated earnings in FY 1997 is now largely moot, but collecting the FY 1998 actuals would be desirable. In the alternative, OCA contends that the initially requested revenue requirement of $2.447 billion should be adjusted to account for many of Postal Service witness Porras' adjustments as well as a $51 million reduction proposed by DMA for supervisory savings related to new programs. OCA rejects the Postal Service requests for an additional $298 million for ADP Year 2000 expenses and the conditional contingency increase. OCA contends "other program" expenditures should be reduced by at least 10 percent ($500 million) to account reasonably for an FY 1998 shortfall in "other program" expenditures. These reductions would reduce the proposed rate increase by about $1.1 billion. The reduced revenue requirement would permit retention of the 32 cent First-Class single-piece rate and allow for implementation of CEM.

II. CEM ISSUES

OCA proposes that the Commission recommend Postal Service adoption of Courtesy Envelope Mail ("CEM") at a rate equivalent to Prepaid Reply Mail ("PRM") (without PRM's high fees). CEM consists of preprinted, automation-compatible self-addressed business envelopes that would be provided by mailers voluntarily to their customers. The envelope would have to bear indicia signifying that the piece is eligible for the CEM discount. If the Commission were to adopt the Postal Service's proposed costing methodology, the proposed CEM rate would be four cents lower than the First-Class single-piece rate, reflecting a 100 percent passthrough of mail processing cost

avoidance. Under such a methodology, revenue loss from CEM adoption should not be substantial, amounting to about $183 million.

In support of CEM's adoption, OCA notes that consumers like lower prices, and that the Postal Service effort to portray CEM as "too inconvenient" is a smokescreen effort to protect its excess profits generated from this type mailpiece. Monitoring CEM provider compliance and educating CEM envelope providers and mailers will not be a problem, especially since the media likely will give wide coverage to a First-Class rate reduction. Further, CEM is an attractive alternative to PRM, the Postal Service's high-cost and unpopular (with large CRM providers) response to Commission approval of CEM in MC95-1. Moreover, the discount available under CEM advances Postal Service objectives such as meeting the threat of electronic diversion and ensuring operational simplicity. CEM also will promote the statutory goals of 39 U.S.C. § 3623(c), e.g., because CEM more closely aligns rates with costs. Not recommending CEM will conflict with the undue discrimination provisions of 39 U.S.C. § 403(c).

Postal Service criticisms of CEM have no merit. There will not be widespread confusion over which rate applies – postal customers now deal with a wide variety of rates (including First-Class rates) and there is no evidence of consumer confusion. Nor will consumers tend to short-pay non-CEM mail by applying a CEM stamp. Consumers in fact tend to *overpay* rather than underpay postage – perhaps out of a desire to ensure that important bill-payment or personal mail get to their destinations. Although CEM is portrayed as "inconvenient" by the Postal Service, occasional purchase of a CEM stamp booklet is hardly an inconvenient transaction – and 68 percent of recent survey respondents said they were very or somewhat likely to use CEM stamps if the savings were just three cents. The Postal Service arguments that approving CEM will make the rate schedule too complicated, and that this will run counter to consumer preferences for simplicity in retailing, are belied by the Postal Service's own proposals for increasing the complexity of an already highly complicated rate schedule, while its opinion evidence on simplicity in retailing trends is contradicted by factual analysis. Nor is there evidence that there will be widespread readdressing of CEM envelopes.

The Postal Service's arguments that CEM will substantially increase education and window service costs for the Postal Service have no support in the record; in

addition, the last minute submission of evidence discloses likely discovery violations. Analysis of the education and window service cost evidence reveals it should be entitled to little or no weight because it could not be verified on cross-examination. The argument that businesses could encounter problems from CEM consists of naked assertions with no empirical support. In contrast, OCA has shown that major CRM providers will encounter few problems and will incur only *de minimis* costs converting to CEM.

The Postal Service also speculates that there may be envelope design problems, forgetting that it also has argued on the record that it is highly skilled in mailpiece design and vigilant in ensuring that mailers comply with automation compatibility standards. (Such standards now exist for CRM mailpieces, and CEM is but a small variation on current CRM pieces.) CEM will not cause stamp inventory problems – one would note that the Postal Service offers hundreds of stamp designs and denominations now. And because CEM is just a minor variation of CRM (but at a lower rate for household consumers) its adoption will not intrude upon Postal Service management prerogatives. Finally, OCA recommends that to avoid pervasive discrimination among First-Class Mail users, the Commission must condition any rate and classification recommendations upon concurrent adoption of CEM by the Postal Service.

III. UNDUE OR UNREASONABLE DISCRIMINATION OR PREFERENCE

OCA examines two Postal Service proposals in this proceeding that are unduly discriminatory both from a service and rate standpoint. The Postal Service's proposed expansion of parcel post length and girth limitations is unduly discriminatory from a service discrimination standpoint because it is being offered only to high volume mailers, i.e., those with nine or more parcels in the same mailing. The non-compensatory rate proposed is discriminatory from a rate perspective.

Further, its delivery confirmation proposal is unduly discriminatory from a service standpoint because it arbitrarily does not extend this premium service to certain mail classes (such as First-Class). It is discriminatory in a ratemaking sense because it precludes household and small business mailers from taking advantage of the lower-priced computer access service available to large mailers.

The discrimination section of the brief discusses service discrimination at length because it is less often encountered than rate discrimination. Though less familiar, the economic dangers and statutory proscriptions associated with service discrimination are very real. The Commission's *Red-Tag* decision, where service discrimination was found, also is discussed. OCA further argues that it should be the evidentiary burden of the Postal Service to show why the cited discriminations are not *unduly* discriminatory. OCA also takes the position that remedying the discriminations discussed will not unduly interfere with postal operations.

IV. RATE ISSUES

A. Post Office Boxes.

The testimony of OCA witness James F. Callow (OCA-T-500) addresses the Postal Service's post office box fee proposals. Witness Callow's testimony presents the only proposal now before the Commission that would restructure post office box fee groups and move toward a more cost-based fee schedule. His proposal would restructure Fee Groups C and D into six new fee groups based upon the Cost Ascertainment Group (CAG) of post offices in order to create more rent-homogeneous groupings, as part of a transition to a further restructuring of these fee groups. In so doing, witness Callow's proposal would create a more fair and equitable fee schedule by better aligning fees with costs.

His proposed fees reflect a new cost allocation methodology that distributes a portion of volume-variable post office box costs by CAG. His proposed box fees in new fee groups CAG H-L are generally lower than under the Postal Service proposal, because their allocated costs are lower. Correspondingly, box fees are higher in other fee groups where allocated costs are higher. Witness Callow points out that average postal rental costs are higher in larger post offices, because larger post offices tend to be located in higher-rent urban areas. Also, there are virtually no supervisors in offices CAG H or below.

B. Standard B Library Rate.

Library Rate Mail is a low volume subclass with a small number of IOCS tallies. The thin sample of tallies from which the Library Rate costs are derived causes statistical distortion and does not inspire confidence that these are the true costs. OCA proposes a remedy for this cost instability and demonstrates how its proposal will prevent the *de facto* elimination of a preferred category of mail. Under the Postal Service's proposal, over 95 percent of the Library Rate subclass is expected to migrate to the Special Rate subclass because the rates would be less. OCA witness Collins' use of Special Rate costs as a proxy for the unreliable costs of Library Rate is appropriate. The rates she recommends are reasonable, the impact on revenue is minimal, and her rates preserve historical, Congressionally set rate relationships.

C. Stamped Cards.

Witness Carlson proposes a different methodology for setting the rate for stamped cards, which OCA endorses. He demonstrates that the current 20-cent rate for stamped cards will produce a 263 percent cost coverage under his proposals. This is a more appropriate coverage level for stamped cards than the Postal Service proposal, which would produce an astronomical cost coverage level of over 300 percent. Witness Carlson shows that stamped cards are much more compatible with automation than are private cards and thus are much less costly to process. OCA believes his proposals will lower costs and benefit both customers and the Postal Service.

V. RESOLVING METHODOLOGICAL AND CLASSIFICATION ISSUES

Although OCA advocates that the Commission refuse to raise rates in this proceeding because the Postal Service has not supported the revenue requirement it proposes, there are narrow exceptions where rates will need to be raised slightly. A separate issue arises concerning what action should be taken on proposed new classifications and services and proposed new costing methodologies. OCA firmly believes that all of these matters should be decided on their merits. In those instances where Postal Service revenue requirement and costing methodology influences are

embedded in the proposed rates of new classifications, it may be necessary to recommend beneficial changes only as shell classifications.

VI. METHODOLOGICAL ISSUES

A. Ramsey Pricing.

OCA summarizes the evidence presented by Dr. Roger Sherman concerning Ramsey prices and the efficient component pricing principle. Dr. Sherman's Ramsey pricing analysis differs from the approach used by Postal Service witness Bernstein by using long-run (instead of short-run) elasticities to forecast volume responses, which is advisable because the prices that are adopted should be in place beyond the period of the test year. Dr. Sherman presents a summary of Ramsey prices and their effects, and compares this with Postal Service proposals at the level of five major mail classes. He finds that the overall welfare loss is greater under the Postal Service's proposed rates by more than $1 billion. He then explores Ramsey prices under different constraints and presents such constrained prices and their effects for the main subclasses of mail, comparing them with Postal Service proposals. He shows that Ramsey prices minimize welfare losses. The prices proposed by the Postal Service impose a welfare loss of $3.159 billion, or about $1 billion more than the most constrained Ramsey prices. Dr. Sherman also examines worksharing discounts, offering his perspectives for consideration in future cases.

B. Parcel Post Volume Distribution.

OCA witness John O'Bannon criticizes the Postal Service's rigid application of the historical distribution of parcel post volumes to individual rate cells without regard to widely varying magnitudes of price increase and decrease in discrete cells. The Postal Service's distribution procedure implies positive own-price elasticities for the DBMC rate category, an outcome that violates basic principles of economic theory. Witness O'Bannon advocates a more common-sense approach in which cells experiencing a decrease in rates would be allotted a larger share of a projected DBMC volume increase than those experiencing a large increase in rates.

C. Special Handling.

OCA discusses the Postal Service's Special Handling proposal. The costs reported for Special Handling are derived from the IOCS. Because the volume of Special Handling is so low, there are very few tallies associated with it. This thin sample results in costs that suffer from the same defects which affect Library Rate Mail. Given the fatally flawed Postal Service cost analysis, the Postal Service's proposed 220 percent fee increase must be rejected by the Commission.

D. Hazardous Materials.

OCA discusses the proposed Hazardous Medical Materials ("HMM") surcharge. The Postal Service, which bears the burden of proof regarding its proposed HMM surcharge, has failed to meet that burden. Industry witnesses conclusively show that the Postal Service has not made realistic estimates of costs and volumes associated with the proposed surcharge. They also demonstrate the Postal Service's lack of clear thought and erroneous assumptions regarding the HMM industry. In fact, lack of consultation with the industry is probably the cause of many of the proposal's defects. The numerous shortcomings fatally flaw this proposal and the Commission must reject it.

VII. VOLUME VARIABILITY

The Postal Service, via witness Bradley's testimony, has introduced a new method for calculating the volume variability of the labor component of mail processing costs. Traditionally the Postal Service has assumed 100 percent volume variability for labor as a function of Total Piece Handlings ("TPH") for mail processing costs. Witness Bradley's computations produced variabilities ranging from 15 percent to 100 percent, depending on activity.

Witness Bradley's new approach for measuring labor cost variability is not acceptable because the proposed methodology and study are flawed. The Bradley approach does not provide a basis for changing the traditionally assumed 100 percent volume variability assumption.

OCA witness Smith and UPS witness Neels provided detailed analyses of the Bradley study's major deficiencies. The study is based on a database whose reliability has been questioned by the Postal Service itself. The data scrubbing efforts that were designed to improve database reliability were incorrect and biased the conclusions. The use of TPH and labor hours as exogenous and endogenous variables respectively is inaccurate. Neither variable captures the economic activity for which it is used. Further, the analysis of the relationship between TPH and hours in the study is not in good agreement with the underlying data structure, as shown by actual plots of the data and the computation of an F test. Economic theory does not substantiate the form of the translog model used by witness Bradley, for he has the wrong variables in his analysis. The subsequent application of the fixed effects estimation procedure is wrong. The fixed effects estimation procedure fails to treat capital as a driving variable interacting with labor and technology. Capital is a key factor of production which affects the cost of labor in mail processing; the Postal Service has discussed a large capital investment plan focused on technology improvement and cost reduction. These longer run expenditures will be made during the period in which rates will be in effect, but are ignored in terms of their impact on labor costs and mail processed. As a result, the study's focus is short run. A pooled or cross-sectional approach should be considered, along with the use of added explanatory variables in order to capture longer run cost behavior.

Even if the study were correct, which it is not, the study should not be extrapolated to non-MODS offices, which account for approximately 25 percent of mail processing labor and the overwhelming majority of facilities. In addition, it is inappropriate to use the study to model by proxy certain postal activities for which data are unavailable. There is no substantiation for such extrapolation, and the conclusions appear to be dubious. Nor does the study meet the accepted standards for a regulatory study. Given the lack of substantiation for witness Bradley's study, OCA urges the Commission to reject it.

VIII. COSTING ISSUES

A. Cost Distributions.

Postal Service witness Degen has made great strides in the distribution of component 3.1 mixed-mail costs. He partitions mail processing costs into MODS cost pools and then exploits strong subclass associations to operations, item types, and container types within the cost pools. Challenges to his testimony are feeble and he easily parries them on rebuttal. Moreover, no effective barriers to adopting the Degen distribution approach while rejecting witness Bradley's volume variability analysis have been erected.

B. Cost Model.

OCA summarizes how witness Thompson updates the Commission's cost model to reflect Postal Service costing methodology changes, and how she uses it to replicate the Postal Service's Base Year (FY 1996), FY 1997 and FY 1998 (Test Year) data. Witness Thompson's testimony gives the commands for executing the updated model, and provides intervenors a personal-computer-based cost model that may be used to replicate Postal Service costs and run alternative cost allocations. In R84-1, the Commission stated that the best way to validate the assumptions and data inputs of a complex model is to independently replicate each series of calculations made by the model. In the past, the Commission has provided updated copies of its cost model and all associated files as library references to its recommended opinions and decisions. However, the Commission's cost model operating instructions and documentation require a degree of familiarity with the Postal Service's costing methodology. The cost model documentation in witness Thompson's testimony and library references provides instructions on executing the Commission's cost model program for those users with minimal knowledge of the Postal Service's costing methodology. Her testimony explains the procedures she followed to update the Commission's version of the Postal Service cost model, and provides intervenors an updated Commission cost model which allows a fuller discussion and a more accurate assessment of the 39 U.S.C. § 3622(b) criteria.

IX. INSURANCE

OCA argues that before approving the substantial increase in insurance fees proposed, the Commission should address important insurance issues affecting consumers. Consumers are provided little information during the insurance purchase transaction, yet there are significant exceptions in coverage. The Postal Service has no incentive to disclose such information, especially because of the legal protections the Postal Service enjoys in the insurance area. If a private business were to sell (non-insurance) service contracts in the same way in which the Postal Service sells insurance, it arguably would be subject to legal action by the Federal Trade Commission for engaging in deceptive practices. OCA argues that the Postal Service should be compelled to give the consumers adequate insurance information at the time of purchase through a written communication such as a consumer pamphlet. Such a minimal requirement will not intrude upon Postal Service management prerogatives, and is necessary to protect consumers.

I. REVENUE REQUIREMENT

A. The Postal Service Has Not Carried Its Burden Of Proof To Demonstrate It Will Have A Revenue Deficiency For The Test Year And The Commission Must Therefore Recommend No Revenue Increase.

OCA demonstrated in the first section of its initial brief why the Postal Service rate increase must be rejected by the Commission.[52] Any reasonable projection of the Postal Service earnings for the test year to-date when considered with recent prior year earnings history indicates a probable profit in excess of $1 billion. The Postal Service has therefore failed to carry its burden of proof that it will not break-even during the test year and, pursuant to the policies set forth in the Postal Reorganization Act,[53] the rate request must be rejected.[54] Additionally, the first section of the OCA brief contends that the projected earnings for the test year justify rejection of the Postal Service's claim for any rate increase due to a contingency or Recovery of Prior Year Losses (RPYL) requirement.[55]

This OCA position does not suggest the entire proceedings are fruitless. We previously indicated that the above rulings would still permit the Commission freedom to make adjustments within the current rate level to each class of mail or type of service as it finds necessary in accordance with other policies of Title 39.[56]

New earnings information has become available since the first section of the OCA brief was filed. That portion of the brief relied upon earnings of the Postal Service reported through Accounting Period 5 (A/P 5) for the four-week period ending January 30, 1998. At that time, the Postal Service had already earned $1.155 billion for the test

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[52] Initial Brief of the Office of the Consumer Advocate, Initial Brief, First Section, Docket No. R97-1, filed March 16, 1998.

[53] 39 U.S.C. § 3622 (b).

[54] Witness Porras agrees that the Commission does have the authority to recommend no rate increase if it so chooses. Tr. 35/18627.

[55] Initial Brief, First Section at 29-32.

[56] *Id.* at 3, note 3.

year[57] as opposed to an estimated total test year loss in the rate filing of $1.392 billion.[58] During rebuttal cross-examination, witness Porras reported for the first time Postal Service earnings for A/P 6 of $78 million or $148 million more than budgeted.[59] Year-to-date through A/P 6, the Postal Service has now reported earnings of a whopping $1.233 billion,[60] which is $284 million ahead of budgeted projections,[61] and only $31 million shy of earnings for the entire FY 1997 year. Thus, the Postal Service is consistently continuing to exceed its budget by a large margin as OCA has projected.[62]

However, only seven accounting periods remain in the test year and the Postal Service stubbornly continues to project a loss of $2.4 billion despite mounting contrary evidence.[63] In other words, the Postal Service now claims in the rate filing that it will lose what amounts to an average of $350 million in each of the remaining seven test year accounting periods,[64] or almost $90 million per week. The Postal Service's own budget projects an average loss for the same seven accounting periods of a considerably lower amount, $163 million.[65]

Witness Porras assures the Commission that the Postal Service will lose what it has projected if the program managers spend funds as promised.[66] But his pleas are unconvincing. The basis for the large loss estimates[67] and all hopes of actually losing

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57 Tr. 35/18604.

58 USPS-T-9, Exhibit USPS-9B, revised 8/22/97.

59 Tr. 35/18604.

60 Tr. 35/18604.

61 ($1.155 billion + $78 million) = $1.233 billion. $1.233 billion - $949 million = $284 million. Tr. 35/18661.

62 In the rate case filing, the Postal Service does not estimate test year earnings by accounting period. Therefore, it is not possible to make a direct comparison by accounting period of actual test year earnings with estimated rate case test year earnings.

63 Tr. 35/18603.

64 $2.447 billion / 7 remaining accounting periods.

65 ($1,141,473 / 7), Tr. 35/18661. Over the entire year the Postal Service budget projects a loss per accounting period of $188 million ($2.447 billion / 13 accounting periods).

66 Tr. 35/18625.

the $1.3 billion in the last five accounting periods or upwards of $2 billion assuming there is no rate increase,[68] rely on the program managers' spending program money.[69] Same period last year (SPLY) experience and the year-to-date earnings belie his exhortations. In this record, all the detailed and sophisticated econometric forecasts placed end-to-end do not reflect the harsh reality of actual earnings. Contrasted to the detailed econometrics is a the vast void of detailed information as to just when the delayed program expenses (on which all hopes of a Postal Service loss now rely[70]) will be incurred during the last part of the test year. By no stretch of the imagination can realistic projections of the current Postal Service test year actual performance be held consistent with the break-even policy of the statute.[71] The Commission must therefore find the Postal Service will earn a profit in the test year and recommend no rate increase in this proceeding.

B. Assuming, Arguendo, The Commission Determines The Year-To-Date Test Year Earnings Should Not Be Used As A Basis For Its Revenue Requirement Recommendation, The Commission Must Consider Whether To Obtain Actual Earning for FY 1997 and Roll-Forward Those Figures To The FY 1998 Test Year.

In its February 13, 1998 response to the Commission's Notice of Inquiry No. 5, the OCA explained why the Commission should obtain and rely upon actual FY 1997 data.[72] Postal Service witness Porras contends that the large underestimated profits in FY 1997 resulted, for the most part, from increased revenues, not decreased expenses.[73] He says that recalculating the distribution keys for the relatively small changes in expenses

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67 Tr. 35/18680.

68 Tr. 35/18687.

69 Tr. 35/18681 and 18691.

70 Tr. 35/18680-1 and 18691.

71 39 U.S.C. § 3621.

72 Office of the Consumer Advocate Response to Notice of Inquiry No. 5 On Recognizing Interim Year Results, February 13, 1998.

73 Tr. 35/18577.

from those estimated would have little impact and consequently is not warranted.[74] At this time, so late in the proceeding, OCA agrees that obtaining now *only* the FY 1997 actuals for purposes of rolling them forward to calculate more precise distribution keys and for other adjustments would not be worthwhile. OCA believes that with the passage of time, the issue of whether to obtain *only* FY 1997 actuals is largely moot. The essential actuals to be obtained are the FY 1998 figures. If detailed actuals are to be collected, the FY 1998 actuals should be gathered in light of the high earnings so far this test year to determine whether any rate level increase is justified or, if so, to what extent the revenue requirement should be reduced.

C. Assuming, Arguendo, The Commission Declines To Determine The Revenue Requirement On The Basis Of FY 1998 Actuals, The Revenue Requirement Estimated By The Postal Service Must Be Adjusted Downward For The Reasons Stated Below.

The following sections discuss the reductions OCA contends must be made to the Postal Service revenue requirement. They consist in part of various downward and upward adjustments to routine expenses. The other more significant portion of the adjustments relate to matters directly within the control of the Postal Service and are tied to "other program" expense.[75] OCA accepts most of the adjustments but rejects the untimely adjustment for the ADP Year 2000 program. OCA believes a significant downward adjustment must also be made in the "other program" amounts for the reasons discussed below.

1. Postal Service downward adjustments to the revenue requirement.

Starting with a revenue requirement estimate of $2.447 billion,[76] witness Porras presented exhibits listing several possible downward adjustments that he reluctantly offers as potential downward adjustments to the Postal Service's original revenue

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[74] Tr. 35/18577-84.

[75] Tr. 35/18710-11.

[76] Exhibit USPS-9A, Tr. 35/18603.

requirement.[77] OCA agrees that, at a minimum, the Commission must adjust the revenue requirement in accordance with the downward adjustments presented by witness Porras.[78]

The Postal Service also seeks to collect an amount for the recovery of prior year losses (RPYL). In the original rate filing, the Postal Service requested $446.9 million[79] for RPYL. Witness Porras has recalculated that amount to reflect the higher than anticipated FY 1997 earnings. One-ninth of the current RPYL is $377.1 million.[80] This additional downward adjustment must be recognized.

Witness Porras argues that lowering the Postal Service's original revenue requirement would "subvert the policy objectives of management and the Board...."[81] Further, witness Porras states that updating Postal Service data with more current information is not necessary and would be unfair to intervenors who spend months evaluating Postal Service estimates. Witness Porras believes that updated information would not be adequately reviewed and thus should not be changed or updated.[82]

Witness Porras' pleas for maintaining the *status quo* are without merit. In his own testimony, he acknowledges that forecasts are prepared ahead of time.[83] As new data becomes available, the Commission has an obligation to consider all information. Failure to do so would result in the Commission being negligent in exercising its statutory responsibilities and inconsistent with past practice.

A detailed breakdown of the downward expense adjustments included in witness Porras' Exhibit USPS-RT-11B indicate reductions of $635,654,000 less than previously

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77 Tr. 35/18595, Exhibit USPS-RT-11B. Witness Porras prefers no downward adjustments.

78 *Ibid.*

79 Tr. 35/18596, Exhibit USPS-RT-11C.

80 *Ibid.*

81 Tr. 35/18576.

82 *Id.* at 18576-81. *See also,* Tr. 35/18654.

83 Tr. 35/18573.

estimated expenses.[84] The downward adjustments are comprised of the following, in thousands:[85]

• COLA reductions	($228,880)
• FERS contribution rate decreases	(102,348)
• Health benefit premium changes	(24,808)
• Actual inflation indexes	(84,719) [86]
• Personnel related other programs	(131)
• Personnel related other programs	(3,911)
• Workload adjustment recalculated due to COLA, health benefits and FERS contributions	(6,365)
• Mix adjustment recalculated due to COLA, health benefits and FERS contribution	(874)
• Note interest reduction due to reduced borrowing due to FY 1997 earnings	(116,320)
• Error correction in volume variability adjustments	(55,298)
Total	($623,654)

Most of the downward cost adjustments listed above relate to specific adjustments in personnel costs required by law or by contract. Except for the error adjustment, the adjustments relate to certain changes in various personnel or interest costs, all of which are tied directly or indirectly to the rate of inflation. The cost reductions are virtually certain to occur. As the Postal Service internal memorandum discussing these cost reductions says, the reductions are known, quantifiable, actual events.[87] None of the above costs relate to any adjustments in the Postal Service's new program expenditure estimates.

The only program cost reduction offered by the Postal Service by witness Porras' rebuttal testimony relates to the single reduction offered in a group of adjustments to a single Postal Service program, Mail Transportation Equipment Centers (MTEC). As a result of the MTEC program and opening delays, witness Porras estimates a net cost

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[84] The sum of all negative amounts in the exhibit.

[85] Tr. 35/18595.

[86] A small cost increase due to substitution of actual inflation indexes for “all other non-personnel “costs of $654,000 is included in witness Porras' exhibit and excluded in this table but added back below. Tr. 35/18595.

[87] Tr. 35/18730, para. 1.

reduction in non-personnel costs and additional mail transportation equipment costs of $52,154,000.[88]

Accordingly, personnel cost changes etc., and the MTEC costs, are the only downward cost adjustments the Postal Service has recognized since its rate filing. These downward cost adjustments total $675,808,000. At a minimum, the Commission must reduce the Postal Service revenue requirement by the amount of these cost reductions.

Additionally, DMA witness Buc recommends the Commission correct a $51 million ($31 million + $20 million) error made by the Postal Service[89] relating to the reduction of supervisory costs for new programs which the Postal Service failed to account for in its new program estimates. Postal Service interrogatories tried to suggest that witness Buc erroneously assumed the program managers' estimates failed to take into account expense reductions for supervisors. Witness Buc's assumptions are adequately explained in his interrogatory responses. He noted program managers were not instructed to determine whether the planned savings would reduce supervisor hours. Also, he pointed out that no supervisor savings appear in the cost estimates for “other programs” in Postal Service Library Reference H-10.[90]

All the above downward adjustments to the revenue requirement total $726,808,000. This does not include any reduction for an overall “other program” expenditure shortfall which OCA contends must be recognized to some extent, as discussed below. Upward adjustments must also be made which are discussed next.

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[88] Tr. 35/18598, Exhibit USPS-RT-11E.

[89] Tr. 28/15363, DMA-T-1 at 5.

[90] Tr. 28/15399-400. *See also*, Tr. 28/15401- 03 and 15428-32.

2. Postal Service proposals for upward adjustments to revenue requirement for statutory, personnel and inflation adjustments.

a. OCA does not object to certain upward adjustments to the revenue requirement proposed by the Postal Service.

Witness Porras attempts to offset all but $195 million of his downward adjustments to Postal Service test year expenses. As the Postal Service's memorandum relating to the planned rebuttal testimony of witness Porras states, these additional expenses were added "to offset the decreases."[91] Witness Porras' additional expenses total $480.8 million (($675.8)-($195)=($480.8)).[92]

Following are the relatively minor expenses witness Porras included in his rebuttal testimony to offset the reductions in revenue requirement occurring since the rate filing, in thousands:[93]

• Personnel related cost reductions	$ 281
• Personnel related cost reductions	7,430
• Transfer of the workers' compensation liability	14,330
• Capitalized interest	29,400
• Substitution of inflation indexes for non-personnel programs	654
• Impaired assets building depreciation	15,000

The above cost increases amount to $67,095,000 and relate to statutory changes or personnel costs resulting from inflation adjustments and related interest rate changes. OCA does not object to these adjustments.

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[91] Tr. 35/18730, para. 2.

[92] Tr. 35/18595, Exhibit USPS-RT-11B. The net of the increased expenses appearing in the "Totals" column.

[93] Tr. 35/18595, Exhibit-USPS-RT-11B, Total column, positive amounts except for "other programs" which are discussed below.

b. Postal Service proposals for upward adjustments to revenue requirement for "other programs," highway transportation service and ADP Year 2000 program.

It is important to remember that the structure of the rate filing allows the Postal Service virtually free reign to add whatever expenses it chooses on the flimsiest of rationales in order to reach any desired expense goal. The expenses estimated by the Postal Service for "other programs" for FY 1998 exceed the prior year "other program" expenses by over $2.5 billion.[94] That amount is simply added to the bottom line of all other Postal Service expenses in calculating the revenue shortfall the Postal Service needs to recoup with increased rates.[95] The amounts for newly added expenses are wholly within the control of the Postal Service as add-ons to its ongoing base operating costs. Thus, if the Postal Service desires a particular rate recommendation from this Commission, it need only establish new programs with expenses equal to the amount required. For instance, in this proceeding, the $2.5 billion of new program expenses (that is, new programs whose expenses are *greater than and in addition to* last year's new programs expense amount)[96] far exceed the estimated operating loss of $1.4 billion and are about equal to the total rate increase request of $2.4 billion.

This is not to suggest the Postal Service has approached the rate proceeding in this way. But it does suggest that this Commission must look very closely at the justifications for the new program expenses; especially here, where the total of new programs expenses have just about doubled over last year from $2.5 billion to about $5 billion.[97] Even though the Postal Service was adequately geared up last year to spend only half the money on new programs which it projected for this year, last year the Postal Service nevertheless fell short at least ten percent, and probably more, of its new program spending goal.[98]

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[94] Postal Service Library Reference H-10, Exhibit B, Total Other Programs. *See also,* Tr. 9/4567-70.

[95] Tr. 9/4565.

[96] Tr. 9/4561, 4563.

[97] Tr. 9/4562-3.

If the Postal Service had not been quite so ambitious in its new programs for FY 1998, the rate request would have been lessened by a proportionate amount. For instance, if the Postal Service had only planned a 50 percent increase in new programs expenses over FY 1997 (still an enormous undertaking for any company), the revenue shortfall would have been reduced by half that amount, or $1.25 billion. Then the need for any rate increase this year would have been erased unless the Postal Service expected to file a rate increase merely to increase the rate level for a contingency and/or to recover for prior year losses.

The Commission must also look very carefully at the Postal Service's assurances that it will spend the amount it claims for new FY 1998 programs this year. It does not require a large shortfall in new program expenses to totally decimate, if not eradicate, the Postal Service claims of revenue deficiency. It is OCA's contention that despite the assurances of the Postal Service's witness Porras that managers claim funds will be spent, other facts contradict this conclusion and the Commission should adjust downward the estimates for new program expenses.

i. Highway transportation service.

Witness Porras proposes to add a large cost adjustment with a minimum of justification for additional Highway Transportation service expenses of $115.763 million because costs are 11.6 percent higher than for the same period in FY 1997.[99] The same type of adjustments could be made for almost every ongoing program. Each program will likely spend an amount at variance from the original estimate. However, OCA does not contest this upward revision.

ii. ADP Year 2000 program.

Witness Porras' largest expense increase occurs in the ADP, Year 2000 program, and amounts to $298 million of the $429 million of expense increases he proposes.[100]

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[98] Tr. 9/4563-4. Witness Tayman estimated the FY 1997 spending shortfall on new programs to be in the $250-350 million range. Tr. 9/4563and 4400.

[99] Tr. 35/18585.

While the ADP, Year 2000 program, in general, is certainly an important program, the amounts the Postal Service recently decided to spend in FY 1998 for expenses on this program test credulity. Witness Porras offered no detail to support his assertions. When this lack of support is considered along with the Postal Service's strategy memorandum which the Postal Service inadvertently included in witness Porras' filing,[101] it is clear the Postal Service recognized it needed to conjure up some amount for this record to offset the cost reductions realized in its FY 1998 estimates.[102]

The test the Postal Service seems to apply before agreeing to a reduction in expenses is much more stringent than the test it would apply when, as here, it wishes to increase its expenses. The downward adjustments to cost reductions discussed above reflect known and certain changes in the prior estimates for items such as COLA, inflation, etc. On the other hand, the upward adjustments for the year 2000 software are not known and not certain. To the contrary, the claimed expenses are not, at this time, "known, quantifiable, actual events."[103]

Any new program added during this proceeding to offset actual cost reductions must be required to pass the same scrutiny it would have had to pass had it been offered initially. A program must not be included in the test year if it only has limited evidentiary support. First, the record contains a document indicating the intent of the Postal Service to offset the cost reductions with new programs. Second, programs in USPS library reference H-10 are supported by documentation in that exhibit demonstrating the expected costs and savings prepared by the managers of the programs and set out for each cost segment in that exhibit.[104] Witness Porras does not do this in his exhibit for the ADP Year 2000 software. Witness Porras did not provide any detailed project schedule for the ADP Year 2000 program. There is no underlying documentary support

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[100] Tr.35/18598, Exhibit USPS-RT-11E.

[101] Tr. 35/18730.

[102] The document states: "Provide updated information on cost increases to offset the decreases included under number 1" and "In order to balance back to the original revenue requirement…increase in the contingency from 1.0% to 2.0%." Para. 2.

[103] Tr.35/18730.

[104] Tr. 9/4558-9.

for his bare assertions that the Postal Service has suddenly decided to spend in this fiscal year another $298 million on ADP Year 2000 costs in addition to previously planned amounts. There is no documentation indicating when the $298 million will be spent. There is no back-up of the type provided in USPS library reference H-10. Witness Porras was asked for details of the planned expenditures by accounting period and he stated, "I don't have that detail with me, that information."[105]

It is the Postal Service's responsibility to supply evidence for the record. It is not the responsibility of participants to request this documentation if it is missing. It is the responsibility of the Commission to determine the appropriate test year costs. To do this the Commission must determine whether, as a matter of fact, the Postal Service will spend the amounts it says it will spend or that it "plans" to spend on this program. To reach any factual conclusion, the Commission must consider the evidence of record. The *only* evidence of record for the $298 million ADP Year 2000 expenses are witness Porras' recent assertions without any back-up support, despite having been asked several times why he believed the amount would be spent. He offered no documentation. He offered no representation of any documentation; only that he has been "told" money will be spent.[106]

The total ADP program expense estimate is to spend $1.019 billion during the test year,[107] yet as of accounting period 5 only $56 million was spent.[108] At this time, the flimsy support in the record proffered by the Postal Service to justify these new FY 1998 program expenditures on the ADP Year 2000 program does not outweigh the conclusion (not to mention the shear head-shaking disbelief) that these expenditures are not certain enough to warrant interjection into the Postal Service test year cost of service. The Postal Service needs to offer better justification for such expenditures offered at the last minute, just one day before the end of the scheduled hearings when the time for interrogatories is long past.[109] There should be internal justifications, approvals,

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[105] Tr. 35/18699.

[106] Tr. 35/18700.

[107] Tr. 35/18694.

[108] Tr. 35/18696.

budgeted expenditures and the like. These have not been offered. The Commission must reject any estimates deficient in this respect.

The OCA therefore believes the Commission should reject the additional $298 million of expenses claimed by witness Porras for the ADP Year 2000 program.

3. OCA's proposed reduction to the revenue requirement for probable deficient “other programs” expenditures in FY 1998.

Turning to the broader picture and Postal Service plans for new programs expenditures in their entirety, the Postal Service estimate is not firm enough to warrant total acceptance.

The Commission must decide the credibility of the Postal Service witnesses and the reasonableness of their claims. Witnesses Tayman and Porras claim the planned FY 1998 other program funds will be spent. They are relying on what others tell them. Even if they believe the Postal Service’s managers, it does not follow that the Commission must blindly accept their assertions. The Commission must have available sufficiently detailed spending schedules in order to be properly assured the Postal Service investment and related expense targets are going to be met. Normally such detailed evidence might not be necessary, but the large earnings to date in the test year, last year's spending shortfall, and the huge impact that even a small shortfall in planned expenditures would have on targeted costs, require a more detailed evidentiary showing.

The Commission also has the duty to consider the reasonableness of the Postal Service assertions. The assertions are not reasonable. To accept them, one must assume the Postal Service is willing to throw money at projects to insure that expenditures meet the rate case estimates made only one year ago but which have proven to be unrealistic. Apart from newly planned additional expenditures on new programs, witness Porras admits the Postal Service is behind in its test year spending plans on new programs.[110] The credibility of witness Porras' assertions must be

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[109] Witness Porras testified on Thursday March 19, 1998, the 35th day of hearings. For all practical purposes, the hearings in this proceeding concluded the next day, March 20, 1998, although one day of hearings were held on March 30, 1998.

[110] Tr. 35/18710.

questioned when he claims that all the money for new program expenses will be spent even though the Postal Service is way behind in its projected expenditures.

The Postal Service does not have a blank check to throw money at new programs. There is no question that the Postal Service has the management prerogative to determine the funds it needs. However, according to a fundamental Postal Service Reorganization Act policy, the Postal Service does not have the prerogative to spend funds inefficiently.[111] Nor does the Postal Service have the prerogative to estimate new program expenditures by merely picking a number out of thin air. The Commission has the duty to ensure that all estimates are reasonable. The Postal Service profits to date may well reflect year-to-date under-spending on these programs.

On cross-examination, Witness Porras could not tell which programs are ahead or behind in their spending schedules, and how much is to be spent on them in the test year. Incredibly, he declined to provide the information, stating, "I don't have that information with me."[112]

Witness Porras also said many of the expenses are for services.[113] For instance, the ADP Year 2000 program includes many services. Services require time. Common sense suggests that once planned services are behind schedule, especially services of the magnitude in the Postal Service programs, only additional time will allow them to catch up. That means the delayed expenditures will not be made-up in the test year and witness Porras' testimony readily recognized that possibility.[114] Witness Porras' claim that a systematic review was undertaken on the 81 programs and that expenditures are on target is nullified by his admission that there may be some programs with lower costs but that such information has not been given to him.[115] There is no substantive showing

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[111] 39 U.S.C. § 3621.

[112] Tr. 35/18710.

[113] Tr. 35/18748.

[114] Tr. 35/18705. It is clear that the Postal Service is depending solely on the expenditures for new programs to ensure a loss for the test year. The managers may be in a dilemma. If, as a group, they do not spend the funds on new programs, the Postal Service will have very nice earnings. If they do not spend the funds quickly enough to lead to a loss, the Commission may not recommend a rate increase to make up for losses.

that these expenditures will naturally "catch-up". The Commission should assume that, once delayed, a project will not catch up unless the Postal Service provides specific documented evidence to the contrary.

OCA recommends the Commission review the Postal Service responses to questions concerning the status of just one program, the Augmented Sales Force program, part of the "Tactical Sales Force Strategy." As long ago as last summer and early fall, it was apparent the Postal Service was making wholesale adjustments to its other programs without informing the Commission about any updates.[116] Tracking the planned and redirected expenditures is like watching a shell game. First, an expense is planned here, and then it is moved over there, but then again maybe it is not there at all. Given this kind of ongoing changes in the programs it is impossible to believe that all the programs are "on target" as presented to the Commission in this record.

It is highly unlikely the planned "other program" expense funds will all be spent during the test year. If one looks to last year's FY 1997 record, the Postal Service expenditures fell at least 10 percent below the spending goal.[117] Witness Porras concedes that last year the Postal Service was "geared-up" to spend the money on new programs[118] but it nevertheless did not meet its spending goals[119]. Projecting the FY 1997 experience to FY 1998, when about twice as much is planned to be expensed on new programs, it does not stretch the imagination that the Postal Service will fall at least 10 percent short, or even more, of its spending goal again this year. The Postal Service has not presented any numbers demonstrating that it is on its spending target for FY 1998.[120] Given all the experience of the Postal Service, the most reasonable conclusion

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[115] Tr. 35/18706.

[116] Tr. 9/4484, 4510, 4521-2.

[117] Tr. 9/4563-4. "Details by program are not available." Tr. 9/4572.

[118] Tr. 35/18692-3.

[119] Estimates of the shortfall varied between $250 million and $350 million. Tr. 9/4400 and 4562.

[120] Witness Porras surmised that he believed spending on new programs to be about $50 million behind schedule. He offered no supporting documentation and was very vague and unhelpful about details. The Postal Service has not placed any plans for spending, by accounting period, in this record. Tr. 35/18710, 18706.

is that the Postal Service cannot reasonably be expected to spend all the money it projects to spend on new programs in FY 1998. The Commission should therefore make a reasonable downward adjustment in the Postal Service estimates.

Another aspect for reviewing the record is available to the Commission as a cross-check of the rate filing. The Postal Service budgeted an FY 1998 loss of $228 million assuming a rate increase on June 1 of the test year.[121] The rate increase assumes an annual increase of approximately $2.4 billion. The increased revenue would average about $200 million per month. Accordingly, in the four months the new rates would be in effect, it is reasonable to assume the new rates would recover an additional $800 million that would not otherwise be recovered. Adding $800 million to the budgeted deficit for FY 1998, it appears the budget numbers implicitly assumed that without the rate increase the Postal Service would experience a loss of $1.028 billion.[122]. This is distinctly at odds with the rate-filing deficit of $1.4 billion.

Witness Porras' testimony suggested the difference might be slightly less than the $375 million calculated since he believed the new rates projected a benefit of an amount closer to $900 million.[123] On the other hand, the summer months are the slowest months for the Postal Service and it seems more likely the new rates would recover $700 million or less over the remaining four FY 1998 months. The amount is significant. If the amount is $700 million, then the Postal Service FY 1998 budget implicitly assumed without the rate increase a deficit of only $928 million for the test year. This is about $475 million in higher earnings than the earlier Postal Service estimate in its rate filing prepared about six months earlier.[124]

This analysis does not indicate the source of any increased earnings that might have been projected in the budget but which were not estimated in the rate filing. Remember that OCA's analysis only relates to shortfalls in "other program" expenses. It does not even consider unanticipated volume growth to which the Postal Service

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[121] Tr. 35/18661 and 18648.

[122] Tr. 35/18669-70.

[123] Tr. 35/18671.

[124] Tr. 35/18673-78 and 18644.

attributes most of the FY 1997 earnings surprise. The cross-check analysis does show the Postal Service anticipated earnings would move in the same positive direction that the actual year-to-date earnings have been moving. It also suggests that the Postal Service's own figures tend to recognize the rate filing overstates the actual deficit in the $500 million range. This is certainly in the same ballpark as the OCA estimates based upon the Porras updates and indicates a reasonable expectation about the new program expense shortfall based on last year's experience.[125]

The net effect of OCA's position is that, assuming, arguendo, the Commission is (1) unwilling to recognize the huge profits of the test year and reject the rate increase on the basis there are large profits in the Test Year, and (2) unwilling to update the record in its entirety for the FY 1998 actuals, then the Commission should nevertheless reduce the Postal Service revenue requirement. The $738,500,000 revenue requirement reductions must be those listed by witness Porras and witness Buc, discussed above, offset only to the limited extent of the certain cost increases of $182,858,000, discussed above.

Additionally, the revenue requirement should be reduced by at least ten percent to reflect delays in estimated other program expenditures. This amounts to about $500 million. Such a reduction would, in part at least, recognize the delays in program expenses which are undoubtedly reflected in the high unanticipated test year Postal Service profits.

4. Postal Service's increased contingency request must be rejected.

The Postal Service is also seeking an increase in rates to cover a potential contingency loss of at least $605.6 million. Witness Porras recently added another $299.9 million to the request for a total contingency request of $905.5 million,[126] or almost $1 billion. The Postal Service memorandum, referenced above, indicates the Postal Service’s view that an increased contingency is set at a level to assure a pre-

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[125] OCA wants to make clear that this in no way contradicts the views expressed in the First Section of its brief where the conclusions are drawn primarily from an analysis of the Postal Service earnings year-to-date.

[126] Tr. 35/18596, Exhibit USPS-RT-11C.

conceived level of revenue requirement. It states, "In order to balance back to the original revenue requirement an argument will be made for an increase in the contingency from 1.0% to 2.0%."[127] Similarly, witness Porras' testified:

> As witness Tayman testified, "the Postal Service might have opted for a larger contingency if the test year costs projected for this filing had been lower." Tr. 9/4458. Let me reinforce Mr. Tayman's testimony by stating that had the moderately lower expenses I have documented in my testimony been known, I would have recommended a slightly larger contingency to the Board.[128]

The Postal Service suggests that if the revenue requirement is reduced by the Commission, based upon legitimate evidentiary findings, an increase in the contingency to make-up for the reduction would be justified. This view totally ignores the policies and purposes of the legislative framework. The Postal Service theory would wrench from its very foundation the Commission's authority to recommend rates consistent with the break-even policies of the Act. The Commission should not even seriously consider such a request.

D. OCA Supports Major Mailer's Association's (MMA's) Proposal To Retain The First-Class Single-Piece Rate of 32 Cents.

Given the necessary revenue requirement reductions to the Postal Service test year cost of service, the question arises of how to design rates to take the reductions into account. MMA witness Bentley advocates retention of the current 32-cent rate for the basic First-Class stamp.[129] OCA wholeheartedly supports this proposal, both for the reasons outlined throughout this section of the brief and for the reasons presented by witness Bentley. First, the revenue loss from retaining the First-Class rate is calculated at about $809 million.[130] Witness Bentley contends the revenue loss should be made up

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[127] Tr. 35/18730.

[128] Tr. 35/18586-7.

[129] Tr. 21/11165 (MMA-T-1 at 10).

[130] Tr. 21/11229, testimony of witness Bentley (MMA-T-1).

in part by a reduction in the revenue requirement requested by the Postal Service.[131] The reduction is of the same order of magnitude as the total revenue requirement reductions which OCA proposes. Second, retention of the 32-cent rate would be consistent with the maintenance of equivalent mark-up indices between First-Class and Standard Mail and the cost coverages of both would move closer to a systemwide average.

MMA's rationale for retaining the current 32-cent First-Class rate has its roots in declarations made in numerous Commission opinions that First-Class and Standard Mail (or third class) should have roughly equivalent markup indices, and that the cost coverage of both classes should move closer to the systemwide cost coverage average.[132] As proposed by the Postal Service, the First-Class markup index would be 119, while that of Commercial Standard Mail A would be an unjustifiably smaller 106. Witness Bentley is very concerned (as is OCA) that:

> Thus, First-Class letters, which account for 49 percent of mail volume and only 17 percent of weight, are being asked to contribute 55 percent of total mail revenues. In contrast, Commercial Standard A mail, which accounts for 34 percent of volume and 69 percent of weight, is being asked to provide only 20 percent of total mail revenues.[133]

Consequently, OCA, together with MMA, urges the Commission not to increase the First-Class, first-ounce letter rate of 32 cents.

E. Conclusions On Revenue Requirement.

Based upon the above discussion, and as an alternative to rejecting the entire proposed rate level increase as set forth in the first section of OCA's Initial Brief, OCA recommends the following adjustments to the Postal Service revenue requirement:

Original revenue requirement, deficiency as revised	$1,392,000,000

[131] Tr. 21/11229.

[132] *Id.* at 11158.

[133] *Id.* at 11157-8 (citations omitted).

Postal Service downward adjustments	
Exhibit USPS-RT-11B reductions and MTEC	(675,808,000)
DMA downward adjustment	(51,000,000)
Limited Postal Service upward adjustments	
Exhibit USPS-RT-11B increase and Hwy Trans. Ser.	182,858,000
OCA downward adjustments for “other program” expense shortfall	(500,000,000)
Operating deficiency	$ 348,050,000
Contingency	605,600,000
Recovery of Prior Year Losses	377,100,000
Total increased revenue requirement	$1,330,750,000

OCA's proposed revenue requirement reduces by $1.117 billion the original revenue deficiency proposed by the Postal Service, from $2.447 billion to $1.331 billion. This reduction in the revenue requirement allows the Commission to recommend retention of the First-Class 32 cent rate. It also allows more than sufficient revenue for OCA's CEM proposal.

II. OCA PROPOSES THAT THE COMMISSION RECOMMEND POSTAL SERVICE ADOPTION OF COURTESY ENVELOPE MAIL ("CEM")

A. CEM Defined.

OCA proposes that the Commission recommend Postal Service adoption of CEM at a rate four cents below the single piece First-Class Mail rate. CEM consists of preprinted, self-addressed business envelopes that would be provided by mailers voluntarily, as a courtesy, to their customers.[134] To qualify, CEM mail would have to bear a facing identification mark;[135] bear a proper barcode; bear a proper ZIP code; bear indicia signifying that the piece is eligible for the discount; meet Postal Service automation compatibility standards; and be preapproved by the Postal Service.

B. CEM Rate Recommendation: A Four Cent CEM Discount Will Not Cause Appreciable Revenue Loss.

> OCA recommends that the CEM rate be four cents lower than the First-Class single-piece rate. The cost study prepared by Postal Service witness Miller for Prepaid Reply Mail and Qualified Business Reply Mail ("PRM" and "QBRM," respectively) showing a cost avoidance of 4.0 cents for PRM/QBRM letters, applies to CEM.[136] Under current regulations and operations, the cost avoidance of courtesy reply mail ("CRM")[137] and PRM letters is the same. The statement of Postal Service witness Fronk that the "new [PRM] rate better aligns rates with costs"[138] thus also would apply to CEM. The widely used CRM envelopes will be transformed into

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[134] The proposal involves CEM as a rate category within the existing First-Class letters subclass; the proposal does not extend to cards.

[135] The upper right hand corner of the mail piece would bear a postage affixation block informing consumers that a First-Class discount stamp may be used. The Postal Service may choose to add other indicia to ensure that postal workers could identify the piece readily.

[136] Direct Testimony of Postal Service witness Miller, USPS-T-23, at 11.

[137] Courtesy reply mail is a preprinted return envelope (or card) provided as a courtesy to customers. The customer pays the postage at the full single-piece rate.

[138] Direct Testimony of Postal Service witness Fronk, at 40.

> CEM mail with only one likely minor alteration – the addition of a CEM indicator informing consumers they may use a discounted CEM stamp.

Revenue loss from CEM adoption should not be substantial. According to Postal Service witness Miller on rebuttal, "[t]aking into account the likely percentage of CEM usage, a revenue loss of $134 million would be a more plausible projection."[139] This stems in part from a recent survey put into the record by Postal Service rebuttal witness Ellard showing that 61 percent of consumers were very or somewhat likely to use a discounted stamp.[140] OCA witness Willette had projected a maximum revenue loss of $219 million, but indicated revenue loss likely would be less because not all households would buy CEM stamps.[141]

OCA witness Willette originally suggested that only three cents of the four-cent cost avoidance be passed through. She reasoned: "Not passing through the full amount of the estimated cost savings is consistent with past practice involving new discounts, and provides a hedge against the product attracting more volume than anticipated."[142] However, OCA now believes that newly emerged facts warrant changing OCA's original support of a three-cent discount to four cents. First, with the benefit of the Ellard study, which, OCA believes, shows 68% of consumers are very or somewhat likely to use a CEM stamp, there is good evidence that the revenue loss will be lower than the maximum amount projected by witness Willette. In addition, as detailed in the first section of OCA's brief, the Postal Service is doing much better financially than anticipated, and will in all likelihood make a profit during the test year. The Postal Service's arguments to the contrary are porous – they just do not hold water. Third, there is now solid evidence that consumers tend to overpay postage rather than

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[139] Tr. 33/17475. In later parts of the CEM section of this brief, OCA has outlined why witness Miller's projections of substantial added costs are not supported by the record and are otherwise illogical.

[140] Tr. 33/17475. *See also* Ellard Rebuttal Testimony, Tr. 35/19080, Table 3. OCA thinks the revenue leakage could be slightly higher because it appears that 68% of the respondents when shown the current First-Class rate as a base were very or somewhat likely to use a discounted stamp.

[141] Willette Direct Testimony at 12.

[142] *Id.* at 4, n.4.

underpay.[143] For example, Postal Service rebuttal witness Sheehan acknowledged as "probable" that consumers who are slower to make changes will apply the full First-Class postage rate to CEM mail.[144] Consequently, OCA now recommends a full four-cent pass through. This is equitably warranted, given that household mailers have been overpaying postage on CRM mail for many years. Given witness Miller's estimate of a $137 million revenue loss at three cents, a four cent discount would result in a projected revenue loss of about $183 million.[145] This figure is certainly modest when one compares it to OCA's net revenue projections for the Postal Service, as discussed in the First Section of OCA's brief (filed March 16, 1998) and the financial updates preceding this section.

In determining whether or not to follow OCA's recommendation that the Postal Service not receive any general rate increase, the Commission may wish to consider that CEM-related revenue loss initially should not be as much as even the relatively modest figures discussed above (between $137 million and $183 million). Household mailers may be slow to adapt to the new two-stamp system. Postal Service witness Sheehan acknowledges that postal consumers are sometimes slow to react to changes.[146] Witness Miller opines that "it would take time for the 'transformation' to occur as mailers would want to exhaust old envelop inventories . . . ."[147] If a consumer is slow to purchase CEM stamps, it will mean that the Postal Service will enjoy unanticipated revenues for a time, since consumers will be placing the full single-piece rate on CEM mail.

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[143] Tr. 33/17359.

[144] Tr. 33/17430, line 14. *See also* his comments at Tr. 33/17432 generally.

[145] It is possible that if the discount is four rather than three cents, some slight additional percentage of consumers might use CEM stamps. However, the evidence cited by witness Miller on rebuttal suggests that a five cent discount converts only 66 percent of consumers to two-stamp use. Miller Rebuttal Testimony at Tr. 33/17458, discussing 1988 Tracking Study. Witness Miller interprets witness Ellard's survey as showing that "61 percent of the respondents were very or somewhat likely to purchase the discounted stamp." Tr. 33/17475.

[146] Tr. 33/17372, lines 14-21.

[147] Tr. 33/17454.

C. Consumers Like Lower Prices.

The Postal Service has focused much attention in this case on the alleged "inconvenience" of CEM, and has tried to divert attention away from the fact that consumers like lower prices. That consumers prefer lower prices is not only common sense, but is a tenet of microeconomics theory, which shows that demand increases when price decreases.[148] In explaining reasons for what he calls "The Law of Downward-Sloping Demand," economist Paul Samuelson says: "This law is in accordance with common sense and has been known in at least a vague way since the beginning of recorded history."[149] Consumers will not be hostile to the lower prices CEM will feature. As witness Sheehan acknowledged in the following colloquy:[150]

> Q. If Coke decides to offer discounts in the form of coupons or lower prices on existing products, do you think that generates a negative reaction on the part of consumers?
>
> A. If they discount their product?
>
> Q. Yes.
>
> A. No.
>
> Q. In other words, if consumers are accustomed to paying one price for a six pack of Coke and then Coke decides for a period of time or maybe even on a permanent basis to lower its price, that generally doesn't generate an unfavorable reaction, does it?
>
> A. No.

It has become necessary to state the obvious in this brief because of the Postal Service smokescreen over CEM, trying to portray CEM as a one-dimensional issue (convenience), when it is a multi-dimensional issue (convenience, price, and consumers' freedom to choose). The short answer to all this controversy is – if a consumer doesn't

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[148] Robert Dorfman, *Prices and Markets* (2d ed.), Fig. 2-3 at 22.

[149] Paul A. Samuelson, *Economics* (9th ed.) at 61.

[150] Tr. 33/17433.

like CEM or doesn't think the cost savings are significant enough to bother purchasing a second set of stamps, he/she does not have to use it. Each consumer can make the convenience/price tradeoff himself. Consumer choice is also the law of the land, as expressed in the nation's antitrust laws. The Sherman Act prohibits price-fixing not just because it is economically inefficient but also to promote consumer choice. As the Supreme Court has stated: " . . . Congress designed the Sherman Act as a 'consumer welfare prescription.' *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343, 99 S. Ct. 2326, 2333, 60 L. Ed. 2d 931 (1979). A restraint that has the effect of reducing the importance of consumer preference in setting price and output is not consistent with this fundamental goal of antitrust law." [footnote omitted][151]

D. Monitoring Mailer Compliance And Educating CEM Envelope Providers And Mailers Will Not Be A Problem.

Monitoring CEM provider compliance and educating CEM envelope providers and mailers will not be a problem. The Postal Service can monitor automation compatibility compliance for CEM the same way it does for CRM envelopes. The Postal Service makes considerable efforts to ensure that mailers meet automation compatibility standards and has had success ensuring that such standards are met, including through its ongoing education efforts.[152] CEM envelope providers generally are sophisticated business entities, and fully be expected to fully and easily understand the minimal changes in the CRM envelope that will be necessary. Therefore, the Postal Service should have no problem educating providers about new CEM requirements, and ensuring that CEM mailpieces are automation compatible.

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[151] *NCAA v. Bd. Of Regents*, 468 U.S. 85, 107 (1984).

[152] Domestic Mail Manual Section C810.8.0 requires courtesy reply, business reply and meter reply mail to be automation compatible when they are mailed as enclosures in letter-size pieces that are mailed at an automation postage rate. For a description of this monitoring, see Responses of Postal Service to OCA/USPS-T32-111, 26, 56, and 32. Postal Service witness Moden acknowledged that: "Generally, courtesy reply envelopes meet the automation compatibility requirements, so there has not been a need for formal survey or analysis." Response of Postal Service witness Moden to Interrogatory OCA/USPS-T32-51, redirected from witness Fronk, Tr. 11/5900.

The Postal Service also can educate consumers in the same way it informs them, e.g., about the myriad of basic single-piece First-Class postage requirements.[153] As noted by rebuttal witness Sheehan:[154]

> Historically, when the USPS Board of Governors announces the implementation of new rates arising from an omnibus rate case, an important objective of postal management is to ensure that household mailers are aware of the changes that will affect them most. At the local level, postal managers educate customers through a variety of methods, including lobby displays in post offices and postal customer councils. At the national and local levels, the Postal Service also provides considerable information to television, radio, and daily print media outlets in order to more broadly disseminate information about the various rate and classification changes to the general public. Nevertheless, the media tends to focus on the single-piece First-Class Mail rate.

OCA would add that in addition to the usual avenues of education described by witness Sheehan, the Postal Service might consider printing informative material on the insides of any CEM stamp booklets it issues.

Upon adoption of a CEM rate, it is highly probable that media coverage will be extensive.[155] After all, this will be a rate reduction for First-Class mail commonly used by consumers. OCA is not aware that any such *reduction* has ever occurred, at least since postal reorganization. Educating the consumer about CEM will pose few additional costs,[156] since the public will have to be educated about a slew of other changes affecting them directly (e.g., PRM, raised insurance rates, and, perhaps, a new First-Class single-piece rate).

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[153] *See* Postal Service Response to OCA/USPS-T32-8, describing its efforts.

[154] Tr. 33/17370-71.

[155] That being said, it is highly unlikely that the media will have to explain such esoteric points as FIM marking, as the Postal Service would have the Commission believe. *See* rebuttal testimony of Postal Service witness Sheehan, Tr. 33/17424-25. After all, the CEM envelope indicator will be a simple way to alert consumers about qualifying envelopes. OCA would note that the Postal Service to our knowledge has not educated the "Aunt Minnie" American public about specific CRM qualifications, e.g., the desirability of not obscuring the FIM mark with postage.

[156] Below, OCA discusses the public education cost estimates presented in the rebuttal testimony of witness Miller, and concludes they should be accorded little if any weight.

Witness Sheehan fears that the media will erroneously report about the CEM rate.[157] This statement is not supportable. Nor are the substantial education costs reported by witness Miller, discussed below. OCA submits positions such as these are "scare" tactics, part of the longstanding Postal Service antipathy towards CEM.[158] Thus, it is noteworthy that the Postal Service has not displayed any concerns about educational efforts concerning PRM or any new First-Class single-piece rate, for example.

E. CEM Is An Attractive Alternative To Prepaid Reply Mail.

PRM was advanced by the Postal Service as an alternative to CEM. Witness Fronk argued that PRM "avoids burdening and confusing the public with differently-rated postage stamps . . . ."[159] However, CEM is an attractive, and superior alternative to PRM because CEM costs to the courtesy reply envelope provider would be far lower than PRM costs.[160] This is because the mailer would not have to pay the PRM postage, and because there would be no need for the auditing system PRM would require.[161] Costs of administering CEM also would avoid the PRM auditing costs projected to be incurred by the Postal Service itself, which costs are the condition precedent for the lofty PRM mailer fees.[162]

CEM also is attractive because CRM providers already know the basic system. CRM providers who now take advantage of automation discounts must already ensure

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[157] Tr. 33/17371.

[158] *See* PRC Op. 87-1, paras. 5034-59; PRC Op. R90-1, at iii. paras. 5161-81; PRC Op. R90-1 On Remand, paras. 112-157; and, PRC Op. MC95-1, paras. 5050-84.

[159] Fronk Direct Testimony at 6.

[160] OCA does not oppose PRM and QBRM. Rather, the CEM proposal enhances the Postal Service proposal by giving providers a third choice, one in which they can gain good will with customers by providing certified CEM envelopes that will give their customers the opportunity to use discounted CEM stamps.

[161] The necessity for a PRM auditing system and the proposed fees for such a system are discussed in the Direct Testimony of Postal Service witness Fronk at 41-42.

[162] Fronk at 41.

that the CRM envelope is automation compatible. It is this automation-compatible CRM envelope that would be transformed into a CEM envelope, and upon which the consumer could affix a reduced postage stamp. Moreover, even converting existing CRM envelopes to CEM ones would not be costly – running between 0.3 cents and 1.2 cents per envelope.[163]

OCA observes that the American Bankers Association supports the CEM proposal, stating that CEM is vastly superior to PRM.[164] OCA also notes that a letter supplied to the Commission Docket Section by the Postal Service as a library reference indicates that a number of trade associations and large mailers strongly oppose PRM for many of the same reasons advanced in witness Willette's testimony.[165] These associations and mailers stated that "PRM will produce many unintended and harmful consequences for businesses and PRM will harm consumers."[166] Their observations include:[167]

> If PRM is implemented, it will force mailers to incur significant new operations, systems, customer service and postage costs, and it will create multiple new administrative compliance burdens. For example:
>
> PRM will require multi-million dollar changes in billing systems and equipment for account statement insertion and remittance processing since mailers are required to administer this new rate program. * * * To comply with the extensive range of new costs, businesses would have to make large new investments in equipment, business process redesigns, and training for customer service staff. These unnecessary costs will ultimately need to be recovered.

While there was extensive discussion on the record as to whether or not the concerns stated in this letter are evidence[168] (i.e., are the statements in the record

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[163] Direct Testimony of OCA witness Willette, Tr. 21/10691.

[164] American Bankers Association Trial Brief, February 10, 1998.

[165] Letter of January 16, 1998 to Chairman Winters and Postal Service Board of Governors, filed as Postal Service Library Reference H-342.

[166] *Id.* at 1.

[167] *Id.* at 1-2.

supportable) there is no doubt they were made. Thus, witness Miller could fairly testify that as to the list of mailers, "it's obvious that some of them are high volume mailers."[169] He also could acknowledge that "it's obvious mailers have some concerns . . . ."[170]

Finally, because the PRM and QBRM proposals make mailing a reply card or letter seem free to the customer, some customers may choose reply mail even though they would not do so if they faced its full cost. Thus, the final outcome may not be optimal for society. This is because some customers who would choose to pay their bills by other means, such as stopping at an office on their way to work at a cost worth 5 to 10 cents, may now pay by mail simply because it seems free to them.[171] Yet, the actual cost of using PRM or QBRM may be greater. Indeed it may be optimal for such customers to shift to an electronic means of payment. By contrast, allowing reply mailers to choose whether to mail a courtesy reply envelope at a *reduced* rate under CEM seems feasible, however, and its efficiency benefits are clearly desirable.[172]

F. CEM Advances Postal Service Objectives.

CEM advances Postal Service objectives. A primary concern of the Postal Service in this proceeding is the threat of electronic diversion. In recent years, consumers have taken advantage of technological developments and increasingly have been paying their bills by telephone, automatic debit payment devices, and by personal computer.[173] CEM addresses the threat of electronic diversion by providing consumers a convenient, but less expensive way to return bill payments by mail.

Another Postal Service goal is to encourage the use of automation-compatible mail. For example, the Postal Service states that "PRM is clean, pre-barcoded mail and

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[168] Tr. 33/17629 *et seq.*

[169] Tr. 33/17623.

[170] Tr. 33/17605.

[171] *See* Direct Testimony of OCA witness Sherman, at 56.

[172] *Id.* at 57.

[173] *See*, e.g., Direct Testimony of Postal Service witness Fronk, at 35-36.

incurs less mail processing costs than non-barcoded mail."[174] As noted above, the cost avoidance for CRM, and hence CEM pieces, is the same as the cost avoidance for PRM pieces. "By recognizing some of the cost savings associated with this mail, the Postal Service [through PRM] is able to permit the general public to more directly share in the benefits of automation . . . ."[175] Likewise, consumers who return CEM mail will be able to share directly in the benefits of automation by paying a discounted rate.

Further, the Postal Service states that an overriding factor in developing PRM is operational feasibility, developing a processing and accounting approach that is workable for both mailers and the Postal Service."[176] In this regard, CEM is superior to PRM because it is less complicated. Operationally, potential CEM providers who now enjoy a prebarcode discount will have to do almost nothing to comply with CEM regulations. Currently, the CRM return envelope also must be automation-compatible.[177] CEM providers will only have to ensure additionally that the CEM return envelope bears an appropriate stamp indicator.

In comparison, compliance with PRM will be more complicated, requiring such providers to maintain a debit account[178] as well as setting up an internal auditing mechanism.[179] Indeed, the Postal Service's CEM auditing costs may be less, because it will not have to audit mailers' internal accounting systems. Such systems are unnecessary for CEM. Instead, the Postal Service will only have to verify that CEM mailers' return envelopes are appropriately barcoded. The Postal Service's PRM inspection costs, on the other hand, appear to be substantial, with the result that PRM providers will have to pay a $1,000 monthly fee.[180]

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[174] *Id.* at 37.

[175] *Ibid.*

[176] *Id.* at 40.

[177] DMM §§ C810.8.0 through C810.8.2.

[178] Direct Testimony of Postal Service witness Fronk, at 40.

[179] *Ibid.*

[180] *Id.* at 41-42 [footnotes omitted].

G. Recommending The Adoption Of CEM Will Promote Statutory Goals.

Adopting CEM will promote the statutory goals of 39 U.S.C. §3623(c), which enumerates classification change factors. As to the first criterion, equity and fairness, CEM more closely aligns rates with costs, permitting a broader base of customers (e.g., household mailers and small businesses) to more directly share in the benefits of automation. In addition, CEM is fairer than PRM to small business mailers who wish to offer their customers the advantage of reduced rates. Some business mailers' volumes preclude economical use of PRM.[181] For others, the cost of paying 30 cents in postage may be prohibitive. Thus, PRM costs are a discriminatory obstacle to small businesses.

The second factor is "the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and service of mail." Consumers highly value the mail system as a way to pay bills. The desirability and justification for the CEM classification is that it more closely aligns rates with costs for household mailers.

The next pertinent criterion is "the importance of providing classifications with extremely high degrees of reliability and speed of delivery." CEM mail is "clean" mail, the type most easily and economically processed by the Postal Service. Because CEM (like CRM) is prebarcoded and screened for accuracy, the reliability of delivery is greater than for much of First-Class mail.

The fifth criterion is "the desirability of special classifications from the point of view of both the user and of the Postal Service." As to users, CEM is a realistic way to ensure that consumers will be paying a cost-based First-Class rate for prebarcoded envelopes. From the point of view of business mailers, as noted above, CEM offers a more practical and less expensive way for them to gain good will. In addition, since CEM has the handling and delivery characteristics of CRM, CEM providers would benefit because CRM/CEM ensures that bill payments are sent to the correct address through the use of

[181] The $1,000 monthly fee for PRM means that a mailer needs to save 3 cents – the discount per piece – on more than 33,333 pieces of mail each month in order to break even on the $1,000 monthly fee alone – not to mention other administrative costs it may incur.

standardized preprinted addresses and through the use of accurate, readable barcodes.[182]

The final criterion is "such other factors as the Commission may deem appropriate." The Commission especially ought to consider that the Postal Service's past resistance to CEM means that consumers using prebarcoded courtesy reply envelopes have been overpaying the "correct" postage on their bill payments for a number of years.[183]

H. Not Recommending The Adoption Of CEM Will Conflict With 39 U.S.C. §403(c) And Other Statutory Requirements.

Title 39 U.S.C. §3623(c)(1) requires "the establishment and maintenance of a fair and equitable classification system *for all mail*." (emphasis added). Further, 39 U.S.C. §3622(b)(1) requires "the establishment and maintenance of a fair and equitable schedule . . . ." And, "*[I]n providing services* and in establishing classifications, rates, and fees. . . the Postal Service shall not, except as specifically authorized in this [Act], make any undue or unreasonable discrimination among users of the mail, nor shall it grant any undue or unreasonable preferences to any such user." 39 U.S.C. § 403(c). [emphasis added]

As noted by the D.C. Court of Appeals in *Mail Order Ass'n of America v. U.S. Postal Service*, 2 F.3d 408, 423-24 (D.C. Cir. 1993) (hereinafter, "*Mail Order Ass'n*"):

> During the course of a ratemaking proceeding, the Commission has the authority, and indeed the duty, to assess the fairness and equity both of the proposals before it and of its own recommended decision to the Governors. 39 U.S.C. § §3622(b)(1), 3623(c)(1); see also *National Ass'n of Greeting Card Pubs. v. USPS*, 607 F.2d 392, 403 (D.C. Cir. 1979) (the "prevention of discrimination among the mail classes" was major purpose of Congress in passing PRA) . . . .

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[182] Response of Postal Service witness Fronk to OCA/USPS-T32-79, Tr. 4/1544.

[183] For a history of prior CEM proposals, see appendix A to Direct Testimony of OCA witness Willette, Tr. 21/10716 *et seq.*

The Postal Service's refusal to support CEM is a classic form of price discrimination -- pricing like services or products differently for one group than for another.[184] As discussed above, households mailing prebarcoded single-piece First Class mail cause the Postal Service to incur precisely the same costs as PRM mail. Yet, under the Postal Service proposal in this docket, consumers who return CRM prebarcoded pieces would continue to pay the standard single-piece rate. This disregard of cost in the design of First Class single-piece rates is thus a clear violation of Section 403(c), for "the cost element is at the heart of the concept of price discrimination . . . ."[185]

I. Postal Service Criticisms Of CEM Have No Merit.

As is well known, the Postal Service opposition to CEM (or variations thereof) is longstanding. This opposition is understandable – a monopolist naturally does not like to see cost-based rates for mail which in the absence of regulation it could obtain high profit margins from.

The Postal Service re-revives many of its earlier criticisms of CEM, which are discussed in full below. Before discussing why these criticisms and some new ones it has added have no merit, several points should be made. First, the Commission dismissed many of these criticisms in its Docket No. MC95-1 opinion.[186] There the Commission noted that the CEM "proposal is quite familiar at this point, since the Commission has recommended its adoption or recommended a more inclusive category, in two previous omnibus rate proceedings."[187] Although the Postal Service has failed to

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[184] *See Competitive Telecommunications Ass'n v. FCC*, 998 F.2d 1058 (D.C. Cir. 1993)(Unreasonable discrimination in charges under FCC Act can come in form of lower price for equivalent service or enhanced service for equivalent price).

[185] *Payne v. Washington Metropolitan Area Transit Commission*, 415 F.2d 901, 915 n. 71 (D.C. Cir. 1968). *See also AT&T and Western Union Private Line Cases*, 34 FCC 217 (1963), *aff'd sub nom. Wilson & Co. v. United States*, 335 F.2d 788 (7th Cir. 1964); *St. Michaels Utilities Commission, et al. v. The Eastern Shore Public Service Co. of Maryland*, 35 FPC 591 (1966), *aff'd* 377 F.2d 912 (4th Cir. 1967); *Southwestern Public Service Co.*, 33 FPC 343 (1965).

[186] PRC Op. MC95-1, at V-33 *et seq.*

add anything substantial to its older criticisms, for the purpose of completing and updating the record in this docket, OCA will readdress the older criticisms.

Second, the Postal Service's criticisms ring hollow when one considers a widely publicized statement made by the Postmaster General. In a Postal Service publication entitled "Max It! For the new value in business mail" Postmaster General Runyon is quoted as saying: "If it costs less for the Postal Service to process and deliver, it should cost less for you to mail."[188] Given the current opposition to CEM by the Postal Service, it appears that the sentiments expressed above are felt only towards large business mailers. In fact, individual consumers are the only users of the mail who have not been given an opportunity to benefit directly from the Postal Service's automation efforts.[189] It appears that Postal Service opposition to CEM reflects behavior one expects from a monopolist – having a firm grip on the public's wallet, the Postal Service is unwilling to let go.

Third, as discussed herein, OCA attempted during discovery to provide empirical flesh to the debate over CEM by asking questions intended to shed light on past Postal Service criticisms of CEM. One may observe that the Postal Service stated it simply had no data, or had not thought about the issue since Docket No. MC95-1. This lack of response to prior Commission support for a CEM rate suggests that the Postal Service remains haughtily secure in its twin-towered legal fortress: the First-Class mail monopoly and the ability it has to reject Commission recommendations.

OCA will now discuss why the Postal Service's criticisms have no merit.

1. Confusion over what rate applies.

Witness Miller believes that "CEM would complicate the simple and basic First-Class rate schedule . . . ."[190] He also states that the "CEM proposal would also

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[187] *Id.* at V-33. The history of CEM can be gleaned by referring to PRC Op. R87-1, paras. 5034-5059; PRC Op. R90-1, at 111., paras. 5161-81; and PRC Op. R90-1 On Remand, paras. 112-157.

[188] The Commission may take official notice of this publicly available document.

[189] PRM would in theory allow consumers to enjoy automation benefits to the extent PRM providers did not recover the costs of PRM from consumers, but OCA doubts use of PRM will be widespread. The only apparent support for PRM comes from a single mailer, Brooklyn Union Gas.

increase the likelihood that the general public could become confused when using the nation's mail system."[191] Before assessing these proclamations, OCA notes that in Docket No. MC95-1, the Commission stated that the Postal Service witness "seriously underestimates the general public's capability to change their mail preparation habits. * * * Also, it is probable that providers of CEM envelopes will assist in the education process to ensure that courtesy envelope mail is used in an appropriate fashion."[192]

There is no empirical evidence on the record of consumer confusion about the myriad First-Class Mail requirements, though the Postal Service asserts that introducing a single new variation -- CEM -- will confuse the consumer. In order to determine whether the Postal Service took seriously its previously stated concerns that household consumers would be confused by introduction of a CEM stamp (the so-called "two-stamp" problem), OCA queried the Postal Service on consumer awareness of the differences between various First-Class Mail rates. Thus it asked the Postal Service: "Does the Postal Service have an estimate of the number of households that are aware of the difference between the First-Class stamp rate and the single-piece card rate . . . ."[193] The Postal Service had no information, stating that it "*has not had a need for such an estimate.*"[194] Nor, apparently, does the Postal Service sense consumers are too confused to prepare Priority Mail, Express Mail and Parcel Post pieces and enter them into the mailstream without inspection by the Postal Service. This is germane because the postal customer at times must be able to independently determine the weight and postage of the piece.[195] The Postal Service admits that "most customers have been able to comprehend the 'no postage necessary . . .' endorsement

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[190] Tr. 33/17455.

[191] *Ibid.*

[192] PRC Op. MC95-1 at V-35.

[193] Interrogatory OCA/USPS-T32-7, Tr. 19D/9332.

[194] Response of Postal Service to OCA/USPS-T32-7, Tr. 19D/9332. Similar questions about the nonstandard surcharge and the additional-ounce rate met with the same responses. *See* Responses of Postal Service to OCA/USPS-T32-2-6.

[195] Such pieces may be entered without prior postal clerk intervention; see Response of Postal Service to OCA/USPS-T32-11, Tr. 19D/9336.

on business reply mail."[196] Postal Service rebuttal witness Sheehan stated his belief that household mailers are not confused about the use of BRM.[197] He admitted that the Postal Service had no empirical evidence on confusion over the message contained in the standard First-Class postage block (e.g., Post Office will not deliver without postage),[198] while rebuttal witness Miller acknowledged that the Postal Service does not standardize the message found in the postage affixation block for CRM.[199] This lack of standardization indicates the Postal Service believes consumers can follow mailing directions.

The Postal Service has inferred that postal workers might not be able to identify whether an envelope was a qualifying CEM envelope or not.[200] But "[s]urely postal workers would know by looking at the envelope whether it qualified as a CEM envelope."[201] This is the same type of qualifications knowledge required, e.g., of the postal worker who accepts a Business Reply Mail envelope which does not require any postage at all.

The proposition that postal workers could be easily confused flies in the face of the picture the Postal Service has attempted to paint in the Provisional Packaging Service case, Docket No. MC97-5. Responding to criticisms that postal employees will not be sufficiently trained in the rather complex task of finding the right packaging materials for fragile packages and using them properly, the Postal Service has maintained that postal employees can perform such tasks, have experience that will enable them to do the job, and in a short time will receive adequate training and supervision.[202] OCA maintains that postal clerks have experience in differentiating

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[196] Response of Postal Service to OCA/USPS-93, Tr. 19C/9172.

[197] Tr. 33/17426, line 14.

[198] Tr. 33/17426.

[199] Tr. 33/17599, lines 17-19.

[200] Tr. 21/10783.

[201] Oral testimony of OCA witness Willette, Tr. 21/10783.

[202] *See*, e.g., Postal Service Initial Brief at 32-33; 74-75.

many different types of mail pieces and the postage required for each, and that they can be easily trained to identify one additional type of mail piece.

OCA observes that the household mailer currently is confronted with a large variety of commonly used rates. Further, the consumer already must be able to interpret envelope instructions. For example, Business Reply Mail envelopes instruct the consumer that no postage is required if the mail piece is mailed in the United States. CRM mail pieces inform the consumer that postage is required. Moreover, the Postal Service's proposed PRM and QBRM will undoubtedly require mail pieces that instruct consumers that they need not apply postage.

The Postal Service has not explained why consumers would be "confused" over the addition of a CEM stamp to the many postage levels and postage stamp choices available. It merely states that "[I]ntelligence is not the issue"[203] and that "the issue is one of inadvertent use of the wrong stamp resulting from confusion"[204] without explaining what might cause the confusion.

Further, consumers already are faced with a large number of choices in postage stamps. Consumers may purchase booklets of 55-cent stamps for additional ounce mail and 20-cent booklets for post cards.[205] The consumer is faced with 30 different stamp denominations[206] and 241 different 32-cent designs.[207]

OCA has not proposed actual envelope design requirements. The Postal Service has the best technical knowledge about how to accomplish this. Once this is done, however, one can assume that postal workers will be instructed properly, just as they are on all the other myriad postage requirements for all classes of mail.

OCA queried the Postal Service on its education plans for informing the public that, while the proposed First-Class single piece rate would increase, the additional ounce rate would not. The Postal Service stated that it did "not anticipate that the public

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[203] Response of Postal Service witness Fronk to OCA/USPS-T32-35, Tr. 4/1525.

[204] Response of Postal Service witness Fronk to OCA/USPS-T32-36, Tr. 4/1526.

[205] Response of Postal Service to OCA/USPS-T32-46(j), Tr. 19D/9363.

[206] Response of Postal Service to OCA/USPS-T32-47(a), Tr. 19D/9368.

[207] Response of Postal Service to OCA/USPS-T32-47(c), Tr. 19D/9369.

will be confused if the rate does not change."[208] This lack of anticipation that confusion will result is interesting, given that there is disparate treatment of the rates, i.e., they are not moving in parallel. In short, the same sort of public educational efforts and postal employee training efforts described for introduction of the proposed 33-cent stamp, PRM, and QBRM could easily add CEM into the mix.[209] And, media coverage of a rate *reduction* will likely be extensive.

2. Underpayment of postage.

The Postal Service speculates that consumers will short-pay non-CEM mail by applying a CEM stamp.[210] In Docket No. MC95-1, the Commission stated that "consumers faced with the possibility of a late charge should a remittance be returned for postage due will be motivated to use the discounted stamp only when appropriate."[211] It should be added that late payments will be reflected on one's credit record, another motivating factor not to short-pay postage. Further, since many full rate First-Class mailings will be personal mail, household mailers likely would consider the ramifications of short payment of postage on the intended message. As witness Willette commented: "I mean I think most people who mail a birthday card or a handwritten piece – I know when I send a birthday card to my aunt I want to be sure she gets it, so I am not going to put a CEM stamp on it and risk the fact that she'll never get the birthday card."[212] She continued: "I think very few people who put things in the mail are indifferent as to whether they get to their destination or not, and postage is certainly a part of whether that happens."[213]

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[208] Response of U.S. Postal Service to OCA/USPS-T32-113, Tr. 19D/9428.

[209] These planned efforts are described in Responses of Postal Service to OCA/USPS-T32-8, 9 and 50, Tr. 19D/9333-34, Tr. 19D/9371.

[210] Tr. 33/17373.

[211] PRC Op. MC95-1, at V-35.

[212] Oral testimony of OCA witness Willette, Tr. 21/10781.

[213] Oral testimony of OCA witness Willette, Tr. 21/10782.

The Postal Service conjures up a picture of a vast army of employees needed to thwart short-paid CEM mail. Postal Service witness Sheehan fears that implementing CEM "would require that the human element would have to be employed more extensively to address short paid mail . . . ."[214] He states that short-paid enforcement could undermine customer relations.[215]

However, as OCA witness Willette noted, "I think it is much more likely that people will mail a qualifying CEM piece using a higher priced stamp."[216] This position is supported by the evidence that historically overpaid postage has dwarfed underpaid postage. "For FY96, overpayment on single-piece First-Class Mail is estimated to have occurred on 1,099,982,000 pieces,[217] generating $257,234,000 in overpayment."[218] Underpayment was only $124,221,000.[219] Thus, consumers were more than twice as likely to overpay as to underpay.

The reasons advanced by the Postal Service as to why people overpay are consistent with witness Willette's testimony: "Generally, overpayment occurs when: (a) mailers of additional-ounce single-piece mail apply available 32-cent stamps to pay for additional ounce postage, rather than obtain stamps equivalent to the 23-cent additional ounce rate; and (b) mailers of single-piece postcards apply available 32-cent stamps, rather than obtain stamps equivalent to the 20-cent postcard rate."[220]

Rebuttal witness Miller supports the notion that consumers will not take the chance of underpaying postage on CEM mail, as illustrated by this colloquy:[221]

> Q. Do you know why it is that mailers tend to overpay rather than underpay?

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[214] Tr. 33/17374.

[215] Tr. 17375-76.

[216] Oral testimony of OCA witness Willette, Tr. 21/10773.

[217] *See* the errata filed at Tr. 33/17360.

[218] Tr. 33/17359.

[219] *Ibid.*

[220] *Ibid.*

[221] Tr. 33/17603-04.

A. I would think for the most part it's a convenience issue.

Q. Would you think also that in the case of bill payments such as those that could be made with CEM that mailers would want to take great care that their bill payments do arrive at their intended destination and in a timely manner? Would you agree to that?

A. I would think the American public takes great care in applying postage to all their mail pieces.

Q. And that's true of bill payments as well, isn't it?

A. Yes.

Q. And it may be true particularly of bill payments. Does that sound right?

A. I would imagine that's true.

The Postal Service argument that CEM would be "inconvenient" also is relevant to this discussion. Although the argument is made that a CEM stamp would be "inconvenient,"[222] it may also be argued that the "inconvenience" of a multi-tier First Class rate structure will lead some consumers to overpay on their CEM mailings, just as consumers have in the past put two full-price stamps on a letter weighing more than one ounce.[223]

The Postal Service has no countervailing data to back up its assertion about the potential for short-payment of CEM mail. For example, when asked whether it is more likely that households mailing a CEM stamp would overpay, or that households will affix CEM stamps to non-CEM First-Class Mail, witness Fronk could only say he had "no basis for commenting on this question."[224]

It is also common knowledge that occasionally one will see postage notices on greeting card envelopes or on post cards, informing the purchaser that additional

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[222] Rebuttal Testimony of Postal Service witness Ellard, at 10.

[223] Oral testimony of OCA witness Willette, Tr. 21/10770.

[224] Response of Postal Service witness Fronk to OCA/USPS-T32-127, Tr. 4/1570.

postage is required. The Postal Service is aware of such notices but does not know the extent to which they are used.[225] If underpayment in these situations were perceived to be a problem, the Postal Service could adopt regulations requiring greeting and post card manufacturers to place appropriate postage notices on envelopes and card. Yet there are no such regulations.

Finally, if short-paid postage were a rampant problem, the Postal Service could alter its automated equipment to detect short-payments. For example, witness Fronk admitted that facer cancelers (AFCS) do not distinguish mail pieces on the basis of weight.[226] Therefore, its equipment cannot detect whether a First-Class single piece item should pay the one ounce rate or a greater rate based on excessive weight. In addition, its processing machines can detect only letters with no postage, or letters that use non-phosphorous stamps (those bearing denominations of less than ten cents).[227] Thus, a letter bearing, e.g., a 23-cent stamp will not be detected by the Service's automated processing equipment. This is a signal that the issue of underpayment is not as important as the Postal Service now pretends it to be.

a. OCA requests that the Commission take note of the Postal Service's failure to properly respond to discovery on the issue of overpayments.

OCA notes that the Postal Service stated during discovery that it had no documents on the question of whether households underpay or overpay postage for First-Class mail, the First Class additional ounce rate, single-piece cards, or the nonstandard surcharge.[228] And, when asked in OCA/USPS-T32-16 to "separately quantify revenues lost *and revenues gained* by any of the underpayment or *overpayments* queried about in USPS-T32-12 through 15" the Postal Service replied

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[225] Responses of Postal Service to OCA/USPS-T32-27-28, Tr. 19D/9346-47.

[226] Response of Postal Service witness Fronk to Question Posed At Hearings, Tr. 4/1686-87, filed in writing on October 17, 1997.

[227] Response of Postal Service to OCA/USPS-25, Tr. 19C/9046-47.

[228] Response of Postal Service to OCA/USPS-T32-12-15, Tr. 19D/9337-40.

"None."[229] It stated that it "*has not had a need for such data for households*."[230] [emphasis added]

During the direct oral testimony of OCA witness Willette, however, the Presiding Officer asked the Postal Service to supply substantially similar data.[231] In response to interrogatory OCA/USPS-T32-29,[232] the Postal Service only supplied estimates to OCA on underpayment, but not overpayment. Thus, it did not provide the damaging (to its case) overpayment data to the OCA discovery request. Obviously, it was able to quantify such data when originally asked.

This apparent discovery violation should not go unnoticed because of the prejudice it potentially could have caused; the overpayment evidence supplied only in response to the Presiding Officer's request bolsters OCA's general position that short-paid CEM mail will not be a problem. Normally, a Rule 28 sanction request by OCA would be made.[233] For example, OCA could move under Rule 28 that the Commission take it to be established that short-paid CEM mail will not be a problem, and that, in fact, overpayments are more likely. OCA will not make such a motion, given the strength of the evidence favoring its position. However, we believe the Commission should address the issue of discovery violations in its opinion. This is not an isolated instance. As noted below, there are substantial discovery violation issues relating to witness Miller's rebuttal testimony.

3. Inconvenience of CEM.

The Postal Service, as it has in the past, thinks that CEM is too "inconvenient."[234] OCA believes, as discussed above in subsection C., that the Postal Service has focused

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[229] Tr. 19D/9341.

[230] Response of Postal Service to OCA/USPS-T32-16, Tr. 19D/9341.

[231] Tr. 21/10804-05.

[232] Tr. 19/9052.

[233] 39 C.F.R. §3001.28.

[234] *See*, e.g., the Rebuttal Testimony of Postal Service witness Steidtmann generally. *See also* Tr. 33/17449, lines 13-26.

on this argument to divert attention away from the fact that consumers prefer lower prices, other things being equal.

The "inconvenience" argument overlooks some basic facts. If one looks just at Postal Service products, the current structure of First-Class rates could be characterized as "inconvenient," in the sense that consumers cannot just put one stamp on all First-Class Mail. For example, the inconvenience of maintaining two sets of stamps is the same for the additional ounce rate as it would be for CEM.[235]

The inconvenience argument also overlooks the basic fact that consumer choice is an essential element of a capitalistic economy. Postal Service Witness Steidtmann, whose testimony is discussed below, speaks of trends towards price and product choice simplification, ignoring such major facts as the fall of Communist economies where choices were restricted. But as OCA witness Willette stated, "I consider saving money to be pretty convenient."[236] Amplifying on this statement, she stated:[237]

> I think that consumers would maintain two sets of stamps in order to save money. Is that inconvenient? It's no more inconvenient than saving money on anything else that a discount is offered to you on. I see people in the grocery store all the time with coupons that they give to the checkout person and they may represent a very small portion of the total grocery bill, but still people use them. Is that inconvenient, cutting those coupons out of the Sunday paper? Is it inconvenient a little bit maintaining two sets of stamps? Yes, but you're saving money. * * * I think saving money outweighs any inconvenience is what I'm trying to say.

It must be emphasized that any "inconvenience" to the consumer from purchasing two sets of stamps is so low as likely to be unquantifiable. Witness Willette observed:[238]

> I would not characterize the occasional purchase of a CEM stamp booklet as inconvenient, since this purchase could be made at the same time as other stamps are purchased. Furthermore, if the Postal Service were to make two-denomina-

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[235] *See* oral testimony of OCA witness Willette, Tr. 21/10767.

[236] Oral testimony of OCA witness Willette, Tr. 21/10767.

[237] Oral testimony of OCA witness Willette, Tr. 21/10768.

[238] Response of OCA witness Willette to USPS/OCA-T400-1(e), Tr. 21/10740-41.

> tion stamp booklets (i.e., containing regular First Class and CEM stamps) widely available, consumers could purchase such booklets as conveniently as they purchase 32-cent stamp booklets today.

It must be kept in mind, as one tries to wend one's way through the Postal Service's "inconvenience" smokescreen, that no one is forced to use CEM:[239]

> Keep in mind that the purchase and maintenance of two sets of stamps is voluntary. I would expect consumers who find it inconvenient would choose to use only the full-price stamps. Also, if enough demand for CEM stamps develops, private sector retailers who sell stamps (e.g., grocery stores) may offer CEM stamps as a convenience to customers.

4. Consumers lack interest in CEM or do not want it.

It has been argued that consumers will not use CEM because the savings are small.[240] It also has been argued by the Postal Service that consumers have indicated a lack of interest in CEM.[241] It should be observed that these Postal Service arguments contradict another basic Postal Service position – in essence that CEM will be *too* popular, substantially eroding Postal Service revenues. In any event, probable use of a two-stamp system is likely to be fairly high. The most recent Postal Service survey, presented by Postal Service rebuttal witness Ellard, indicated that *68% of survey respondents were either very likely or somewhat likely to* use both a regular rate First-Class stamp as well as a CEM-type stamp.[242] Generally speaking, it is very difficult to get more than two-thirds of the American public to agree on anything.

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[239] Response of OCA witness Willette to USPS/OCA-T400-13, Tr. 21/10756.

[240] Rebuttal Testimony of Postal Service witness Ellard, Tr. 35/19074-75.

[241] *See* generally Rebuttal Testimony of Postal Service witness Ellard.

[242] Rebuttal Testimony of Postal Service witness Ellard, USPS-RT-14, Table 3, Tr. 35/19080. OCA believes it is appropriate to use the 68% response rate under the 32/29 cents column. As noted in Section I of our brief, OCA does not believe that any rate increase is necessary at this time, which would leave the First-Class rate at 32 cents. In addition, we are now proposing a four-cent spread between CEM and the single-piece rate, which, economic theory indicates, may motivate more CEM usage.

OCA has further observations about the Ellard study. Witness Ellard surveyed respondents at two rate levels. One rate level was a 32-cent First-Class rate and 29-cent CEM rate. The second was a 33-cent rate for First-Class and a 30-cent rate for CEM. Ellard states:[243]

> Here, it is clear that the choice of present or proposed rates in our question wording affects public response. The lower pair of rates, i.e., the current rate of 32 cents and a discounted rate of 29 cents, were seen as more convenient to use than were the higher rates, i.e., the requested rate of 33 cents and a discounted rate of 30 cents.
>
> As discussed earlier, a respondent saw only one set of rates. There is no implied comparison here, but *there is an indication that mention of an increased price and an accompanying discount affects respondent perceptions of convenience of use more negatively than mentioning a discount without an increase in price.* [emphasis added]

OCA's observations, supported by Ellard's comments, are that consumers seem to prefer discounted rates and to equate lower rates with "convenience." Respondents reacted more negatively to questions that mentioned a higher rate structure. And, they saw the lower pair of rates as "more convenient to use."

The interesting questions that were not asked would have been – "would you prefer a single-stamp system at 29 cents?" "28 cents?"[244] We think even the Postal Service might concede those options would receive overwhelming support. We are not advocating such a system, but we use it to illustrate a point – consumers like convenience *and* lower prices. The fact that two stamps arguably may be less convenient (and we think the "inconvenience" from CEM is infinitesimal) is no reason to throw out the "lower price" baby with the bath water.

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[243] Ellard Rebuttal Testimony at 9, Tr. 35/19072.

[244] OCA uses the 29-cent figure based on a four cent pass-through of cost avoidance from a 33-cent rate, and the 28-cent figure on the same pass-through assuming a continuance of the 32-cent standard rate.

5. Consumers' preference for simplicity.

The Postal Service contends that CEM should not be recommended because CEM will complicate the rate schedule[245] and because it will be inconvenient.[246] Although OCA addresses these arguments in detail, it makes two observations at the outset which indicate the weakness of the Postal Service arguments. As to rate complexity, we note that the Postal Service does not mention this argument as to the other classification proposals that form part of the Postal Service Request, such as PRM, the bulk insurance discount, etc. If one took the Postal Service's CEM "complexity" theory seriously, perhaps the Commission should stop recommending new classifications.

As to the inconvenience factor, how much extra trouble and time will it take to purchase a CEM stamp booklet when one is purchasing a First-Class booklet? The word "infinitesimal" springs to mind.

On rebuttal, Postal Service witness Steidtmann presents testimony that "[r]etail simplification is sound retail practice, and is consistent with recent trends in a variety of companies and industries."[247] He uses various examples of the alleged move towards retail simplification, and states that the purpose of his testimony as follows:[248]

> From a retailing perspective, this proposal will create a two-stamp, or two-tier, pricing schedule, with two rates being charged for very similar products. There are a number of reasons why a company would choose not to introduce different prices for very similar products, even though there may be cost differences between the products.

There are fundamental problems with witness Steidtmann's testimony which indicate that his testimony should be given little or no weight. First, under cross-examination he revealed that he did not even understand the most basic differences between CEM and regular First-Class Mail. When asked whether a mailer would be able

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[245] *See*, e.g., Rebuttal Testimony of Postal Service witness Miller, Tr. 33/17455.

[246] *See*, e.g., Rebuttal Testimony of Postal Service witness Miller, Tr. 33/17459.

[247] Rebuttal Testimony of Postal Service witness Steidtmann, USPS-RT-15, at 4, Tr. 32/17187.

[248] *Id.* at 2, Tr. 32/ 17185.

to hand write an address on a CEM envelope, he responded in the affirmative.[249] Nor did he have quantitative evidence that consumers view such pieces as similar.[250] It was merely his opinion.[251]

Second, his opinions on retail simplicity as applied to a postal context are highly questionable given that he knew so little about the postal system, especially that portion used by consumers. He did not understand that consumers face a wide variety of parcel rates, for example.[252] He admitted he was not an expert on parcel post.[253] In fact, he stated that he was not an expert "in any other postal rates."[254] He was not fully aware of the large number of stamp denominations and designs.[255] He had no idea why the Postal service offered so many different types of stamps.[256] He was willing to make a number of unsupported assertions about the impact of CEM[257] without any research and without specific knowledge of the industry, yet, in commenting on retailing generally, he said that "finding that optimum number [of brands] would require some research."[258] One questions his pejorative portrayal of CEM, which was done apparently with little or no research of the product (CEM) or the postal industry.

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[249] Tr. 32/17197. Postal Service counsel tried to "rehabilitate" the witness, presumably by providing Steidtmann with the correct answer during a break. Tr. 32/17234. This does not correct the clear implication that witness Steidtmann, who admitted he is not an expert on postal matters, Tr. 32/17215, did not really know basic differences between CEM and regular First-Class mail.

[250] Tr. 32/17198.

[251] *Ibid.*, lines 16-22.

[252] In responding to OCA counsel's assertion that there were perhaps some 4,200 parcel prices available, Tr. 32/17204, he thought that was not a problem because "you are dealing with professional shippers . . . ." Tr. 32/17205. He did not realize that household consumers face this large number of rate and service possibilities.

[253] Tr. 32/17207, lines 12-13.

[254] Tr. 32/17215, lines 16-18.

[255] Tr. 32/17200, lines 1-13.

[256] *Ibid.*, lines 14-17.

[257] Tr. 32/17193-94.

[258] Tr. 32/17201.

The third fundamental problem with his testimony is that witness Steidtmann uses no quantitative or empirical results to back up his opinions. Steidtmann uses Wal-Mart as an example of an alleged trend in pricing simplicity.[259] But he stated that he had no idea what percentage of sales are made by everyday pricers such as Wal-Mart.[260] He stated that "[y]ou are basically seeing sort of the end game, if you will, for the coupon business."[261] However, he was not aware of any major grocery chain that did not accept coupons.[262] Nor did he present statistics on coupon use. Witness Steidtmann relies, instead, on a few anecdotes (which themselves are poor examples, as discussed below).

Unsupported anecdotes of this sort should be accorded little, if any weight, especially when the witness is so uninformed about the prospects of obtaining such evidence. When asked about everyday pricers in quantitative terms, he stated:[263]

> Again, I don't have a percentage. I don't know. It's not a, you know, a data set that is published by a trade group or by any government entity. So it would be hard to say.

Witness Steidtmann is incorrect. Such data sets are available. For one thing, publicly-held firms are required by Securities and Exchange Commission regulations to furnish revenue information, which is available to the public. *Fortune Magazine* seems to be able to come up with detailed information, by industry type, when it publishes its Fortune One Thousand list.[264] Thus, perusing such a list, one could find out the revenues of the leaders within the General Merchandise category (e.g., stores such as Wal-Mart, Sears, K-Mart, Dayton Hudson, J.C. Penney, etc.). Determining whether or not such stores are "everyday" pricers is relatively simple, since newspaper advertisements from such stores can be investigated.

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[259] Tr. 32/17190-91.

[260] Tr. 32/17211, line 2.

[261] Tr. 32/17213, lines 12-13.

[262] Tr. 32/17213, line 16. In addition to newspaper and direct mail distribution of coupons, media advertisements for Best Buys, the retail chain, tell of the availability of coupons for that store via the Internet.

[263] Tr. 17214, lines 19-22.

[264] *See*, e.g., *Fortune*, April 28, 1997.

Given the availability of such data, then, witness Steidtmann's everyday pricing trends theory should be accorded little or no weight, especially given common experience (e.g., opening up a Sunday newspaper and seeing a multitude of sale priced merchandise from chain stores) that makes a contradictory hypothesis seem more plausible. A relevant observation in this regard comes from an opinion by Judge Frank of the Second Circuit, who observed:[265]

> As Mr. Justice Holmes once suggested, judges need not be extraordinarily naïve. We ought to be at least as world-wise as the eminent philosopher who said recently: "On the theory of fair dealing, it is extremely improbable that my opponent will hold four aces twice in succession. When that actually happens, the hypothesis of fair dealing is not refuted; but we may well reconsider it, and entertain the contrary one as a more satisfactory account of the situation." [footnotes omitted]

The fourth problem is that witness Steidtmann has what may charitably be called an unconventional view of economics. When asked during a hypothetical involving differently sized hamburgers that cost the seller different amounts, he stated that cost of the product to the seller was irrelevant:[266]

> Q. Do you think that there is a cost difference that might be reached where clearly the vendor would charge a different price for two different-sized hamburgers?
>
> A. No, I really think that, you know, that they are going to be charging a price that reflects consumer demand for that product.

Yet he contradicts this assertion (as well he should have) by agreeing that gasoline retailers change their prices often because "[t]he gasoline retailing business to a large degree is a commodity business that's driven by the cost from a wholesale level . . . ."[267] It is a well-established tenet of microeconomic theory that both

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[265] *Old Colony Bondholders v. New York, N.H. & H.R. Co.*, 161 F.2d. 413, 448 (2d Cir. 1947) (dissenting opinion).

[266] Tr. 32/17199.

[267] Tr. 32/17214, lines 2-4.

consumer demand and industry supply determine both prices and quantities in a market. Thus, "the long-run equilibrium position of the firm is at the point at which its long-run average total costs equal price."[268]

Fifth, his own public utterances contradict his testimony concerning consumer preferences for simplicity in pricing and product line. A brief survey of public comments[269] by the witness contradict his position that consumers could "become confused and dissatisfied with a two-tier pricing system."[270] In a *Business Week* article of March 17, 1997, entitled "Grabbing Bargains—And A $2 Cup of Coffee," he stated: "Status has been redefined, so that it's not just the brand you have *but also the deal you got." "People are buying discount."* In a *Fortune* article of February 5, 1996, entitled "The Economy," he stated: "The holiday says more about overexpansion of the retail industry than about consumers, *who are forcing retailers to cut prices to get their business*." (The article goes on to note that "when stores slashed prices in the week after Christmas, sales skyrocketed 13.2% from a year earlier . . .") In a November 27, 1995, *Time Magazine* article Steidtmann stated: "*This will be the most promotional Christmas in a decade*." Apparently, hard-pressed retailers across the country were cutting prices to bring people into their stores. As to the issue of consumer choice for product line simplicity, in an article in Forbes of January 7, 1991, he is quoted as follows: "Stores aren't giving customers what they want," he [Steidtmann] says. *"They have reduced inventories, and that reduces choice."*

Moreover, Steidtmann was not consistent in his testimony:[271] "Well, within the retail environment, the segment that has had the fastest amount of growth over the past decade has been discount, without question." He also admitted that Wal-Mart, which he

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[268] Edwin Mansfield, *Microeconomics* (4th ed.) at 257.

[269] Hoping to be able to find writings in order to test the consistency of his statements at the hearing, OCA did a literature search from 1982 to the present in the *Journal of Economics Literature* and was unable to find any entries under the witness' name. Thus, it resorted to quotations in general circulation periodicals. The Commission may take official notice of these publicly available comments. The full texts are readily available using Westlaw and making an inquiry under "Steidtmann" in the business periodicals section of Westlaw.

[270] Tr. 32/17193, lines 6-9.

[271] Tr. 32/17201, lines 2-4.

cites as an example of the trend towards "everyday" pricing (i.e., not advertising sales) "certainly is not – I would not say it was the rule . . . ."[272]

Sixth, witness Steidtmann's isolated examples of everyday pricing or pricing simplicity as illustrative of a trend do not withstand even the kind of scrutiny available between the rebuttal phase and brief submission. Some examples follow immediately below.

The Saturn Example. Witness Steidtmann states:[273]

A specific example of this [retail simplification in the automobile industry] is Saturn, a division of General Motors, which was created with retail simplification as an objective. Only three automobile models are offered under the brand and each model comes in only two or three option packages. As a result, there is a simple product line – a total of seven automobiles – from which customers have to choose. * * * *Saturn offers only one price . . .* [so] customers are very satisfied as a result of the simplified retail experience . . . . [emphasis added]

First, Saturn is a curious choice for a "trend" example. According to the March 12, 1998 *Washington Post*, page D2, "Saturn, which normally produces 320,000 cars a year, has already taken 50,000 cars out of its production schedule since last year." According to the Association of American Automobile Manufacturers ("AAMA"), Saturn sold 251,099 vehicles in the last calendar year.[274] It would appear that Saturn's fortunes are declining. In addition, Steidtmann does not cite one other example of "no haggle" new car retailing. Saturn is a small player in the new car market. Total purchases of new cars in the U.S. during calendar year 1997 amounted to 8,272,000.[275] This means Saturn's market share was a paltry 3%. Witness Steidtmann's isolated example of Saturn ignores the rapid introduction and cessation of new car models by other manufacturers.[276]

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[272] Tr. 32/17201, lines 21-22.

[273] Tr. 32/17187.

[274] Source: staff telephone call with AAMA staff member Shirley Simms, March 18, 1998.

[275] *Ibid.*

But automobile "price" is more than Manufacturers Suggested Retail Price with a cash payment. One must take into account equipment options, which may be added to the basic Saturn models. Perusal of the publicly accessible Saturn website[277] reveals that one may customize one's Saturn from a list of seven options. As the website states: "To create your Saturn - click away."

But the real complexity of Saturn pricing comes when one clicks on the Interactive Pricing Center. (Of course, cash is still accepted.) Saturn offers various leasing plans, and is currently running a special series of leasing plans courtesy of Chase Automotive Finance. Some of the basic terms of a lease for an SL model are set forth below.[278] The special ends April 30, 1998, indicating that Saturn "prices" fluctuate over time. However, the March 21, 1998 *Washington Post*, at p. E33, contained a much different version of a 36-month lease for what appears to be the same model as the one featured on the website.[279] Steidtmann makes no mention of the relatively recent leasing trend in the new car industry with its accompanying complexities. Not only are car leases quite complex, but so are the comparisons between car lease "price" and new car "price."

Are leases too complex for you? One can use traditional financing, either GMAC[280] or a bank rate, from 12 to 60 months. Of course, shopping around will get you a different final car "price," as will the length of your lease.

But that's not all.

Saturn also offers a separate GMAC Smartbuy plan, featuring low monthly payments and actual car ownership, but with a balloon payment at the end. According to

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[276] Just among American manufacturers recent model introductions include the Cadillac Catera, Chevrolet Malibu (a resurrected model name, replacing the Corsica), Chrysler Cirrus, Dodge Neon, Ford Contour, Ford Aspire, Oldsmobile Aurora, Oldsmobile Intrigue, Oldsmobile Silhouette, Plymouth Breeze, and Plymouth Neon. Source: 1997 Consumer Reports Buying Guide.

[277] www.saturn.com.

[278] For the 1998 Saturn SL 5-speed with A/C, payments are $129 month under a 36 month lease, with $1424 due at signing. License, title, registration fees, taxes, and insurance are extra. The first month's lease payment is $129 plus an $800 down payment and a $495 acquisition fee. The option to purchase at lease end is $6,988. There also is an excess mileage charge, and the lessee is responsible for excessive wear and use.

[279] In the newspaper ad, the monthly payment was $99 per month, with $2,444 due at signing.

[280] General Motors Acceptance Corporation, the GM car financing company.

the website, "[E]ach month you pay for the portion of the vehicle you expect to use." At the end of the contract, you can (1) keep the vehicle and make a final balloon payment, (2) keep the vehicle and refinance the outstanding balance, (3) sell the vehicle yourself, pay the outstanding balance and keep any profit, and (4) simply return the vehicle to the dealer and pay a $250 disposal fee.[281]

Finally, there is the matter of what a Saturn dealer will give you for your trade-in. It is well known that the value of trade-ins differs according to current demand for given models and their general condition (e.g., mileage, body integrity, general mechanical soundness, appearance, etc.). It simply is not possible to have a fixed price for a trade-in. The value of a trade-in, in turn, affects the final price of the new vehicle.

Thus, there is more to Saturn pricing than a single "price," and more to the automobile industry than one tiny member.

The McDonald's example.[282] Steidtmann uses a McDonald's promotion example to illustrate his pricing simplicity theory. A McDonalds' advertising campaign had offered a Big Mac or Egg McMuffin when purchased with a drink and french fries. He says the program was abandoned because of consumer confusion. However, McDonald's uses a fairly complex pricing schedule, and is not an everyday pricer.

A visit to a McDonalds's at the current time will disclose that McDonald's offers a diverse product line with substantial pricing complexity. McDonald's offers a variety of versions of the basic hamburger. Its latest addition to its line – replacing the failed "Arch Deluxe" -- is the "Big Xtra," which is currently being sold at a sale price, and at a special combination price if one orders it as part of a "combo" meal. In addition, McDonald's other entrees can be ordered individually, or (with special pricing) as part of a combo meal. Further, one can "supersize" each combo meal. A consumer has plenty of price choices to make, since the package meals are lower in price than if one ordered the items individually. Steidtmann says the McDonald's "value meal" is an example of simplicity,[283] but this is not so. A value meal requires the consumer to make a complex

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[281] Mandatory terms vary in some states.

[282] Tr. 32/17188-89.

[283] Tr. 32/17188.

price calculation to determine how much one saves if one buys the items a la carte or in combination. He has it backwards. The simplest way to price is to make everything a la carte. And the supersizing of the value meal adds a level of complexity to even this basic computation.

To put it another way, if the American public can order a meal at McDonald's, it can certainly figure out when use of a CEM stamp is appropriate.

The Apple Example.[284] Apple is simplifying its product line because of lack of consumer demand. But while they may be simplifying choice by reducing the number of items they sell, they retain a complex pricing scheme. Reference to the Sunday, March 15, 1998 *Washington Post* shows they are engaging in sale pricing, including use of a rebate. Rebates usually require the consumer to follow purchase directions and mail in a coupon. This is more complicated than merely reducing price. The ads also disclose that Apples can be had under leasing plans, too. This adds complexity to the consumer's purchase decision. Apple also is offering package systems, but one can also order the parts of the system. This is hardly a trend towards pricing simplicity.

The Long-Distance Telephone Industry. Another curious example of retail simplicity used by witness Steidtmann is the long-distance telephone industry, with its increasing tendency towards per minute rates.[285] Anyone who has seen television ads for the major long distance carriers (e.g., AT&T, Sprint, Telecom and its 10-321 calls) or read company literature knows that the rates among these carriers differ, and that the carriers are continually adjusting their rates to meet the competition. It is also common knowledge, of which the Commission may take official notice pursuant to Rule 31(j) of the Commission's Rules of Practice, that there are various qualifications for some of the rates. For example, under one plan AT&T offers a per minute rate if one pays a flat monthly fee. Thus, consumers must make a complicated price comparison to determine whether or not it is worth it to switch to the AT&T flat rate schedule from the standard schedule. But the telephone industry example is especially curious, and perhaps portentous, because AT&T once held a monopoly over long distance calls under the

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[284] Tr. 32/17189.

[285] Tr. 32/17190.

theory that it was a natural monopoly. Would witness Steidtmann have us go back to a time when the consumer was given only one rate choice from a monopolist?

In short, one may observe isolated instances where retailers simplify a product line or pricing. Even a heavy advertiser of sale prices that otherwise engages in complex pricing through use of buyers clubs, coupons, and daily and weekly specials may "simplify" from time to time, e.g., perhaps dropping a product line. Such individual observances of simplification do not constitute empirical evidence of a trend. The apt analogy would be how one experiences a prevailing wind. Standing outside, a person may feel occasional swirls of wind that indicate it is coming from one direction, then another, albeit briefly. Yet the weather forecaster has spoken of a prevailing wind from a certain direction. The occasional buffets of air from a contrary direction do not signal a change in overall direction, but are merely manifestation of temporary shifts. Pricing and product offering multiplicity still are the "prevailing wind" in the American retail economy.

6. Consumers readdressing CEM envelopes.

Rebuttal witness Miller asserts, without any citation of empirical evidence, that re-addressed reply envelopes "could become a problem."[286] Note that readdressed envelopes in theory could be a problem even without CEM. Thus, consumers could alter CRM envelopes just for the sake of saving the price of an envelope. They also could alter BRM mail, believing that the "No Postage Necessary" message applied to the envelope, and entitled them to free postage no matter who the envelope was addressed to. The same possibility exists for PRM and QBRM.

There is simply no evidence that this has been, or will be, a problem. In interrogatory OCA/USPS-T32-115, OCA asked the Postal Service to explain why it has not had a need "to collect data on the volume of pre-paid pre-addressed envelopes that have been inappropriately entered into the Postal Service's mail stream by patrons who have altered the pre-printed address and used the envelope for purposes other than its original intent. Is the lack of information on the part of the Postal Service due to low or non-existent volume of such altered envelopes?" The Postal Service meekly replied that

[286] Tr. 33/17473.

it "has not had a need to collect such data on a mailpiece by mailpiece basis."[287] Witness Fronk was not able to quantify how many persons would "deliberately use a second, lower-denominated stamp on non-barcoded mail" saying the number was "unknown . . . ."[288] Nor were any estimates made about the possibility of households readdressing preaddressed PRM envelopes, the Postal Service stating it has not had "a need to prepare such an estimate."[289]

The Postal Service seems to have retreated from earlier positions that deliberate altering of mailpieces might occur under CEM – in Docket No. MC95-1, the Commission had found it "improbable that consumers will make the effort or investment to use computers to forge indicia . . . in order to obtain a discount."[290] In response to OCA/USPS-T32-125, the Postal Service took the position that "the overwhelming majority of the mailing public is honest and is not likely to deliberately shortpay postage."[291] In this proceeding, the Presiding Officer noted that 18 U.S.C. §501 makes it a crime to forge or counterfeit any postage stamp, punishable by up to five years in jail.[292] The Postal Service position, said the Presiding Officer, is that it "assumes the worst in people."[293] Witness Willette was undoubtedly correct when she stated that it was unlikely that anyone would do so given the risks.[294] One reason the Postal Service may have backed off the "dishonesty" position is that PRM and QBRM present higher potentials for abuse, given that a dishonest mailer could save full First-Class postage.[295]

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[287] Response of Postal Service to OCA/USPS-T32-115, Tr. 19D/9430.

[288] Response of Postal Service witness Fronk to OCA/USPS-T32-36, Tr. 4/1526.

[289] Response of Postal Service to OCA/USPS-T32-20, Tr. 19D/9344. Similarly, it has no such evidence about inappropriate mailstream entry of pre-paid Postal Service envelopes mailed by the Service to postal patrons. Response of Postal Service to OCA/USPS-T32-21, Tr. 19D/9345.

[290] PRC Op. MC95-1, at V-35.

[291] Response of Postal Service to OCA/USPS-T32-125, Tr. 4/1569.

[292] Comment of the Presiding Officer, Tr. 21/10794.

[293] *Id.*, at Tr. 21/10795.

[294] Oral testimony of OCA witness Willette, Tr. 21/10794.

[295] OCA does not think any such dishonesty will occur in any of the three types of mail, except perhaps on an extremely isolated, idiosyncratic basis.

Of course, if a consumer deliberately doctored a CEM envelope, it could be detected in the same way that a doctored PRM or QBRM envelope could be detected.[296]

As noted in interrogatory OCA/USPS-T32-125, an article in the August 15, 1997, edition of the *San Francisco Chronicle* entitled "All Stamps Equal at Post Office" contained the following statement in reference to an alleged problem concerning the potential for short-paying of postage:

> "This is not a big problem in America," said Dan De Miglio, a Postal Service spokesman in San Francisco. "No American sits home and, on purpose, puts 'short pay' on an envelope. Why would you take a chance on your mortgage payment not getting there on time? Overwhelmingly, Americans are honest people, and they're just not going to do that."

7. CEM increasing education and window service costs for the Postal Service.

The Postal Service argues that CEM will cause it to incur substantial increased costs such as those for educating the public, and those associated with window service transactions.[297] OCA addresses these topics from two perspectives. The first, set forth in subsection (a) herein, is a procedural one. The second is the substantive analysis, set forth in subsection (b).

OCA wished to explore these and other cost issues in discovery, but was met with a blank wall. Thus, OCA asked the Postal Service what would be the incremental cost of selling any new stamp, but the Postal Service stated it had not measured such costs.[298] Further, it stated: "The Postal Service has not had a need to analyze the incremental window costs of releasing a new version of a 32-cent First-Class stamp."[299] This seemed reassuring to OCA; apparently the Postal Service did not have these fears of increased window costs for the full rate single-piece First-Class stamp, which, as is

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[296] Witness Fronk stated that a doctored PRM or QBRM envelope "could be identified at a number of points in the processing and delivery cycle . . . ." Response of Postal Service witness Fronk to OCA/USPS-T32-117, Tr. 4/1567.

[297] Rebuttal Testimony of Postal Service witness Miller, Tr. 33/17465 *et. seq.*

[298] Response of Postal Service to OCA/USPS-T32-46(c), Tr. 19D/9361.

[299] Response of Postal Service to OCA/USPS-T32-67, Tr. 4/1538.

known, comes in 241 different versions.[300] In fact, when considering whether or not to release a new version of a 32 cent stamp the Postal Service said it does not even analyze incremental window costs.[301]

Then came rebuttal testimony and a whole different story emerged, complete with data presentations.

a. Portions of witness Miller's testimony reveal a violation of the Commission's discovery rules, and those portions should be accorded little or no weight.

Portions of the Rebuttal Testimony of Michael W. Miller, USPS-RT-17, reveal that the Postal Service has violated the Commission's discovery rules by not providing requested documents at the time they were requested, and by failing to submit responsive information when it subsequently became available. Relevant to this argument is Rule 25(e) of the Commission's Rules of Practice, which states:

> A participant who has answered interrogatories is under the duty to seasonably amend a prior answer if he/she obtains information upon the basis of which he/she knows that the answer was incorrect when made or is no longer true.

(In addition, witness Miller could not testify on cross-examination on various subjects because he had no personal knowledge of the material, which otherwise was not sponsored or supported even by library references. This is discussed in subsection (b) below.)

OCA considered filing motions to strike certain rebuttal testimony, as discussed below, but the violations did not become apparent until rebuttal testimony was filed, and, in many cases, until witness Miller appeared to testify on March 17, 1998. A pending motion to strike would have made brief writing problematic. Consequently, OCA here takes the position that the Commission rectify the prejudice which OCA has incurred by according little or no weight to the portions of the testimony indicated. Of course other avenues are open to the Commission if it concludes that widespread abuse of its

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[300] Response of Postal Service to OCA/USPS-T32-47(c), Tr. 19D/9369.

[301] Response of Postal Service to OCA/USPS-T32-47(e), Tr. 19D/9370.

discovery rules has occurred, including disciplinary actions or changes in its discovery rules.

The rebuttal testimony of Postal Service witness Miller concerns OCA's CEM proposal. Specifically, on the entirety of pages 18, 19 and 20, and the portion of page 21 preceding Section C., witness Miller testified that CEM would force the Postal Service to incur substantial additional costs.[302]

First, the Postal Service argues that CEM will force it to incur substantial education costs.[303] OCA pursued the issue of education costs in discovery. Interrogatory OCA/USPS-31 asked:

> Please provide the estimated cost to educate and notify households on the appropriate postage required if CEM as proposed by the OCA in Docket No. MC95-1 were implemented. If you are unable to provide an estimate, please explain why you cannot comply with this request.

The Postal Service replied:

> The Postal Service has not prepared an estimate of the cost of educating and notifying the public about CEM. Therefore, it can provide no estimate in response to this question[s] [sic].

Witness Miller's rebuttal testimony provides a detailed estimate about a multimedia public education campaign for CEM as proposed in this docket. He projects education costs of $33 million,[304] based on Exhibit USPS-RT-17B.[305] This contrasts with the interrogatory response, where the Postal Service was explicitly asked to provide an estimate for CEM service as proposed in Docket No. MC95-1. The two CEM proposals are substantially the same. The response to the original interrogatory is at a minimum evasive, at a maximum false. If the Postal Service could perform the calculation for the rebuttal exhibit, it could have prepared it for a response to the interrogatory.

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[302] Tr. 32/17465-67 and lines 1-17 on page 17468.

[303] Tr. 33/17465-66.

[304] Tr. 33/17465.

[305] Tr. 33/17491-94.

The Rule 28 issue is – when did the information used for Exhibit B become available? Witness Miller said the work on developing costs "began in December."[306] Cost data he used that came from the USPS 1997 annual report was received sometime in December of 1997.[307] He obtained printing cost information from Young & Rubicam through other employees in December."[308] A schematic media plan was provided by Cohn & Wolfe by the middle of February.[309]

However, with just a few days to go before close of the record, OCA was confronted with information that could have been provided weeks or months ago. The late filing of this information thus also conflicts with Rule 25(e), which requires updating of interrogatory responses. Yet no updating was ever supplied.

Next, the Postal Service alleges that window costs would increase.[310] On August 15, 1997, OCA submitted interrogatory OCA/USPS-T32-46, which was responded to institutionally by the Postal Service on September 9, 1997. OCA/USPS-T32-46(c) asked: "What is the incremental window cost to the Postal Service of selling a new issue of (the current) 32-cent First-Class stamp, e.g., the Bugs Bunny stamp?" The Postal Service replied: "The Postal Service has not measured this cost."[311]

In rebuttal, the Postal Service discloses a cost calculation for window service stamp transactions. "Each window service stamp transaction currently costs the Postal Service 39 cents."[312] The response to the original interrogatory is at a minimum evasive, at a maximum false. If the Postal Service could perform the calculation for the rebuttal exhibit, they could have prepared it for a response to the interrogatory. Thus, with just a

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[306] Tr. 33/17593.

[307] Tr. 33/17594, lines 13-14.

[308] Tr. 33/17595, lines 8-10.

[309] Tr. 33/17596, line 11.

[310] Tr. 33/17467-68.

[311] Tr. 19D/9361.

[312] Tr. 33/17467, lines 19-20.

few days to go before the end of rebuttal testimony, OCA was being confronted with information that could have been provided earlier.

Further, Rule 25(e) has been violated again, since no update to the original interrogatory was provided. The Postal Service supports its rebuttal testimony about window service costs through use of Exhibit USPS-RT-17C.[313] Work on the exhibit "began in the middle of January."[314] Preliminary figures were available "close to the end of January."

As part of its argument concerning window transaction costs, Postal Service witness Miller stated: "Many households currently purchase stamps through these alternative sources (*73 million transactions annually*) [footnote omitted] [emphasis added] and would have to make additional trips to the post office . . . ."[315] Footnote 30 on page 20 of the Miller rebuttal testimony, Tr. 33/17467, states that this estimate comes from estimated FY 1997 stamp sales transactions managed by Amplex Corporation, the administrator of the USPS stamps on consignment program. However, in response to OCA/USPS-T32-46(d), a question about consignment sales outlet savings, the Postal Service stated: "The number of consignment transactions is unknown." Clearly, this information should have been provided earlier than it was. The original answer may have been evasive or false. In any event, at some point the evidence used in Exhibit 17B was available earlier than the submittal of rebuttal testimony and should have been supplied under Rule 25(e).

The Postal Service failure to accurately and fully respond to OCA's discovery questions has prejudiced OCA. For one thing, accurate interrogatory responses would have enabled OCA to submit follow-up questions on these issues earlier on in the case. Once the Postal Service indicated there was a lack of information, further discovery on the issue seemed pointless.

Rule 28 provides that for failure to obey an order to provide discovery, the Commission or the presiding officer may make such orders in regard to the failure as are

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[313] Tr. 33/17496 *et seq.*

[314] Tr. 33/17597, lines 1-2.

[315] Tr. 33/17467.

just.[316] These include striking the problematic evidence.[317] At a minimum, we believe the Commission should accord the portions of the rebuttal testimony indicated above (the entirety of pages 18, 19 and 20, and the portion of page 21 preceding Section C.)[318] little or no weight. Out of an abundance of caution, however, OCA will analyze the evidence submitted by the Postal Service on these cost issues.

b. The education and window service cost evidence cannot be verified and is entitled to little weight.

Even if it should be determined that discovery violations have not occurred, analysis of the education and window service cost evidence reveals it should be entitled to little weight because it could not be verified on cross-examination. Witness Miller could not independently verify many of the figures used to develop the underlying exhibits. The printing costs cited in item 3 of Exhibit 17-B were obtained through employees other than Miller himself.[319] There is no other information available either in the record or as a library reference on how this information was developed.[320] The schematic media request information was developed through another employee[321] and witness Miller was not sure what the nature of the request to the media plan developer was.[322] "I personally don't know how – the details of how these figures [Cohn & Wolfe, and Young, Rubicam] were arrived at."[323] "As far as the television, radio, and newspaper advertising, I wouldn't be able to evaluate."[324] That media plan has not been

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[316] 39 C.F.R. §3001.28.

[317] *Ibid.*

[318] Tr. 32/17465-67 and lines 1-17 on page 17468.

[319] Tr. 33/17594, lines 22-23.

[320] Tr. 33/17595, line 16.

[321] Tr. 33/17596, line 5.

[322] Tr. 33/17595, line 25; Tr. 33/17596, lines 1-2.

[323] Tr. 33/17618, lines 18-19.

[324] Tr. 33/17618, line 25; Tr. 33/17619, line 1.

furnished elsewhere in the record or as a library reference.[325] Thus, details of the plan (and, *ergo*, the appropriateness of the plan) are nowhere in the record. Nor is there any evidence in the record or filed as a library reference to support Miller's use of a figure of 73 million consignment transactions.[326] Nor do we know how the vending machine figures used to support the increased transaction costs testimony were developed.[327]

Finally, publicity over a rate decrease could reduce some Postal Service advertising costs. The Postal Service engages in "good will" advertising. Thus, in a recent Washington Post ad, the Postmaster General expressed pride in a Pew Research Center survey indicating the high trust the American public has in the Postal Service.[328] During the Olympics, it used prime-time advertising to tell the American public that it would be able to vote on new stamp issues. But a rate reduction for commonly-used First-Class mail will allow the Postal Service to bask in the good will created by CEM adoption.

8. Businesses could encounter problems.

Postal Service witness Miller argued that businesses could suffer negative impacts because of CEM.[329] These assertions concerned allegations that, e.g., consignment outlet employees could be "plagued" by customer inquiries; businesses not using CEM may suffer delayed remittances if consumers put the wrong postage on non-qualifying mail; and small businesses allegedly would face the same complexities as consumers in terms of recognizing qualifying CEM pieces. None of the assertions on page 6 of the Miller rebuttal testimony, Section III.B., amount to anything more than bald assertions. The weakness of the arguments can be illustrated by witness Miller's assertion that consignment outlets that did not offer both CEM stamps and First-Class

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[325] Tr. 33/17596, line 21.

[326] Tr. 33/17597, lines 23-25; Tr. 33/17598, line 1.

[327] Tr. 33/17598, line 14.

[328] *Washington Post*, March 16, 1998.

[329] Tr. 33/17450.

stamps could get complaints.[330] If consignment outlets did receive sufficient complaints (which would indicate strong consumer interest in CEM, contrary to the Postal Service position), doubtless the consignment outlets would respond by making both kinds of stamps available. That is what happens in competitive markets – something which the Postal Service may not understand.

9. Major mailers would have to modify envelopes.

Witness Mailers states that major mailers would have to modify envelopes in order to participate in CEM.[331] This is correct. However, the direct testimony of OCA witness Willette noted that transformation of CRM envelopes into CEM envelopes could be done easily and at low cost.[332] Witness Miller then conjures up a host of potential envelope design issues. However, the CEM envelope design would have to be approved by the Postal Service.[333] This would be done in much the same way that the Postal Service approves CRM pieces and BRM pieces.[334] Substantially similar steps will have to be taken for PRM and QBRM. OCA notes that the Postal Service acknowledges that it "provides a significant amount of technical assistance to mailers wishing to make their mail automation compatible."[335] Witness Miller acknowledges this in his rebuttal testimony, saying that "[w]orking with mailers to resolve envelope hygiene problems makes good business sense because the Postal Service can improve the processing characteristics of future reply mail pieces."[336] We agree that this cooperative

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[330] Tr. 33/17450, lines 7-8.

[331] Tr. 33/17450.

[332] Direct Testimony of witness Willette, at 10. For example, existing CRM envelopes could be transformed into CEM envelopes for between 0.3 and 0.5 cents each for orders of 100,000 envelopes or more. *Ibid.*, lines 16-17.

[333] Oral testimony of OCA witness Willette, Tr. 21/10780.

[334] "When a mailer completes an application to mail using reply mail [BRM] pieces, the mailer must submit samples of the proposed pieces in a pre-production format." Response of U.S. Postal Service to OCA/USPS-T32-68, Tr. 19D/9402. "The verifications of BRM pieces include a review of the content and placement of BRM legends and markings in the format design, accuracy of the ZIP code and barcode data . . . ." *Ibid.*

[335] Response of Postal Service to OCA/USPS-T32-32(a), Tr. 19D/9350.

practice does make good business sense. Presumably, this tradition of assistance would be continued.

The Postal Service disagrees that the transformation of a CRM piece into a CEM piece would be simple because reply mail characteristics vary a great deal.[337] However, they do now, and there is no evidence of a substantial problem, as discussed above. OCA echoes what the Commission said in Docket No. MC95-1:[338]

> The Service has proposed in its own direct case a requirement that all courtesy envelope mail pieces included in automation mailings meet the automation standards. [citation omitted] * * * There is no evident reason why certifying a piece as CEM eligible could not be done under the same contemplated review process. It should not be any more costly or time consuming than what the Service has already proposed.

Under current Postal Service regulations, "[r]eply envelopes enclosed in mailings claimed at automation rates must meet automation compatibility standards. All bulk mailings submitted at automation rates are verified to ensure that all enclosures meet all applicable mailing standards."[339] Apparently, there are few problems with this system, since the Postal Service states: "Generally, courtesy reply envelopes meet the automation compatibility requirements . . . ."[340] The various technical problems cited by witness Miller at Tr. 33/17452-53 seem easily surmountable, given that similar if not identical issues exist as to CRM pieces.

Witness Miller notes the OCA proposal that CEM pieces should contain a marking on the envelope designating it as such.[341] He states that placing the notice in the

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[336] Tr. 33/17451.

[337] Tr. 33/17451.

[338] PRC Op. MC95-1, at V-34.

[339] Response of U.S. Postal Service to OCA/USPS-T32-111, Tr. 19D/9426. *See also* DMM Section C810.8.0, which requires courtesy reply, business reply and meter reply mail to be automation compatible when they are mailed as enclosures in letter-size pieces that are mailed at an automation postage rate.

[340] Response of Postal Service witness Moden to OCA/USPS-T32-51, Tr. 19D/9372.

[341] Tr. 33/17452.

postage affixation block would not be an adequate solution because once the stamp was on a postal worker could not tell whether or not the stamp qualified. OCA is certain that one of its Mailpiece Design Analysts can figure out a design solution to this "problem," such as placing a second CEM indicator on the envelope. OCA notes that Business Reply Mail has a BRM indicator, as well as a message in the postage affixation block that no postage is necessary.[342]

OCA notes that the Postal Service portrays its 179 Mailpiece Design Analysts as quite skilled in resolving envelope design problems. "The Postal Service provides a significant amount of technical expertise to mailers wishing to make their mail automation compatible."[343] And it describes its "proactive" approach to ensuring that envelope design problems will not bedevil mailers:[344]

> Generally, courtesy reply envelopes meet the automation compatibility requirements so that there has not been a need for a formal survey or analysis. Moreover, courtesy reply envelopes bear a facing identification mark (FIM) and bar-code as a result of proactive steps taken with mailers prior to the printing of the envelopes. For instance, Mailpiece Design Analysts (MDAs) work with these businesses to help them design their courtesy reply pieces to be automation compatible. Part of this work includes providing the mailer with a camera-ready positive that can be given to the envelope printer, so a FIM and barcode can be printed on the envelope. Likewise, should quantities of reply mail begin to be rejected on our barcode sorting equipment, that information is forwarded to the MDAs so that follow-up corrective action can be taken with the envelope provider.

One would expect the same kind of efficient, proactive envelope design management to occur upon introduction of CEM.

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[342] Witness Miller also states that the CEM indicator would have to be put in the same place on all envelopes. Tr. 33/17452. Perhaps he misunderstands the purpose of the CEM indicator. It is not anything that would seem to need to be machine readable. It is merely a notice to consumers (or to the postal workers, if that is deemed necessary). The Postal Service's automated letter processing equipment cannot distinguish mail weighing more than one ounce; nor can it distinguish among most stamp denominations. Why it would be deemed necessary to read a CEM indicator is not explained on the record.

[343] Response of Postal Service to OCA/USPS-T32-32(a), Tr. 19D/9350.

[344] Response of Postal Service to OCA/USPS-T32-51, Tr. 19D/9372.

Witness Miller opines that enforcing a mandatory conversion to CEM would be difficult.[345] He fears that CRM providers will have a negative reaction to having to change their envelope design because, *inter alia*, they would question what they were getting out of it.[346] For one thing, they would continue to receive the benefits of the automation compatibility discounts they now receive. Second, they would receive substantial good will from their customers for providing discount envelopes. CRM providers are constantly inserting "good will" messages and other correspondence in their mailings. It takes little imagination to realize that CRM providers who become CEM providers will – rightfully – brag about the effort they have made for their customers.

Witness Miller also asserts that costs for processing reply mail could increase. This would allegedly occur if consumers placed two stamps (e.g., a CEM stamp and a three-cent stamp) on non-converting CRM pieces and, by chance, obscured the FIM mark.[347] However, the same opportunity for FIM obscuration exists now, and will exist even more so if the First-Class stamp increases by one cent since consumers are likely to add one cent stamps on existing inventory. Yet there is no evidence that the Postal Service fears such a problem, or that it has ever encountered this as a substantial problem in the past. The Commission may take official notice of the fact that there is sufficient room on reply envelopes between the FIM and the postage affixation block for placing two stamps – one would hope the Postal Service had that in mind when they mandated FIM qualifications.[348]

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[345] Tr. 33/17453.

[346] *Ibid.*

[347] Tr. 33/17455.

[348] Because of the late introduction of evidence by the Postal Service on rebuttal, OCA at various times in this brief asks the Commission to take official notice of commonly understood, or easily observable or ascertainable facts. This is equitable, given the lack of meaningful time for participants to prepare surrebuttal. "Agencies, as a practical matter, though, exercise latitude to rely on information outside the four corners of the record through the invocation of the doctrines of 'official notice' and 'agency expertise.' Official notice is the administrative analog of judicial notice. But, it is much broader. Agencies frequently take official notice of the information contained in various publications, [etc.] . . . ." Edles & Nelson, Federal Regulatory Process: Agency Practice & Procedures (1981), at 117.

10. Postal Service stamp inventory issues.

Witness Miller fears that the Postal Service will face inventory complications under a two-stamp system, since the "current system relies predominantly on one basic stamp denomination for First-Class letters."[349] He also opines that "the average cost per stamp could increase if the Postal Service required smaller batches of more stamp types . . . ."[350] However, the Postal Service now sells 240 different versions on the First-Class stamp, and releases more issues frequently, thus indicating that inventory problems are surmountable, if, indeed, they are a problem at all. It is a commonly observed fact of which official notice may be taken that postal window clerks have a large supply of many different types of First-Class stamps in inventory, and frequently stock more than one version of the First-Class stamp booklet (e.g., a flag design and a flower design). Surely the Postal Service can handle the increase in the number of First-Class stamps from 240 to 241.

The issue of how many CEM stamps to carry is something the Postal Service also has experience with – every time the First-Class rate is increased it must decide how many stamps to carry not only of the new rate but also of the marginal rate (e.g., the one cent stamp that many consumers would use if the Postal Service's proposed rate increase is adopted). The Postal Service's need to judge how many CEM stamps to carry will rapidly diminish once CEM usage patterns are determined.

11. Rate inequity.

Witness Miller argues that implementation of CEM would be "one-sided."[351] He cites at length the concerns of the Governors' message rejecting CEM in Docket No. MC95-1: "As we understand the CEM discount concept, it would offer households the new advantages of deaveraging for their low cost mail."[352] It is not clear what the

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[349] Tr. 33/17454.

[350] Tr. 33/17472.

[351] Tr. 33/17476.

[352] Tr. 33/17477.

relevance of this testimony is, since the Postal Service has not in this docket advanced any "Aunt Minnie" reclassification proposals, e.g., a separate First-Class single piece rate for handwritten addresses. (Parenthetically, OCA would note that if the Postal Service does advance such a proposal, there will be considerable consumer and Congressional interest in such a proposal.)

OCA would note that in interrogatory OCA/USPS-T32-19, Postal Service witness Fronk was asked to explain in regard to a hypothetical CEM "how each of the Board of Governors' objections to the CEM recommendation in Docket No. MC95-1, as expressed in their CEM decision, is relevant."[353] Witness Fronk responded: "I would not want to answer this question on behalf of the Governors. They would need to see a fully developed MPRM[354] proposal and offer a response to it in order for the Postal Service to state the extent to which their objections to CEM applied to MPRM."[355] It thus appears this is another example of the Postal Service responding to discovery when it suits its needs. OCA would add that there is no evidence on the record that witness Miller sought or received authorization to speak on behalf of the Governors.

J. CEM Adoption Will Not Intrude Upon Postal Service Management Prerogatives.

Mail Order Ass'n, *supra*, permitted Commission recommendations based on non-Postal Service proposals as long as such recommendations do not unduly interfere with Postal Service management decisions:[356]

> Had the PAR proposal been aired and presented in the hearings, we would be better able to assess whether the Commission's recommendation unduly interferes with the Postal Service's management decisions or otherwise exceeds the Commission's statutory authority. The record presumably would reveal whether there are overriding operational or policy reasons to distinguish between CEM and non-CEM preb-

[353] Tr. 4/1514-15.

[354] OCA briefly used the acronym MPRM as a possible replacement for CEM.

[355] Tr. 4/1514.

[356] 2 F.3d at 424.

> arcoded individual letters, as well as between bulk and nonbulk automation compatible pieces, or whether, as the Commission claims, it is unduly discriminatory to extend the discount to large-scale mailers and not to the general public. We simply cannot tell on this record.

Under *Mail Order Ass'n*, the Commission must first assess whether its recommendation "unduly interfere[s] in the management and direction of the Postal Service." *Ibid.* The use of the word "unduly" suggests some interference is permissible, and this is corroborated by the additional statement that a proposal should not "*cause an upheaval in the efficient operation of the Postal Service.*" [emphasis added] *Ibid.* Note that "upheaval" is defined as "strong or violent change or disturbance."[357] Thus, it would appear that moderate or slight changes are permissible.[358] As the court noted: "Virtually every rate or classification recommendation will have some impact on Postal Service operations and policies; any such effect alone cannot be permitted to tie the Commission's hands."[359]

OCA's CEM proposal complies with *Mail Order Ass'n*'s guiding principles. Commission action recommending the adoption of CEM, increasing the class of mailers who could take advantage of automation discounts, would not unduly intrude upon Postal Service management because it would not cause an "upheaval" in Postal operations. This can be deduced from the lack of evidence in the record that the Postal Service could not take the small steps necessary to implement CEM. CEM is but a minor variation of existing CRM.

The Postal Service has, for the purposes of litigation, conjured up a number of hypothetical CEM-related problems, anxious as the Service is to maintain the status quo on this overly profitable segment of the First-Class mail stream. However, these hypothesized problems have been shown to be fictitious. Actual Postal Service concerns over such administration and enforcement issues as underpayment of postage,

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[357] *Random House Dictionary of the English Language*, (unabridged ed. 1967) at 1570.

[358] This reading is consistent with the court's opinion that "in remedying these inequities however, the Commission does not have *carte blanche* to intrude as far as it wishes into Post Office management." *Mail Order Ass'n, supra*, 2 F.3d at 424.

[359] *Ibid.*

consumer confusion, and the other issues discussed herein have been shown to be small or non-existent for First-Class Mail generally, where even greater potentials for such problems exist. Thus, it has been shown that consumers tend to overpay rather than underpay postage. The same enforcement and administration "problems" will occur for PRM as well, yet the Postal Service has not demonstrated any concerns about its implementation.

In short, CEM requires virtually no Postal Service operational changes. CEM is really CRM with *de minimis* envelope design changes. Regulatory compliance issues such as monitoring of envelope indicia can be done the same way they are done now for CRM, BRM, and as they will be done for PRM. Issuance of a CEM stamp will cause no problems for an institution that has hundreds of stamps before the public now. Finally, the revenue loss associated with CEM is quite manageable, especially given the Postal Service's currently overflowing coffers.

K. To Avoid Pervasive Discrimination Among First-Class Mail Users, The Commission Must Condition Any Rate And Classification Recommendations Upon Concurrent Adoption Of CEM By The Postal Service.

The PRA provides that "*[I]n providing services* and in establishing classifications, rates, and fees . . . the Postal Service shall not, except as specifically authorized in this [Act], make any undue or unreasonable discrimination among users of the mail, nor shall it grant any undue or unreasonable preferences to any such user." 39 U.S.C. § 403(c). [emphasis added] The record shows that CEM mail avoids precisely the same processing costs as PRM and QBRM, yet the Postal Service would deny a discount to CEM mailers while granting it to the PRM and QBRM categories. This is price discrimination of the rankest sort. Further, it is price discrimination against the type of First-Class mail user – households and small businesses – where the users are the most defenseless. Simply put, such First-Class mail users do not have realistic alternatives for bill paying.

The core purpose of postal reorganization was to protect defenseless First-Class mail users against the Postal Service monopoly. As noted by the D.C. Circuit, "[t]he

central purpose of the Act was to 'get politics out of the Post Office' – to eliminate the discretion to set rates that had resulted in discrimination against certain classes of mail."[360] The Court referred to *"the historical discrimination against first-class mail"* as *"a concern that permeated the passage of the Act . . . ."*[361] [emphasis added] In a previous case, the same court noted that prior to postal reorganization "[d]iscrimination in postal ratemaking . . . . to the great disadvantage of first class mail has long been a part of our postal system."[362] It should be emphasized that the Commission has the legal authority to use its recommendation authority to prevent discrimination. "[T]he Commission may simply decline to recommend a rate or classification that it is convinced is unfair."[363]

One can expect that the Postal Service will once again reject a CEM recommendation detached from the remainder of the Commission's recommendation, as it did in Docket No. MC95-1. If the Postal Service acts as predicted, a substantial portion of First-Class Mail sent by households will continue to be a victim of clear rate discrimination. OCA submits that protection of individual consumers' First-Class mail rights is so fundamental to the Act that all other affirmative rate and service classification recommendations in this docket must be conditioned upon Postal Service acceptance of the CEM category at a discounted rate of four cents from the single piece First Class rate. One way to do this would be to issue a separate recommended decision on CEM and then await the Governors' action before issuing a recommended decision on the Postal Service's overall request.

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[360] *Nat. Ass'n of Greeting Card Publishers v. U.S.* P.S., 607 F.2d 392, 400 (D.C. Cir. 1979).

[361] *Id.* at 414.

[362] *Nat. Ass'n of Greeting Card Publishers v. U.S.P.S.*, 569 F.2d 570, 587 (D.C. Cir. 1976).

[363] *Mail Order Ass'n, supra*, at 424.

III. UNDUE OR UNREASONABLE DISCRIMINATION OR PREFERENCE

A. The Postal Reorganization Act Requires That Services (And Not Just Rates) Be Offered On A Nondiscriminatory Basis.

1. Introduction.

A pervasive problem with some of the Postal Service's service proposals in this proceeding is that they are unduly discriminatory, thus violating the foundational principles that gave rise to the Postal Reorganization Act ("PRA"). The Postal Service's proposed expansion of parcel post length and girth limitations is unduly discriminatory because it is being offered only to high volume mailers, i.e., those with nine or more parcels in the same mailing.[364] Further, its delivery confirmation proposal is unduly discriminatory because it arbitrarily does not extend this premium service to certain mail classes (such as First-Class),[365] and because it precludes household and small business mailers from taking advantage of the lower-priced computer access service available to large mailers to obtain delivery confirmation information.[366] Although the short answer to whether or not the service proposals are discriminatory likely finds an (affirmative) answer in the Commission's Red-Tag Proceeding, Docket No. MC79-3, *infra*, a fuller discussion of the legal precedents concerning service discrimination would benefit the development of the record in this docket.

This brief will discuss service discrimination at some length because it is less often encountered. Though often less familiar, nonetheless, the economic dangers and statutory proscriptions associated with service discrimination are very real. As will be seen, anti-discrimination statutes encompass more than price discrimination such as (1) pricing like services or products differently for one group than for another, and (2) charging different prices for different services but at differentials which are not great

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[364] Direct Testimony of Postal Service witness Mayes, USPS-T-37, at 18. *See* Subsection E.1. herein.

[365] *See* Subsection F.2. herein.

[366] *See* Subsection F.3. herein.

enough (or are too great) in relation to the service rendered.[367] Such statutes also address discrimination in the offering of types of service, i.e., only to a select group of patrons.

2. The relevant statutes.

Title 39 U.S.C. §3623(c)(1) requires "the establishment and maintenance of a fair and equitable classification system *for all mail*." (emphasis added). Further, 39 U.S.C. §3622(b)(1) requires "the establishment and maintenance of a fair and equitable schedule . . . ." And, "*[I]n providing services* and in establishing classifications, rates, and fees. . . the Postal Service shall not, except as specifically authorized in this [Act], make any undue or unreasonable discrimination among users of the mail, nor shall it grant any undue or unreasonable preferences to any such user." 39 U.S.C. § 403(c). [emphasis added]

As noted by the D.C. Court of Appeals in *Mail Order Ass'n of America v. U.S. Postal Service*, 2 F.3d 408, 423-24 (D.C. Cir. 1993) (hereinafter, "*Mail Order Ass'n*"):

> During the course of a ratemaking proceeding, the Commission has the authority, and indeed the duty, to assess the fairness and equity both of the proposals before it and of its own recommended decision to the Governors. 39 U.S.C. § §3622(b)(1), 3623(c)(1); *See also National Ass'n of Greeting Card Pubs. v. USPS*, 607 F.2d 392, 403 (D.C. Cir. 1979) (the "prevention of discrimination among the mail classes" was major purpose of Congress in passing PRA) . . . .

3. The genesis of anti-discrimination regulatory law.

To better interpret the PRA's anti-discrimination statutory provisions and to better understand when a discrimination is "undue," one needs to understand the genesis of anti-discrimination law. One of the nearly universal obligations imposed by Federal and state laws on public utilities and regulated modes of transportation is the obligation to furnish service and to charge rates that will avoid "undue," "unjust," or "unreasonable"

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[367] *See Competitive Telecommunications Ass'n v. FCC*, 998 F.2d 1058 (D.C. Cir. 1993) (Unreasonable discrimination in charges under FCC Act can come in form of lower price for equivalent service or enhanced service for equivalent price)

discrimination or preference among shippers or customers.[368] Indeed, the history of the rule against undue discrimination is as old as Federal utility regulation itself in the United States. Section 403(c) of the PRA is in substance the same as the prohibition against unjust discrimination or undue or unreasonable preferences or advantages contained in Sections 2 and 3 of the Interstate Commerce Act, enacted by Congress in 1887.[369] Such regulation became the pattern for all subsequent regulation of public utilities and carriers.[370]

The importance of "undue discrimination" provisions can been seen in an opinion such as *Public Serv. Co. of Ind. v. FERC*, 575 F.2d 1204, 1212 (7th Cir. 1978) where it was noted that a rate may be found reasonable under one statutory provision, but still fail to pass muster because the rate is unduly discriminatory:

> The FPC's analysis satisfied section 205(a)'s requirement that all rates must be just and reasonable, but it is not responsive at all to the question under section 205(b) of whether the factual difference, *viz.*, the contract, justifies the quite substantial rate differential charged to Frankfort compared with that charged to the other Cities. [footnote omitted] These standards are "twin objectives" of the Act, [citation omitted]

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[368] For purposes of brevity we shall refer to the general concept of unlawful discrimination using the term "undue discrimination."

[369] 24 Stat. 379, 380. Section 2 of the Interstate Commerce Act forbade discriminations taking the form of different charges for the same service. Section 3 dealt with discrimination in all other forms, making it unlawful for a common carrier to "make or give any undue or unreasonable preference or advantage . . . in any respect whatsoever . . . ."

[370] Federal Power Act, Section 205(b), 49 Stat. 851 (1935); Natural Gas Act, Section 4(b), 52 Stat. 822 (1938); Federal Communications Act of 1934, Section 202, 48 Stat. 1070 (1934); Federal Aviation Act of 1958, Section 404, 72 Stat. 760 (1958); and Shipping Act of 1916, Sections 16, 17, 39 Stat. 734, (1916). A typical modern anti-discrimination provision is the one governing activities under the jurisdiction of the Federal Communications Commission ("FCC"). The relevant statute, 47 U.S.C. §202(a), states:

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

> and the Commission must consider them separately and demonstrate that both requirements have been satisfied. . . That the rates Frankfort is charged are reasonable in some general sense does not protect its position vis-a-vis the other Cities.

4. The prohibition against undue discrimination is the very heart of the Postal Reorganization Act.

The prohibition against undue discrimination is the very heart of the Postal Reorganization Act, as illustrated by Senator McGee's remarks on the Senate floor:[371]

> The committee believes that if Congress is to separate itself from the periodic battles over rate adjustments, we should make the separation complete. We should get the Congress out of the clutches of the lobbyist. To retain any ratemaking power is to insure that our halls will be filled with the representatives of special interest groups who will, as they always have, attempt to convince the Members of Congress that the world will truly come to an end if we raise the rate on their mail.[372]

Permitting the Postal Service to offer services only to those groups that successfully lobby the Postal Service defeats the core purpose of the PRA. To permit favored groups to receive special service unavailable to others would mean that the PRA is a hollow shell – special interest lobbyists would merely have moved their venue from Capitol Hill to L'Enfant Plaza. OCA does not think Congress intended such a result when it passed the PRA. Neither do the courts. As stated in *National Retired Teachers Ass'n v. U.S. Postal Service*, 430 F. Supp. 141, 146 (D.C.D.C. 1977): "By taking the matter out of the hands of Congress and placing it in 'impartial professionals', the theory was that members of Congress would not be subjected to 'the relentless pressures of lobbyists for the big mail users.'" [footnote omitted] *See also National Ass'n of Greeting Card Pubs. v. USPS*, 607 F.2d 392, 403 (D.C. Cir. 1979) (the "prevention of discrimination among the mail classes" was major purpose of Congress in passing PRA).

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[371] 116 Cong. Rec. 21712 (June 26, 1970).

[372] As one court has noted: "One of the principal goals of the reorganization was to produce a self-supporting, efficient structure that would operate . . . without excessive congressional regulation." *Nat. Easter Seal Soc., Etc., v. U.S. Postal Service*, 656 F.2d 754, 757 (D.C. Cir. 1981).

5. Only "undue" discriminations are prohibited.

As consistently interpreted across all regulatory schemes, the prohibition against undue discrimination does not mean that all discriminations are prohibited. Only "undue" ones are.[373]

There are practical reasons for permitting some forms of discrimination:[374]

> Discrimination is both unintentional and purposive. It is unintentional in that some discrimination results from the efforts of utilities and commission to simplify the rate structures by grouping customers into a limited number of classifications. It is purposive in that discrimination may be the only way in which service can be provided to some customers. Low-density routes may be subsidized by high density routes (even under competition), small towns by large cities. [footnote omitted] Rather than preventing discrimination, regulation merely seeks to control what discrimination takes place.

Generally speaking, if the regulatory body gives a sufficient reason for permitting a discrimination, it will be upheld.[375] Thus, in *Nat. Easter Seal Soc.*, *supra*, 656 F.2d at 761, a phased-in rate decrease was returned to the Postal Service for reconsideration because the Governors "did not analyze the phasing schedule they adopted in terms of that standard [Section 403(c)] and saw no need to justify the disparate treatment. . . . [A]bsent some reasonable ground for differential treatment, section 403(c) forbids discriminatory phasing of discounts to only one class of mailers." *Id.* at 762.[376] The Second Circuit Court of Appeals has stated the standard as: "The issue at hand is whether the [Federal Communication] Commission's determination that the rate

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[373] *See*, e.g., *Public Serv. Co. of Ind. V. FERC*, *supra*, 575 F.2d at 1204.

[374] Charles F. Phillips, Jr., "The Regulation of Public Utilities (2d ed. 1988), p.63.

[375] *See*, e.g., *Consolidated Edison Co. of N.Y., Inc., v. FERC*, 676 F.2d 763, 773 (D.C. Cir. 1982) (Mere fact that utility's plan treats different kinds of contract for natural gas differently does not mean plan is unduly discriminatory; contractual commitments do not necessarily serve public interest in efficiently allocating scarce natural gas supplies).

[376] At the same time, courts reviewing the actions of a ratemaking body apply a deferential scope of review and will not overturn an order unless the agency's decision is arbitrary, capricious, or otherwise not in accordance with the law. *See* 5 U.S.C. §706(2)(A); *Connecticut Office of Consumer Counsel v. FCC, 915 F.2d 75, 78 (2d Cir. 1990).*

differential . . . is not unjust or unreasonable is a rational one."[377] Thus, a Postal Service decision "may provide different levels of delivery service to different groups of mail users so long as the distinctions are reasonable."[378]

6. To withstand judicial review, a permitted discrimination must be fully and rationally explained.

However, a regulatory agency's decision to approve a discrimination must be rational and fully explained, and based on fresh data. A FERC order prescribing a plan that effected a discrimination was overturned in *State of N.C. v. FERC*, 584 F.2d 1007 (D.C. Cir. 1978) because the agency failed "to make findings as to the impact the plan would actually have on ultimate consumers . . . ." *Id.* at 1012. "From the very beginning of the Natural Gas Act, the courts have held that it is not the theory of a rate order but its impact that determines its legality." *Id.* at 1014.

Agency findings that discrimination is not undue must be more than "generalized recitals." *Harborlite Corp. v. ICC*, 613 F.2d 1088, 1101 (D.C. Cir. 1979): "We agree with Harborlite that for us to defer to these 'generalized recitals' . . . [would be] stretching the poetic license of administrative 'expertise' beyond reasonable bounds."

7. "Due" versus "undue" discrimination in a service context.

The delineation of what is "due," or permissible discrimination, and "undue," or impermissible discrimination in a service context is critical. Findings either way are

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[377] Connecticut Office of Consumer Counsel v. FCC, 915 F.2d at 79.

[378] *Egger v. U.S. Postal Service*, 436 F. Supp. 138, 141 (W.D. Va. 1977). "The goal sought by the Postal Service in the instant case by their discrimination is the efficient and economical delivery of the mail. The goal is legitimate and the only question is whether the distinctions between the three groups are rationally related to the achievement of the goal." At issue was the Postal Service practice of providing only bulk delivery for students living in university-owned housing unaccompanied by their families while providing direct delivery to school-owned apartment complexes occupied entirely by married students accompanied by their families. *Id.* at 139. In finding the discrimination reasonable, the court took note of the Postal Service argument that unmarried students were more transient: "Frequent changes of address obviously have a significant effect on mail delivery and associated processing costs." *Id.* at 142. The court also noted that individual delivery to unmarried students was higher because more students tended to live in such apartments. *Id.* at 142. These evidentiary justifications seem reasonable. However, one should note that the plaintiff, an individual university student, may not have been in a position to develop his side of the case adequately.

highly fact specific to each case. The general rule is that a public utility is under a legal obligation to serve the members of the public without unjust discrimination.[379] Because not all members of the public are alike, the extension of this general rule is that a public utility must serve all alike who are similarly circumstanced (or situated) with reference to its system. In such cases, favor cannot be extended to one which is not offered to another. Nor can a privilege given one be refused to another.[380]

Although certainly not all discriminations are illegal, being grounded upon reasonable classifications, some general fact situations and factors that courts have considered include the following. A rule that is made applicable equally to all patrons of a public utility and with which all can comply with equal ease is not improperly discriminatory;[381] but when, for example, the premises of a resident of a city are surrounded by residences supplied by a public utility, such resident is within an established service zone and is, prima facie at least, entitled to the same service as is accorded to his neighbors.[382] Correspondingly, a public utility may be required to extend its service to any part of a district where it has a franchise and has undertaken to operate if the extension is a reasonable one.[383] The duty to extend service may depend on such factors as the need and cost of the extension, the return in revenue which may be expected as a result of the extension, the financial condition of the utility, the advantages to the public from the extension, and the legal (charter or franchise) obligations to make such an extension.[384] "In regard to the reasonableness of the cost which an extension will entail, it is not necessary that a particular extension of service shall be immediately profitable, or that there shall be no unprofitable extensions, the criterion being generally

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[379] *See* generally 64 Am Jur 2d, Public Utilities, §38 *et seq*.

[380] *Id.*, §38.

[381] *Ibid.*

[382] *Ibid.*

[383] *Id.* at §43.

[384] *Id.* at §44.

whether the proposed extension will place an unreasonable burden upon the utility as a whole, or upon its existing consumers."[385]

8. The public utility rule against undue service discrimination extends also to transportation carriers.

The public utility rule against undue service discrimination extends also to transportation carriers, a relevant issue here because the Postal Service is part public utility, part transportation carrier. At common law, a common carrier owed a duty to the public to carry for all with "substantial impartiality."[386] The grandfather of all regulatory agencies, the Interstate Commerce Commission, was set up to deal with discrimination in transportation. "The principal evil at which the Interstate Commerce Act was aimed was discrimination in its various manifestations."[387]

Of particular relevance is the duty of regulated carriers to serve without unjust discrimination not only as to charges, but also as to provision of services and facilities. Thus, a carrier may not unjustly discriminate among its passengers in providing accommodations, checking and handling baggage, or in granting stopover privileges.[388]

Because the Postal Service is in essence a carrier of property (packages and letters), it is noteworthy that freight carriers such as railroads were subject to the same prohibition against service discrimination. In *United States v. Pennsylvania R. Co.*, 266 U.S. 191 (1924), the Supreme Court per Justice Brandeis upheld an Interstate Commerce Commission ruling that the practice of two railroads extending the use of their tracks to each other for the purpose of terminal receipt operations and delivery of freight within a certain zone while refusing to extend the use of their tracks for the purpose of delivering or receiving freight at other plants similarly located but outside the zone, under substantially similar circumstances and conditions, was unduly discriminatory. "A charge

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[385] *Ibid.*

[386] 13 Am Jur 2d §175.

[387] *New York v. U.S.*, 331 U.S. 284, 296 (1947), citing *Louisville & Nashville R. Co. v. U.S.*, 282 U.S. 740, 749-50 (1931).

[388] 13 Am Jur 2d Carriers §181.

of unlawful discrimination on the part of a common carrier may be predicated upon the granting of an exclusive right or special privilege with respect to the use of any of the carrier's facilities which are intended to serve the public generally . . . ."[389] And, in *Southern Pacific Terminal Co., v. ICC*, 219 U.S. 498 (1911), the Supreme Court ruled it was unjust discrimination to give a Galveston, Texas shipper exclusive use of space on wharves while denying access to other shippers under substantially similar circumstances and conditions.

B. The Commission's "Red-Tag" Decision Is Precedent For OCA's Position On Service Discrimination.

The Commission explicitly recognized the concept of service discrimination being prohibited by the PRA in Docket No. MC79-3, the "Red-Tag" proceeding:[390]

> Based on this record, we conclude that it is unduly discriminatory for non-red-tag mailers to pay the same rate that red-tag mailers pay, and receive a lesser quality service. We find this especially discriminatory when regular rate second-class mailers cannot, even for an additional fee, obtain this expedited service.

In that case, it was found that red-tag publications received significantly better service than ordinary second-class publications.[391] The discriminatory rate aspect of the case was that the red-tag mail preferential service standard, requiring six-day delivery, caused service-related costs, part of which were assigned to second-class mail.[392] However, red-tag and ordinary second-class mail paid the same rates.[393] Finding the parties' reasons for this rate discrimination unpersuasive, the Commission stated: "We will take action now to remedy the situation."[394]

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[389] 13 Am Jur 2d Carriers §198.

[390] PRC Op. MC79-3, at 11-12.

[391] *Id.* at 23.

[392] *Id.* at 24.

[393] *Id.* at 29.

[394] *Ibid.*

The Commission also found that the Postal Service's eligibility requirements for entry into the red-tag subclass were unreasonable.[395] The test used was "whether there is a rational connection between these eligibility requirements and the need for red-tag service on the part of the Postal Service's customers."[396] Examining the eligibility requirements for red-tag service, the Commission recommended that red-tag service be provided to any second-class publication willing to pay the charge for that service.[397] In short, the Commission's analysis focused on two aspects of undue discrimination, service and rate discrimination – mailers unreasonably not being permitted to use a special service offered by the Postal Service, and mailers paying the same rates for two different types of services, one regular and one expedited.

It is noteworthy that a court most likely would have found the pre-existing red-tag arrangement unduly discriminatory. The tangled procedural history of the red-tag proceeding included a concurrent court challenge. The D.C. Circuit preferred to let the Commission resolve the discrimination issue, noting that "assignment of service related costs to mail not receiving preferential service raises serious questions of discrimination." *National Association of Greeting Card Publishers v. U.S. Postal Service (NAGCP III)*, 607 F.2d 392, 411 (D.C. Cir. 1979). The court chose to "defer to the PRC's pending proceeding where the issue will receive further analysis, with this court's concern in mind." *Id.* at 412

C. The Burden Of Showing That Its Proposals Are Not Discriminatory Should Rest With The Postal Service.

Once a difference in proposed Postal Service rates or services is shown, it should then be the evidentiary burden of the Postal Service to show why such differences are not unduly discriminatory. This was the rule adopted by the Seventh Circuit in *Public Serv. Co. of Ind. v. FERC, supra*, 575 F.2d at 1212:

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[395] *Id.* at 65 *et seq.*

[396] *Id.* at 70.

[397] *Id.* at 72. In addressing current eligibility requirements for the service, the Commission found no rational connection between the need for the service and the requirement that the publication must feature "news of a general public interest." *Id.* at 70.

> In our view, all that Frankfort was required to do was show that a substantial disparity in rates existed between customers of the same class. It then became incumbent on PSCI [the utility] to justify that disparity on the basis of factual differences. The FPC in its opinion must show not only that factual differences justify some rate differences, but also that the factual differences justify the specific rate differences permitted.

To the same effect is *Harborlite, supra*, 613 F.2d at 1100, where the District of Columbia Court of Appeals held:

> Rather, the carriers have an opportunity to overcome the complainant's prima facie case by themselves proving that the rate disparity is justified by differences in transportation circumstances. [citations omitted] That is, the disparity is not unlawful if it is "justified by the cost of the respective services, by their values, or by other transportation conditions. [citation omitted]
>
> It is insufficient for the carriers to show that transportation circumstances are not identical for the allegedly preferred and the allegedly prejudiced shipments, for the question is not whether any disparity is warranted. What the carriers must justify is the particular disparity existing in the case under consideration.

D. The Commission Has A Statutory Duty To Remedy Unfair Or Discriminatory Treatment.

Mail Order Ass'n, supra, makes it clear that the Commission is obligated to correct undue discrimination. The court noted that the Commission "is charged with independent discretion to determines that the rates it recommends comply with [the] nine statutory criteria [of] 39 U.S.C. §3622(b)." *Ibid.* Further, "the Commission must exercise its discretion to determine that any classification it recommends conforms to six statutory criteria . . . ." *Ibid.* "With regard to both rates and classifications, the Commission is authorized to consider . . . fairness and equity, *id*. §§3622(b)(1) & 3623(c)(1) . . . ." *Ibid.* "In sum . . . [d]uring the course of a ratemaking proceeding, *the Commission has the authority, and indeed the duty, to assess the fairness and equity both of the proposals before it and of its own recommended decision to the Governors.*" [emphasis added] *Id.* at 423, also citing *National Ass'n of Greeting Card Pubs. v. U.S. Postal*

Service for the proposition that "the 'prevention of discrimination among the mail classes' was major purpose of Congress in passing PRA." *Id.* at 424.

E. The Postal Service's Proposed Expansion Of Parcel Post Length And Girth Limitations Is Unduly Discriminatory Because It Is Being Offered Only To High Volume Mailers.

1. The request to increase the size limit was made at the behest of large volume mailers.

The Postal Service proposes herein to increase the maximum combined length and girth for Parcel Post from the existing 108 inches to 130 inches.[398] The Postal Service notes that the maximum combined length and girth for ground parcels accepted by United Parcel Service ("UPS") is 130 inches.[399]

It is important to understand the reasons for the proposed increase and the significant limitation (hereinafter, "big mailer limitation") placed upon the proposed service:[400]

> Over the years, many of our customers have indicated that, while few of their pieces exceed 108 inches in combined length and girth, when they do encounter some pieces exceeding the 108 inch limit, it is inconvenient for them to isolate those oversized pieces and ship them via another parcel delivery company. Thus, in response to our customers' requests, the Postal Service proposes to increase the maximum combined length and girth for Parcel Post from the existing 108 inches to 130 inches, comparable to that accepted by UPS. The Postal Service proposal would permit no more than ten percent of the pieces in any mailing to have combined length and girth exceeding 108 inches.

In fact, the request to increase the size limit was made by the Parcel Shippers' Association "in particular" as well as other members of the Parcel Classification Reform Steering Committee."[401] It cannot be denied that the members of the Association and

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[398] Direct Testimony of Postal Service witness Mayes, USPS-T-37, at 18.

[399] *Ibid.*

[400] *Ibid.*

Committee meet the definition of "big mailer." The genesis of this request is strong evidence that the Postal Service never wanted to extend such service to all mailers (including households and small businesses).

The proposal's "big mailer limitation" means that one must tender at least nine standard size parcels in order to have an oversize parcel accepted. This limitation effectively means that infrequent and small volume mailers (such as households and small businesses) will not be able to take advantage of the service.

2. The proposal also is discriminatory because rates are not fully compensatory.

Another "feature" of the proposal is that the proposed rates are not fully compensatory:[402]

> As well noted in my testimony, UPS provides delivery service for both business and household mailers of items exceeding 108 inches in combined length and girth. The Postal Service intends to make it easier for mailers who have occasional oversized items, not necessarily those mailers for whom such oversized items are representative of their regular mailing habits. Due to the expectation that these oversized parcels will *not be fully compensatory*, in the absence of evidence that the mailer is shipping additional volume that could be expected to be compensatory, the decision was made to exclude individual shipments of oversized parcels. This restriction will also prevent businesses predominantly shipping oversized items from using the Postal Service for such purposes. [emphasis added]

The interrogatory response quoted immediately above is revealing, providing additional evidence that the overall proposal is unduly discriminatory in design and purpose. The proposed rate for the service will not be "fully compensatory." This means

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[401] Response of Postal Service witness Mayes to OCA/USPS-T13-7(d) in Docket No. MC97-2. The 130-inch proposal was first made in that docket, and carried over to the instant proceeding. Witness Mayes' responses in Docket No. MC97-2, cited herein, were incorporated into the instant record via OCA/USPS-T37-1 and 4, Tr. 19E/9885-86 and 8/4175-76. For a list of members of the Committee, see Response of Postal Service witness Mayes in Docket No. MC97-2 to OCA/USPS-T13-27 (a).

[402] Revised Response of Postal Service witness Mayes to OCA/USPS-T37-5(a), Tr. 8/4178.

that the high volume mailers taking advantage of the service will have those shipments subsidized by other mailers.[403] This is an unduly preferential rate meant to favor the "big mailers" that have sufficient volume to use the service.

The stated reasoning that "the decision was made to exclude individual shipments of oversized parcels" because of the "expectation that these oversized parcels will not be fully compensatory" flies in the face of logic. If the proposed rate was fully compensatory, the "big mailer limitation" would not have to be made, if the Postal Service's explanation is to be believed. It is also curious that the Postal Service claims it does not want to be inundated with oversized parcels when it offers this unduly preferential rate.[404] It is elementary economics that demand and price are inversely correlated. If the rate were higher, demand would be lower. The rate, on its face, appears to be nothing more than favored treatment for high volume mailers, and reinforces the notion that the purpose and design of the proposal is unduly discriminatory.

3. Remedying the discrimination will not unduly interfere with postal operations.

The Postal Service has no credible argument that increasing the size limit for all mailers would inundate its parcel handling system. It simply fails to address the issue, which it should have, since the proposal is discriminatory on its face. In fact, the Postal Service does not even offer credible evidence that volume will increase from big mailers. The only market research projects that volume will be *lost* as a result of the new service.[405] Therefore, a Commission recommendation that the size limitation be lifted for all mailers will not cause any upheaval in postal operations.

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[403] Witness Mayes sought to show why the low rate was not a cross-subsidy from rates paid by households by arguing that household mailers sometimes mail parcels that themselves might not be fully compensatory, using the example of someone shipping perishable, nonmachinable items to a remote area of Alaska. Response of Postal Service witness Mayes to OCA/USPS-T37-6, Tr. 8/4180-81. This extreme example gives meaning to the adage "the exception proves the rule." It implies that typical parcels mailed by consumers who cannot take advantage of the expanded service are subsidizing the less-than-compensatory rate.

[404] Docket No. MC97-2, Response of Postal Service witness Mayes to OCA/USPS,T13-7(c).

4. Postal Service explanations as to why the proposal is not discriminatory are not persuasive.

Witness Mayes attempts to compare the big-mailer limitation to restrictions placed on other types of services, stating in response to OCA/USPS-T37-5(a):[406]

> Simply because there may be a perceived desire for a particular type of service in the market for package delivery service does not imply that the Postal Service must necessarily provide such service. As illustration, please refer to the list of nonmailable and restricted items in the DMM at section C021.

This citation verifies the adage "the exception proves the rule." The discriminations cited here and later amplified upon in response to OCA/USPS-T37-13(a)[407] appear reasonable on their face, e.g., "[f]or example, Class B poisons may be mailable for 'scientific use only . . . ." Obviously, there are sound public policy and statutory reasons for not permitting the public mails to be flooded with poisons, switchblade knives, etc. There are no corresponding public policy reasons for instituting a mail service (at noncompensatory rates) that only big mailers can use. [408] Indeed, the statutory commands go the other way, forbidding undue discrimination and preference.

5. The Postal Service rationale for the big-mailer limitation also is inconsistent with prior postal service explanations for expanding parcel service.

The Postal Service rationale for the big-mailer limitation also is inconsistent with prior Postal Service explanations for expanding parcel service. In response to

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[405] Docket No. MC97-2, Response of Postal Service witness Mayes to OCA/USPS-T13-8. It defies logic that volume would be lost, yet witness Mayes adheres to the market research suggesting there would be a loss. *Ibid.*

[406] Tr. 8/4177.

[407] Tr. 8/4195-96.

[408] Nor are there health and safety reasons: Witness Mayes testifies: "I have not testified that handling oversized parcels will, in fact, compromise the health and safety of employees. * * * In the absence of a mailflow analysis, I know of no reason why the oversized parcels tendered by small shippers or individual consumers would be any more or less injurious to postal employees than the same number of oversized parcels tendered by large shippers." Response of witness Mayes to OCA/USPS-T37-14(e), Tr. 8/4199.

interrogatory UPS/USPS-T37-22 requesting "analyses and documentation supporting the determination of the 130 inch maximum combined length and girth" proposal, witness Mayes stated: "It is my understanding that, similar to the reasons put forth in Docket No. MC83-1 for changing the maximum combined length and girth to 108 inches, the determination on the proposed maximum of 130 inches was based on the repeated requests of parcel mailers, with reference to the limit currently applied by United Parcel Service."[409] However, the Postal Service, in limiting the new service to big mailers, has not followed the non-discriminatory, pro-competitive and pro-efficiency philosophy from that case.

In Docket No. MC83-1, the Postal Service intended to increase the size limits *for all mailers* to 108 inches and 70 pounds and to standardize those limits across all post offices. That nondiscriminatory and efficient proposal was supported by the following reasoning from Postal Service witness Wargo, who observed at pages 10-11 of his direct testimony that

> the enlarged size limits will offer better service to the public. This improved service is particularly significant for household mailers who often find their local post office the most convenient place to bring parcels they wish delivered. [emphasis added]

The Postal Service in that docket also cited efficiency reasons for increasing parcel size limits. At page 3 of the Wargo testimony, he noted that the Postal Service was proposing "to enlarge its parcel size limitations to equal those used by other major providers of small parcel service." He stated at page 4: "My testimony will show the unfairness and inconvenience caused by non-uniform parcel post size and weight limits and size limitations for Postal Service parcel services that are smaller than those for other parcel delivery services." On that same page he stated: "Enlarging parcel size limits will bring more standardization to parcel delivery service, thus reducing confusion and inefficiency." At page 10 he stated that since two of the largest non-postal small parcel delivery services already had a common size limitation of 108 inches in length and girth combined, "[I]f the Postal Service adopted this same size limit for all its parcel

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[409] Tr. 8/4095.

services, a great step would be made toward establishing a uniform size limitation for the parcel delivery industry." At page 10 he noted also the problem of mailers having to "sort out parcels larger than 100 inches in length and girth combined from shipments otherwise to be tendered to the Postal Service." At page 12 he stated: "As I described above, uniform parcel size and weight limits will eliminate the need for mailers to perform extra sortations."

The reasons advanced by the Postal Service in Docket No. MC83-1, if followed today, would have resulted in a proposal expanding the size limitation to all, not just the favored few. Small businesses and households would benefit by having a new competitor, the Postal Service, in the "oversized" parcel delivery market. Absent actual entry in the oversized market, it is not possible to foretell what effect an additional competitor would have on the industry rate structure. However, the availability of an additional competitor normally will exert downward pressure on rates and/or improve service.[410]

Consumers also would benefit by being able to enjoy the convenience of universal service, manifested by the thousands of post office facilities across the country that could accept their 108+ inch parcels. It is well known that carriers such as UPS have limited pickup facilities. Small businesses would not have sortation problems caused by deciding which shipments they otherwise might want to send via the U.S. mail instead had to be resorted for delivery by other carriers.

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[410] This is elementary economics. For a thorough discussion of the effects of increasing the number of sellers in an industry, see F.M. Scherer, "Industrial Market Structure and Economic Performance (2d ed.), pp. 199 *et seq*. For practical application of the theory, see OCA/USPS-T13-32 and the response thereto by witness Mayes. As is known, the Postal Service does not provide parcel delivery service on packages weighing more than 70 pounds, though its competitors do (up to150 pounds). In its interrogatory OCA used a parcel service hypothetical involving a sharp price break upwards at the 70 pound level. Witness Mayes was correct that OCA had used the published rates for UPS's ground residential delivery service in its hypothetical. It is instructive to note that UPS's rates almost triple between 70 and 75 pounds in zone 2.

6. The appropriate remedy is to modify the Postal Service's proposal and require that all mailers be able to tender oversized parcels up to a combined length and girth of 130 inches, and that the rate be fully compensatory.

The appropriate remedy is to modify the Postal Service's proposal and require that all mailers be able to tender oversized parcels up to a combined length and girth of 130 inches, and that the rate be fully compensatory. This proposal is well within the Commission's legal powers, as outlined in *Mail Order Ass'n*, discussed below.

While the Commission's authority to make recommendations is "not without bounds," *Mail Order Ass'n*, *supra*, 2 F. 3d at 422, "the Commission is certainly authorized to do more than give a thumbs up or thumbs down on the Governors' request." *Ibid.* Thus, the *Mail Order Ass'n* decision permitted Commission recommendations based on non-Postal Service proposals as long as such recommendations do not unduly interfere with Postal Service management decisions:[411]

> Had the PAR proposal been aired and presented in the hearings, we would be better able to assess whether the Commission's recommendation unduly interferes with the Postal Service's management decisions or otherwise exceeds the Commission's statutory authority. The record presumably would reveal whether there are overriding operational or policy reasons to distinguish between CEM and non-CEM prebarcoded individual letters, as well as between bulk and nonbulk automation compatible pieces, or whether, as the Commission claims, it is unduly discriminatory to extend the discount to large-scale mailers and not to the general public. We simply cannot tell on this record.

If the Commission "puts forward a proposal that it deems necessary for reasons of fairness and equity,"[412] the Postal Service, "[p]ermitted to put on evidence . . . may well be able to demonstrate that a proposed rate or classification is either unworkable or inconsistent with general Postal Service objectives and policies."[413] Thus, the court held that the burden of proving management intrusion rests with the Service.

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[411] 2 F.3d at 424.

[412] *Ibid.*

[413] *Ibid.*

The court also set forth a decisional paradigm the Commission should employ when considering its recommendations. The Commission must first assess whether its recommendation "unduly interfere[s] in the management and direction of the Postal Service." *Ibid.* The use of the word "unduly" suggests some interference is permissible, and this is corroborated by the additional statement that a proposal should not "*cause an upheaval in the efficient operation of the Postal Service*." [emphasis added] *Ibid.* Note that "upheaval" is defined as "strong or violent change or disturbance."[414] Thus, it would appear that moderate or slight changes are permissible.[415] As the court noted: "Virtually every rate or classification recommendation will have some impact on Postal Service operations and policies; any such effect alone cannot be permitted to tie the Commission's hands."

If the Commission concludes that a remedy not emanating from the Postal Service "unduly" intrudes upon its management, it then has two options. "First, it may conclude that, within the framework of existing Postal Service policies and capabilities, a rate or classification that it had considered unfair or inequitable, is, instead, sufficiently fair to be included in its recommended decision." *Ibid.* Thus, a minor discrimination may be sufficiently digestible, when compared to the upheaval a remedy would cause in Postal Service operations. Thus, a balancing test was envisioned by the court, with the Commission weighing the amount or effects of the discrimination versus the operational upheaval that might be thrust upon the Postal Service.

However, according to the court, a perceived inequity may just be too egregious. Then, the "Commission may simply decline to recommend a rate or classification that it is convinced is unfair." *Ibid.* [416]

OCA's proposed remedy complies with *Mail Order Ass'n*'s guiding principles. Commission action expanding the class of mailers who could take advantage of the

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[414] *Random House Dictionary of the English Language*, (unabridged ed. 1967) at 1570.

[415] This reading is consistent with the court's opinion that "in remedying these inequities however, the Commission does not have *carte blanche* to intrude as far as it wishes into Post Office management." *Mail Order Ass'n, supra*, 2 F.3d at 424.

[416] In addition, the Commission can recommend only one set of rates which presumes adoption of a classification change. It need not recommend alternative rate schedules. When the Postal Service argued otherwise, the D.C. Circuit rejected "this casting of the Commission's duties . . . ." *Id.* at 422.

proposal to increase the acceptable size of parcels would not unduly intrude upon Postal Service management because it would not cause an "upheaval" in Postal operations. This can be deduced from the lack of concern the Postal Service has shown about the impact of larger-sized parcels that would be tendered from large mailers. The Postal Service is quite willing to accept whatever additional volume such mailers would tender, and has presented only a scintilla of evidence on volume projection (curiously, showing a projected volume decrease). Further, the Postal Service did not even present volume evidence under a scenario where expansion of the size limitation was extended to all mailers. It should have done this considering the facial discrimination present in its proposal. And, of course, the less-than-compensatory rate proposed is discriminatory per se, advanced by the Postal Service without any credible justification whatsoever. Weighing the clear and egregious service and rate discrimination against the non-existent evidence that Postal operations would be upset results in a clear decision – the Commission should modify the proposal so that the service is extended to all mailers at a compensatory rate.

F. The Postal Service's Delivery Confirmation Proposal Is Unduly Discriminatory From A Service And Rate Perspective Because It Precludes First-Class, Periodicals And Standard A Mailers From Obtaining Delivery Confirmation Services, And Because It Precludes Household Mailers From Taking Advantage Of The Lower-Priced Computer Access Service To Obtain Delivery Confirmation Information.

1. Description of the service.

The Postal Service proposes to introduce a delivery confirmation service for mailers of Priority Mail, Parcel Post, Bound Printed Matter, Special and Library Mail that will provide customers with the date of delivery (or, if appropriate, the date of attempted delivery).[417]

[417] Direct Testimony of Postal Service witness Plunkett, USPS-T-40, at 16.

Two types of services will be available.[418] The first is the so-called manual delivery confirmation service. Senders of individual mail pieces may obtain delivery confirmation service at the postal retail counter or through their retail carrier. The postal clerk will apply the delivery confirmation barcoded label and the customer will be given a receipt that shows the delivery confirmation identification number. "The customer may then access delivery confirmation by use of a toll-free phone number or the Internet."[419] Those using the toll-free phone number will thus depend on the Postal Service's corporate call management system, whose per-call costs are developed by the Postal Service.

The second type of delivery confirmation service "*is designed to serve the needs of larger volume shippers* who are capable of providing the Postal Service an electronic manifest of all delivery confirmation pieces on the day that the pieces are mailed."[420] [emphasis added] "Users of the electronic form of delivery confirmation must apply the necessary labeling themselves, and must access the delivery confirmation information electronically."[421] This is the so-called electronic delivery confirmation service.

2. The Postal Service's delivery confirmation proposal is unduly discriminatory from a service perspective because it precludes First-Class, periodicals and standard a mailers from obtaining delivery confirmation services.

The Postal Service is not extending delivery confirmation service to First-Class Mail, Periodicals Mail, or Standard A Mail. Postal Service witness Treworgy was asked to describe whether consideration was given to providing such services, and if not, why not. His generalized response fails to justify why some mailers will receive such service and why others would not:[422]

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[418] *See id.* at 16-17.

[419] *Id.* at 17.

[420] *Ibid.*

[421] *Ibid.*

[422] Response of Postal Service witness Treworgy to OCA/USPS-T22-8(b), Tr. 3/1238.

> As with most decisions, no single factor controlled the Postal Service's decision to provide delivery confirmation only for Priority Mail and Standard B. Decision making is inherently a subjective mix of factors. The goal of delivery confirmation is to meet the needs of expedited and package mailers. The proposed delivery confirmation service for Priority Mail and Standard B is designed to satisfy these mailers.

Nor can witness Treworgy explain whether any operational difficulties, i.e., in acceptance and delivery procedures, would occur from extending the services to these other classes. He acknowledged that the delivery confirmation procedures developed for Standard B and Priority "may also be applicable" to the excluded classes of mail.[423] He also stated that the unit volume variable costs "may also be applicable" to the excluded classes.[424]

The exclusion is *per se* unduly discriminatory. Witness Treworgy's justification lacks specific reasoning, and thus does not provide a rationale acceptable under 39 U.S.C. §403(c), the anti-discrimination statute, for why the excluded classes will not be permitted to enjoy the benefits of delivery confirmation. Indeed, Postal Service witness Treworgy, when asked why the proposed service was not being extended to other classes, merely stated that "my understanding is that it was less of a decision to not extend it to those other classes of mail, and rather more of a decision to extend it to Priority Mail and Standard B customers, an affirmative decision."[425] In other words, there was no reason not to extend it to these other classes. And while some market research was done to gauge a market response to potential users of the service as proposed, none was apparently done to see whether other classes of mail users would want the service.[426]

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[423] Responses of Postal Service witness Treworgy to Interrogatories of Office of the Consumer Advocate from Docket No. MC97-2 as Response to USPS-T-22-8A, designated as OCA/USPS-T9-11, 13, 14, 15, 17, and 19. *See* Tr. 3/1267.

[424] Responses of Postal Service witness Treworgy to Interrogatories of Office of the Consumer Advocate from Docket No. MC97-2 as Response to USPS-T-22-8A, designated as OCA/USPS-T9-19, 21, and 22, Tr. 3/1273, 1274 and 1275.

[425] Testimony of Postal Service witness Treworgy, Tr. 3/1305.

[426] *Id.*, Tr. 3/1306.

There may be a hidden rationale, however, as to why the service is not being offered to First-Class mailers. OCA thinks it possible that the decision not to offer such services was made because it likely would divert volume from the vastly more expensive certified mail services the Postal Service offers. Although the two services produce different types of information to the mailer, consumers might prefer having the option of receiving the simpler confirming information that a First-Class letter actually made its way to its destination. Such information could be very useful, e.g., it could establish that a bill payment was sent and received by a certain date.

3. The Postal Service's delivery confirmation proposal is unduly discriminatory from a service and rate perspective because it irrationally precludes household mailers from taking advantage of the lower-priced computer access service.

OCA's other concern is with the fees charged Standard (B) manual customers versus electronic customers, $0.60 and $0.25 respectively.[427] Electronic customers will be able to access information using the Internet, and the pricing differential between electronic and manual is based in part on the fact that it will be less expensive for the Postal Service to provide information via Internet access than it will be for the Service to provide access through a telephonic system (using the Postal Service's corporate call management system).

However, Postal Service witness Treworgy acknowledged that manual customers *will* be able to use the Internet[428] to obtain delivery confirmation information, and that the system "will work in similar fashion to the current process for Express Mail customers."[429] He "expect[s] that [the cost of obtaining delivery information via the Internet] would be less than that of using the corporate call management system."[430] He

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[427] Direct Testimony of Postal Service witness Treworgy, at 19.

[428] Postal Service witness Treworgy stated that "manual" users will be able to use the Internet for delivery confirmation information as soon as delivery confirmation is introduced to the marketplace. Tr. 3/1304.

[429] Response of Postal Service witness Treworgy to OCA/USPS-T22-6(a) and (b), Tr. 3/1235. *See also* his response to OCA/USPS-T22-22(c), Tr. 3/1259.

[430] Response of Postal Service witness Treworgy to OCA/USPS-T22-6(c), Tr. 3/1235.

was not able to say exactly what this differential would be, since he did not know the costs associated with Express Mail retrieval "offhand."[431]

If manual customers can use the Internet, then the costs of using the more expensive corporate call management system should not be attributed to them. Witness Treworgy confirmed that he assigned corporate call management costs of $0.0847 for a manual delivery confirmation transaction and that a customer using the Internet to obtain delivery confirmation information would not cause the Postal Service to incur these costs.[432]

4. The Postal Service's delivery confirmation system could easily be offered to household mailers and small businesses who would not be able to take advantage of the electronic manifesting system but nonetheless have internet access.

OCA queried Postal Service witness Treworgy whether there would be operational difficulties associated with offering two types of "manual" delivery confirmation. This question was intended to determine whether there was a rational reason for not permitting individual consumers to use a lower cost access method via the Internet. Witness Treworgy responded:[433]

> I have not studied the possibility of offering two forms of "manual" delivery confirmation, but there might be several operational difficulties that would impact cost and service. Costs could increase for two reasons. First, retail procedures could be more complicated (increasing transaction time and cost) because additional explanation of delivery confirmation by clerks to customers could be required. Second, label costs could increase due to the necessity of stocking two types of labels at the retail window.
>
> Customers service could also be adversely affected for similar reasons. A customer may be confused by the offering of two similar products and, consequently, purchase a product which does not meet her needs. Moreover, the presence of

[431] Tr. 3/1300-01.

[432] Response of Postal Service witness Treworgy to OCA/USPS-T22-22(a) and (b), Tr. 3/1259.

[433] Response of Postal Service witness Treworgy to OCA/USPS-T22-23, Tr. 3/1260.

> two similar sets of delivery confirmation labels could increase the likelihood of the clerk using the wrong label, resulting in the customer being unable to access the delivery confirmation information in the manner she requested.

As noted, witness Treworgy argued that costs could increase for two reasons: retail procedures could be more complicated (increasing transaction time and cost) because additional explanation of delivery confirmation by clerks to customers could be required; second, label costs could increase due to the necessity of stocking two types of labels at the retail window. Both arguments are specious. It would take a *de minimis*, and perhaps zero incremental amount of time to ask if the customer wanted to access the information by phone or the Internet. There are nine steps involved in manual acceptance operations which the postal clerk must complete.[434] Surely the postal clerk can say – "Do you have Internet access – the fee is lower if you do?" while he or she is performing one of these steps.

The additional incremental costs of stocking an additional label also would be *de minimis* and perhaps zero. Postal window clerks routinely have a vast array of forms, stamps, and other materials at their fingertips. The Postal Service's only description of such costs are that "[t]here are costs associated with stocking an inventory of labels and to have to stock two stacks instead of one *could* add inventory costs."[435] [emphasis added] The cost of adding another form to the stockpile could likely not even be calculated because it is so inconsequential.

Witness Treworgy also argues that a customer may be confused by the offering of two similar products and, consequently, purchase a product which does not meet her needs. This "customer confusion" argument has been raised in another context – OCA's CEM proposals – and has been rejected by the Commission.[436] Customer confusion will not occur. A customer either has or does not have Internet access, which is the key

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[434] *See* Direct Testimony of Postal Service witness Treworgy, USPS-T-22, at 6. Window acceptance time is measured at 14.32 seconds, during which time the clerk affixes a label and scans the item. *Id.* at Input Sheet B-1. Clearly the clerk would be able to ask the appropriate question during this operation.

[435] Testimony of Postal Service witness Treworgy, Tr. 3/1304.

[436] PRC Op. MC95-1, at V-35.

question the postal clerk should ask, and the customer would certainly know that. If the Postal Service is correct that confusion could occur because a customer cannot tell whether or not he has Internet access, the same customer could be confused as to whether or not he had telephone service.

The Postal Service argument that the consumer might buy a product that does not meet her needs turns logic on its head in this context. By offering another choice there is a greater likelihood that consumers' needs will be better met because they will have a choice of services.

Witness Treworgy also states that the presence of two similar sets of delivery confirmation labels could increase the likelihood of the clerk using the wrong label, resulting in the customer being unable to access the delivery confirmation information in the manner she requested. In this argument the Postal Service is really arguing that its own clerks are not intelligent enough to complete a fairly typical customer transaction. However, postal clerks routinely are required to provide (and be knowledgeable about) a large number of window transactions. Indeed, the nine-step operation described is itself somewhat complex. It strains credulity to believe that a window clerk serving a household consumer or a small businessman could not understand that there are two possible types of access – by computer and by phone. If "disaster" should occur, however, and a customer prone to confusion encounters an unknowledgeable clerk, all is not lost. The customer can simply call the local post office and obtain the correct information (i.e., the 800 number used to track delivery confirmation by phone).

OCA concludes that the Postal Service arguments are *post hoc* rationalizations, as suggested by the weakness of the Postal Service's arguments. Consumers having Internet access should be permitted to access the information using this advanced, lower-cost technology. It is also likely that the fee for individuals using the Internet would be lower because of the avoided costs associated with the corporate call management system.

5. Internet access by households is increasing steadily and there likely is a large consumer base for services accessible through the internet.

One can expect that many household consumers will be able to access delivery confirmation information via the Internet given the significant penetration of personal computers in American households. This capability will grow over time, and should increase significantly even over the effective rate period. Witness Treworgy states that he does not know what proportion of consumers will be able to access such information via the Internet. He believes "that Internet usage by manual customers is likely to be small at first but increase over time."[437] However, if he had read Postal Service witness Tolley's direct testimony, he would have found the following enlightening discussion of growing Internet access capabilities:[438]

> As a result of strong sales of home personal computers, the fraction of households owning personal computers grew from 7 percent in 1988 to 25 percent in 1994, according to The Quarterly Interview Study conducted by the Bureau of Labor Statistics. ["Are Postage Stamps Going the Way of Horse & Buggy?" (Business Wire, December 11, 1996)]. IDC/LINK estimates that 40 percent of households, or 39 million, currently have personal computers. They project that 53.2 million, or 52 percent of all households, will own personal computers by 1999. IDC/LINK also states that nearly two-thirds of all computer-owning households have modems, and expects this percentage to reach 89 percent by 1999 with 35 percent of households, or 36 million, subscribing to at least one online service by the end of the decade. [IDC/LINK, U.S. Consumer Interactive Services Forecast, 1996].

6. The Postal Service's delivery confirmation proposal is discriminatory.

The Postal Service's delivery confirmation proposal is *per se* unduly discriminatory. The proposal forces a needlessly high fee structure on persons whose small volume needs make use of the electronic manifesting system unlikely.[439] However, such persons could easily take advantage of the Internet to obtain delivery

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[437] Response of Postal Service witness Treworgy to OCA/USPS-T22-6(d), Tr. 3/1236.

[438] Direct Testimony of Postal Service witness Tolley, USPS-T-6, at 52-53.

confirmation information, at a cost to the Postal Service that is lower then the cost associated with the telephonic corporate call management system.

The Commission has rejected similar forms of discrimination in the past. In Docket No. R90-1, in proposing a "Public's Automation Rate," the Commission stated: "It is equally discriminatory to propose a separate rate category on the strength of cost avoidance for pre-barcoded letters for certain mailers, while denying that favored rate treatment to other mailers whose pre-barcoded letters avoid the same costs." PRC Op. at V-54. The situation here is almost identical – small users such as household mailers and small businesses that have access to the Internet will be forced to pay a fee associated with the more expensive corporate call management system.

7. The appropriate remedy is to decline to recommend the delivery confirmation classification and rates.

As noted, there are two problems with the Postal Service's delivery confirmation proposal. First, it unaccountably excludes certain classes of mail. The Postal Service witness was unable to explain whether any operational difficulties would be encountered if service were extended to additional mail classes. Second, the proposal requires smaller-sized mailers to pay fees associated with the corporate call management system when those mailers could use the Internet to obtain delivery confirmation information.

These are egregious examples of service and rate discrimination. As such, the Commission should not consider them as the types that are "sufficiently fair to be included in its recommended decision . . . ."[440] Consequently, the Commission has the legal authority "simply [to] decline to recommend a rate or classification that it is convinced is unfair."[441] This will enable the Postal Service to resubmit a delivery confirmation proposal that is fair to all users.

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[439] With electronic delivery confirmation, mailers must affix the delivery confirmation label to the mail item, record the barcode ID number electronically, and communicate this information to the Postal Service. Direct Testimony of witness Treworgy, at 6. This procedure would only be worthwhile for a mailer to set up if a large number of transactions were being contemplated.

[440] *Mail Order Ass'n, supra*, 2 F.3 at 424.

[441] *Ibid.*

We are aware of the potential argument that the Postal Service has a substantial investment tied up in this proposal, and should be permitted to go ahead with its proposal even if it is discriminatory. However, the Postal Service has delayed this proposal once, having submitted it initially in Docket No. MC97-2, and having modified it to a good extent before submitting it in this docket.[442] Further, resubmitting the proposal will enable the Postal Service to address fully whether any rate modifications are needed in providing service to the other mail classes (e.g., different labeling requirements because First-Class mail pieces are smaller). Moreover, the proceeding could be conducted expeditiously, since there would be few issues with which to contend.

It may have been possible to avoid a new proceeding if the Postal Service had come to this proceeding prepared and willing to answer questions about delivery confirmation and alternatives to its proposal. Regrettably, the Postal Service witness was either not prepared or was being evasive. Witness Treworgy, called upon by the Postal Service to support the proposal, did not have specific knowledge about certain key issues, even though he had advance warning about such issues from the interrogatories that had been submitted to him. At the hearing he did not know the costs associated with an Express Mail information transaction, although that was the issue raised in OCA/USPS-T22-22 (c).[443] He had been forewarned by interrogatory OCA/USPS-T22-23[444] that another important issue was whether the "manual" delivery confirmation system could be bifurcated, with one version offering customers the service using Internet access. When queried again at the hearing about this issue he had no additional light to shed on the issue, stating "I am not in a position to say."[445] And when asked if he had additional information on what operational difficulties might exist if delivery confirmation was extended to other mail classes, a topic raised not only in this proceeding[446] but as far back as Docket No. MC97-2,[447] he was still "not aware" of why

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[442] Docket No. MC97-2, *see generally* Direct Testimony of witness Treworgy, USPS-T9.

[443] *See* Tr. 3/1259, and 1300-01.

[444] *Id.* at 1260.

[445] *Id.* at 1301.

[446] Interrogatory OCA/USPS-T22-8(b), Tr. 3/1238.

the Postal Service did not extend its proposal to these other mail classes.[448] OCA would note that witness Treworgy appeared for cross-examination on his designated interrogatory responses on October 7, 1997, while some of the pertinent interrogatories date as far back as March 31, 1997.[449]

The Postal Service's refusal or inability to shed light on alternatives to its discriminatory proposal should not be rewarded by ignoring the blatant discriminations that exist. However, conducting a new proceeding on a resubmitted delivery confirmation proposal is the only fair remedy. Parenthetically, OCA notes that a new proceeding would enable better development of the record on scanner infrastructure and corporate call management system costs.[450]

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[447] Docket No. MC97-2, OCA/USPS-T9-11 *et seq.*, included as responses in this docket at Tr. 3/1267 *et seq.* These interrogatories probed whether the excluded classes had substantially the same acceptance and delivery operations, and attributable unit costs.

[448] Tr. 3/1305.

[449] OCA/USPS-T9-11-22; see Tr. 3/1267 *et seq.*

[450] *See*, e.g., witness Treworgy's response to OCA counsel's question at Tr. 3/1296 indicating the "softness" of the figures presented to the Commission on this $288.6 million expenditure:

> Q.Can you tell me to what extent the number in this spreadsheet are based on actually completed negotiations . . .?
>
> A.No, I – I'm not familiar with that process.

IV. RATE ISSUES

A. The OCA's Proposed Post Office Box Classification And Fee Changes Represent The Only Proposal Before The Commission To Better Reflect Costs And Enhance Fairness And Equity Of Post Office Boxes.

In this proceeding, there are only two proposals before the Commission with respect to post office boxes. The Postal Service proposes a straightforward increase in fees for all post office boxes in Fee Groups A-D. The OCA, by contrast, proposes to restructure the existing post office box fee schedule and move toward a more cost-based schedule. Toward that end, only the OCA's proposal deaverages postal rental costs to create six new fee groups that more accurately reflect post office costs. Only the OCA's proposal, by better aligning fees with costs, creates a more fair and equitable fee schedule. For these reasons, the Commission should recommend the OCA's proposed classification and fee changes for post office boxes.

1. The Postal Service's self-described limited regrouping of post office box facilities is premature and deserves thorough examination by the Commission before implementation.

On rebuttal, the Postal Service presents for the first time its thinking as to what should constitute an appropriate post office box fee structure. Witness Kaneer (USPS-RT-19) describes "[a] hypothetical fee structure based on cost homogeneity and capacity utilization rates . . . to account for cost and demand changes that occur from time to time and place to place."[451] The stated purpose of doing so is to rebut the testimony of OCA witness Callow and share with the Commission the Postal Service's continuing efforts to improve the PO box fee structure.[452] However, the Postal Service's continuing efforts, while intriguing, do not rise to the level of a formal request in this proceeding which requires Commission action.[453] Nor does the alleged "purity" of the Postal Service's theoretical grouping justify postponing regrouping. Since data to carry out the Postal

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[451] Tr. 32/16967.

[452] *Id.* at 16969.

Service's grouping are unlikely to exist for many years, the perfect should not be the enemy of the good.

Witness Kaneer also "describes a very limited regrouping of PO box facilities being planned for implementation together with any classification and fee changes arising from this case."[454] That limited regrouping would involve "80 facilities . . . identified as candidates for reassignment from one fee group to the next highest or lowest (see Exhibit C)."[455]

The Postal Service's limited regrouping proposed for implementation is more problematic. Absent Commission adoption of OCA's proposed restructuring, implementation of the Postal Service's limited regrouping would represent the most significant outcome of the current proceeding with respect to post office boxes. It would also represent a departure from the understood and litigated basis for fee groups established by the Commission in its opinion and recommended decision in Docket No. MC96-3. As such, it raises a host of substantive and procedural questions deserving Commission consideration. It should not be implemented without being presented as a formal request and opportunity for hearings.

a. The Postal Service's limited regrouping raises concerns of fairness and equity.

The limited regrouping described by witness Kaneer highlights concerns of fairness and equity. Exhibit C of witness Kaneer's rebuttal testimony presents the Postal Service's "facility respecification" criteria and 80 facilities proposed for regrouping.[456]

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[453] The Postal Service, through witness Kaneer, confirms that such a hypothetical fee restructuring would not be undertaken without presenting it first to the Commission for consideration. *See Id.* at 17042-43.

[454] *Id.* at 16969.

[455] *Id.* at 16970 [footnote omitted].

[456] *Id* at 16985-87. It should be noted that the scope of the limited regrouping appears to have narrowed between the filing of witness Kaneer's rebuttal testimony and his appearance at oral cross-examination. *Compare* USPS-RT-19 at 22, Tr. 32/16970 ("the total revenue impact would be minimal assuming all 80 facilities were reassigned.") and Tr. 32/17027 ("we don't propose moving anything between [Fee Groups] C and D because of the very large differences between those two groups, so the 80 facilities become something on the order of 40 facilities").

The regrouping is limited to leased facilities for which average rental cost data were available.[457] None are postal-owned facilities since average rental cost was the only cost criterion considered for regrouping.[458] Witness Kaneer views determination of the proper "rental cost" for owned facilities for purposes of regrouping as "problematic," although "not an insuperable problem."[459]

The distinction between leased and postal-owned facilities is more problematic, however, in terms of fairness and equity. In effect, post office box customers in postal-owned facilities would be exempt from the limited regrouping. Moreover, the limited regrouping, by its very nature, would treat similar customers differently. Post office box customers in leased facilities not on the list, but who otherwise meet the "facility respecification" criteria, will not be regrouped and thus will not face changes in box fees. Such fairness and equity concerns also raise procedural questions.

b. The Postal Service's planned implementation of the limited regrouping denies the Commission and interested parties opportunity to examine the merits and ramifications of its approach.

The Domestic Mail Classification Schedule (DMCS) presently does not define post office box fee groups.[460] Consequently, the Postal Service maintains it has the authority to independently implement the limited regrouping described by witness Kaneer without Commission approval.[461] Such a unilateral action would violate not only the spirit but the letter of the law as it would change the fees paid by boxholders without the public and Commission participation required by Title 39.

Procedural due process and fairness obligate the Postal Service to present its regrouping as a formal proposal for Commission consideration. The Postal Service should not be permitted to proceed until the Commission and interested parties have had opportunity to respond to the proposal in a hearing.

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[457] USPS-RT-19, Exhibit C at 3, Tr. 32/16987.

[458] Tr. 32/17034.

[459] Tr. 23/17035 and 17037.

[460] *See* DMCS §§10.01-10.032; Schedule SS-10 (July 1, 1997).

Under § 3624 of Title 39, the Commission may not make a recommended decision on proposed changes in rates and classifications until there has been an opportunity for a hearing on the record under Title 5 of the U.S. Code (the Administrative Procedure Act, "APA"). The Postal Service's limited regrouping of facilities into different fee groups represents both a classification and fee change that requires a hearing under §§ 556 and 557 of Title 5. The fact that the Postal Service is proposing a "limited regrouping" does not alter the legal requirement for a hearing. Clearly, persons using boxes in those facilities being regrouped would be affected substantially.

The decision in *Associated Third Class Mail Users v. U.S. Postal Service* (*Associated*) is pertinent here.[462] In that case, the Postal Service argued unsuccessfully that it had the authority unilaterally to increase charges for services such as: (1) the furnishing of mail list corrections; (2) the privilege of prepayment of postage without stamps; (3) the forwarding or returning of undeliverable mail; (4) the registry of mail; (5) the insurance of mail; (6) the provision of COD mail; (7) the certification of mail; (8) the securing of a signed receipt upon the delivery of mail and the returning of it to sender; (9) special delivery; (10) the special handling of mail, and (11) money orders.[463] The Postal Service argued that it could do so because the services at issue were not of sufficient importance to justify the costs of an adjudicatory hearing, and that Congress did not intend that these services be subject to the APA hearing requirements.[464]

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[461] *See* the colloquy between Chairman Gleiman and Postal Service counsel Rubin:

> CHAIRMAN GLEIMAN: To the extent that, for example, a [post office box] group is identified and defined in the DMCS, is it reasonable to assume, then, that the Postal Service could not make the change on its own without making a request of the Commission?
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> MR. RUBIN: Yes, that sounds right.

Tr. 32/17031.

[462] 405 F. Supp. 1109 (D.D.C. 1975), *affirmed*, 569 F.2d 570 (D.C.Cir. 1976), *vacated on other grounds*, 434 U.S. 884 (1977).

[463] *Id.* at 1115.

[464] 405 F. Supp. at 1116.

The court rejected this view, observing that these services were very closely related to the delivery of mail, and therefore constituted "'postal services' in ordinary parlance."[465] It also observed that fees for these services had a substantial public effect, while acknowledging at the same time that "[e]vidence of the impact of these increases on individual consumers is less precise."[466] Moreover, the court stated that "the proposed increase in fees for money orders would have a substantial impact on some who cannot readily find a cheaper substitute."[467] It thus appears that evidence of substantial effect on consumers need not be precise, and may be on the order of an increase in postal money order fees.

According to the court, the issue posed was "whether the Postal Reorganization Act of 1970 requires that changes in the fees for these services be subject to the scrutiny of a Postal Rate Commission proceeding, as provided in Chapter 36 of the Act."[468] In its ruling, the court held that the Postal Service could not increase fees via regulation without the Commission holding "full and adjudicatory hearings governed by 5 U.S.C. §§ 556 and 557 upon a request submitted by the Postal Service for a recommended decision of a change in rates or fees."[469]

Clearly, post office box service is a "postal service" and is not at issue in this proceeding. Moreover, since the scope of the limited regrouping appears fluid, neither the Commission or interested parties can determine at this time the revenue impact or the number of postal customers effected.[470] However, the effect of fee changes on boxholders subject to regrouping would be akin to the modest amounts that likely would be affected by a change in postal money order fees. And, without obtaining box service at another post office, it would likely be difficult for such boxholders to find a cheaper

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[465] *Id.* at 1115.

[466] *Id.*

[467] *Id.*

[468] *Id.*

[469] *Id.*

[470] USPS-RT-19, at 23, n.6. Tr. 32/16971.

substitute.[471] Finally, as noted above, the limited regrouping raises issues of fairness and equity that have not been explored at this late date in the proceeding.

It is OCA's position that the effect on boxholders whose fees would be increased by the regrouping, while unknown at present, would be substantial enough to warrant a Postal Service request for a change in fees, and that the affected boxholders fees cannot be changed without a formal hearing before the Commission. Moreover, the Commission has within its authority the ability to preclude unilateral Postal Service action by simply incorporating the relevant fee group definitions from the Domestic Mail Manual into the DMCS.

Other pertinent decisions are *National Retired Teachers Ass'n v. U.S. Postal Service* (*NRTA*)[472] and *Combined Communications v. U.S. Postal Service*.[473] Both address the issue of when a regulation works a change in the scope of mail classification, thus requiring an APA hearing, versus when it is merely an interpretation of an existing classification.

In *Combined Communications*, at issue was determining second-class eligibility for a newspaper's essentially all-advertising "Plus" issue.[474] The court noted the procedure whereby various classifications of mail are codified in the Domestic Mail Classification Schedule ("DMCS"). The Domestic Mail Manual ("DMM"), on the other hand, is a detailed set of regulations that interprets and implements the DMCS.[475]

The lower court had found that both interim and final versions of the DMM were more than mere interpretations of the DMCS, but effectively expanded the scope of the DMCS.[476] Quoting NRTA, the Sixth Circuit stated that the Service does possess "a residuum of authority to interpret mail classifications in the process of implementing them, so long as that interpretation does not effect a substantive change in the types of

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[471] *See* Docket No. MC96-3, USPS-T-4 at 25-30; *see also* Docket No. MC96-3, USPS-T-7 at 12.

[472] 593 F.2d 1360 (D.C. Cir. 1979).

[473] 891 F.2d 1221 (6th Cir. 1989).

[474] 891 F.2d at 1222.

[475] *Id.* at 1224.

[476] *Id.* at 1225-26.

mail or identity of mailers encompassed within the classification."[477] The court noted that a mail classification has been defined as a "'grouping' of mailing matter for the purposes of assigning it a specific rate or method of handling. Relevant factors include size, weight, content, ease of handling, and identity of both posting party and recipient."[478] The Sixth Circuit agreed with the lower court that the Postal Service had strayed beyond merely interpreting the DMCS.[479]

The Postal Service's late proposal is clearly a reclassification for the purpose of changing the post office box fee structure, and nothing more. It is not merely an interpretation of an existing classification. Boxholders would pay different fees by virtue of being moved from one fee group to another—fee groups that were proposed by the Postal Service and recommended by the Commission in Docket No. MC96-3. This situation is very much like the case in Combined Communications, where the Postal Service seemed intent upon raising fees for the "Plus" insert. (For example, the publishers had adjusted the publishing schedule of their "Plus" issues to achieve the desired rate status, only to be met by a new regulation ousting them from the desired classification.)[480]

2. The post office box classification and fee changes proposed by the OCA better reflect costs in the pricing of boxes and thereby promote fairness and equity.

Section 403(c) of the Postal Reorganization Act directs that, "In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not . . . make any undue or unreasonable discrimination among users of the mails . . ." 39 USC § 403(c). The Commission is further guided by the Act, with respect to its responsibility to recommend postal rates and fees and changes in postal classifications,

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[477] *Id.* at 1228, quoting NRTA, 593 F.2d at 1363.

[478] *Id.* at 1228, quoting NRTA, 430 F. Supp. at 146-47.

[479] 891 F.2d at 1228-30 generally.

[480] *Id.* at 1224.

to find, in the first instance, that rates and fees and classification changes are fair and equitable. 39 USC §§ 3622(b)(1), 3623(c)(1).

Clearly, cost considerations are the starting point in arriving at fair, equitable and nondiscriminatory classifications and fees.[481] Consequently, both the Commission and Postal Service have understood that "equity and sound economics are served by recognizing in rates some of the major cost differences within classes."[482] Equity is enhanced through the avoidance of unfairness and undue discrimination, as when services with different costs are grouped together and charged the same fees.[483] Sound economics is furthered by more accurate costing that improves price signals to consumers and advances economic efficiency.[484]

In the case of post office boxes, there are known cost differences by CAG that are masked by excessive averaging of postal rental costs within existing Fee Groups C and D. Moreover, the allocation of volume-variable costs to post office boxes fails to take into account differences between offices. These conditions are perpetuated under the Postal Service's proposal. The OCA's proposal would restructure fee groups and reallocate costs to better reflect costs in the pricing of post office boxes.

a. The OCA's proposed classification changes for post office boxes better recognize differences in costs by establishing new fee groups based upon CAG.

The Postal Service's proposal maintains the post office fee group structure established pursuant to its request in Docket No. MC96-3.[485] That structure, consisting of Fee Groups A-E, generally "depend[s] upon specified ZIP Codes, customer characteristics, and type of carrier delivery service."[486] It is clear that post office box Fee

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[481] *See Payne v. Washington Metropolitan Area Transit Commission*, 415 F.2d 901, 915 n.71 (D.C. Cir. 1968).

[482] PRC Op. MC95-1, para. 3065.

[483] *Payne*, 415 F.2d *supra* note 13, at 915 n.71 (discrimination "exists where equal rates are charged for services whose rates ought to be different").

[484] I Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions*, at 66.

[485] *See* PRC Op. MC96-3 at 47-48.

Groups C and D are based upon the type of carrier delivery service available at post offices.[487]

The determination of the average rental cost for each delivery group (e.g., city other or non-city) is used in the allocation of post office box Space Provision costs.[488] The Postal Service's use of the average rental cost for each delivery group, which forms the basis of Fee Groups C and D, masks important differences in cost by office size, as measured by CAG. Those cost differences should be recognized through the establishment of new fee groups that better reflect costs for boxes in post offices with varying costs.

i. There are important differences in average postal rental costs for post offices that can be measured by CAG.

It is well documented on this and previous records that average postal rental costs vary by CAG, and are higher in higher CAG offices. In Docket No. R90-1, the Postal Service found that "space provision costs tend to vary with facility *location* (square foot rents are higher in urban and suburban locales than in rural areas) . . ."[489] (emphasis added). In this proceeding, the testimony of OCA witness Callow shows that there is a wide disparity in average postal rental costs. When city-other delivery offices are grouped by CAG, the average rental cost of CAG A offices is more than double that of the lowest CAG offices, CAG L.[490] There are similar differences for non-city delivery offices, although not as pronounced. The average rental cost of CAG C offices is 32 percent greater than for CAG L offices, while the average of CAG E offices is more than 49 percent greater when compared to CAG L offices.[491]

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[486] Tr. 3/1064.

[487] Fee Groups A and B are identified by specified ZIP Codes. *See* Section D910.5.3, DMM 52, July 1, 1997. Fee Group E consists of customers whose principal characteristic is that they are ineligible for any carrier delivery service. *See* USPS-T-39 at 63-64.

[488] Tr. 3/1067.

[489] Docket No. R90-1, US Postal Service Library Reference F-183 at 2.

[490] Tr. 23/12288.

[491] Id.

There is clear evidence that average postal rental costs are generally higher in higher CAG offices. Postal Service data in two previous proceedings confirm this fact.[492] In both proceedings, the data reveal that, "as one goes from CAG A offices to CAG L offices, there is, with two exceptions, a uniform decline in average square foot rent."[493] In this proceeding, the Postal Service acknowledges that average postal rental costs are higher in CAG A, B and C post offices than average postal rental costs in CAG K and L post offices.[494] Witness Callow's testimony confirms this conclusion with respect to city-other and non-city delivery offices.[495]

The CAG designation of an office, although a measure of office revenues, represents a reasonable basis for grouping post offices according to average postal rental cost. According to the Postal Service, CAG designation can serve as a reasonable proxy for post office rental costs. In Docket No. R90-1, the Postal Service determined that "there is a *significant relationship* between the CAG designation of a facility and its associated square-foot rent (e.g., CAG A offices have higher rents than CAG L offices.)"[496] (Emphasis added).

Witness Callow reasonably relies on this "significant relationship" to create new fee groups for post office boxes by grouping offices according to higher or lower average postal rental costs. The determination of offices with higher and lower average postal rental costs was possible because of the CAG designation of offices.[497]

Moreover, this "significant relationship" has been independently established by prior Postal Service action. In Docket R90-1, the Postal Service proposed, and the

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[492] *See* Docket No. R90-1, US Postal Service Library Reference F-183, Table 6, at 16; *see also* Docket No. MC96-3, Tr. 8/2916, Response of the United States Postal Service to Interrogatory of the Office of the Consumer Advocate OCA/USPS-88(h).

[493] Docket No. R90-1, US Postal Service Library Reference F-183 at 15.

[494] Tr. 3/1173.

[495] Table 1, Tr. 23/12288. In the case of non-city delivery offices, there are no CAG A offices. Nevertheless, the pattern still holds, with CAG B, C and D offices having higher average postal rental costs than CAG K and L offices.

[496] Docket No. R90-1, US Postal Service Library Reference F-183, at 2, n.2.

[497] Tr. 23/12404.

Commission recommended, creation of two new subgroups—Delivery Groups (1A) and 1B—to reflect the disparity in space costs by including offices located in very high cost and high cost (1B) city delivery areas.[498] These high cost areas were then, and continued to be, defined by ZIP Code[499]—not by CAG. Nevertheless, Delivery Group 1B, which later became Fee Group B in Docket No. MC96-3, consists of the highest four CAGs, A, B C and D.[500]

On rebuttal, witness Kaneer claims that "while [the relationship] may be significant to some degree, it is not sufficiently significant for the purposes of basing P.O. box prices."[501] To buttress his claim he points to examples "where CAG is not related to cost."[502]

The significance of the relationship between CAG designation and cost is not negated by the fact that some lower CAG offices have higher average rental costs than higher level CAG offices. Any effort at averaging by CAG would, of necessity, involve some variation. Consequently, with respect to city-other delivery offices, the testimony of witness Callow shows that only two CAG levels have average rental costs greater than CAG A; eight CAG levels have average rental costs below CAG A.[503] In non-city delivery offices, after excluding the three CAG B offices, only two CAG levels have average rental costs greater than CAG C, the second highest CAG level; six CAG levels have average rental costs below CAG C.[504] Considering CAG D offices, the third highest CAG, only three CAG levels have average rental costs higher than CAG D, and five have average rental costs below CAG D.[505] Moreover, because several adjacent

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[498] Docket No. R90-1, USPS-T-22 at 9-10.

[499] DMM 52 (July 1, 1997), *supra* note 19.

[500] *See* OCA-LR-2 at 12.

[501] Tr. 32/17004.

[502] *Id.* at 17007.

[503] Table 1, Tr. 23/12288.

[504] Tr. 23/12384-85. It is reasonable to exclude these three non-city offices because this "small number of observations might explain the comparatively low average rental cost for CAG B offices." Tr. 23/12359.

CAG levels are formed into three new fee groups in Fee Groups C and D, the fact that the average rental costs by CAG are not monotonic is not critical to the proposed restructuring.

ii. OCA's proposed new fee groups recognize differences in average postal rental costs by CAG.

Witness Callow proposes new Fee Groups C-I, C-II and C-III, and D-I, D-II and D-III, that properly group offices according to higher or lower average rental costs.[506] Witness Callow simply deaverages postal rental costs by CAG within the city-other and non-city delivery groups to better reflect known cost differences.[507]

The Postal Service proposal, by averaging office costs by delivery group, perpetuates unnecessary "rate averaging" in Fee Groups C and D. Rate averaging reflects a decision to charge a single price for particular goods or services even though there are different costs incurred in providing those goods or services.[508] The Postal Service relies on an average rental cost for each delivery group, which forms the basis of Fee Groups C and D, to allocate certain post office box costs.[509]

The Postal Service's use of averaging is not per se problematic, since "[a]veraging is an integral part of postal ratemaking."[510] Rather, the real issue is the appropriate amount of rate averaging because it is "neither possible nor wise to establish separate rates for every piece of mail."[511]

Theoretically, product offerings and the rates charged should provide customers with efficient price signals.[512] Because averaging reduces the "quality" of price signals,

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[505] *Id.*

[506] Tr. 23/12291.

[507] *Id.* at 12420.

[508] Alfred E. Kahn & William B. Shew, *Current Issues in Telecommunications Regulation: Pricing*, 45 Yale J. on Reg. 191, at 233.

[509] Tr. 3/1067.

[510] PRC Op. MC95-1, para. 3063.

[511] *Id.*

deaveraging should be undertaken where the information provided by the price signals and resulting set of incentives is improved. However, the benefits of deaveraging should not outweigh administrative and other costs, such as consumer information-gathering costs.

Witness Callow's proposed new fee groups represent the appropriate amount of deaveraging. The proposed new fee groups more accurately reflect costs through lower fees for boxholders in smaller, lower cost offices and, conversely, higher fees for boxholders in larger CAG offices having higher costs. Moreover, the deaveraging of postal rental costs was based on three groups of the same CAG level offices from the city-other and non-city delivery groups—a patently reasonable number. The use of three CAG groups serves the goal of isolating the smallest offices having lower costs while avoiding an administratively complicated fee schedule.[513]

Through deaveraging postal rental costs for offices in the city-other delivery group, the weighted average rental cost for CAG A-D offices was $9.07, while the weighted average for the smallest offices, CAGs H-L, was $4.96.[514] The resulting deaveraged rental costs more accurately reflect average rental costs for city-other delivery offices to be distributed to boxes in those offices. In the non-city delivery group, CAGs E-G have the highest average rental cost at $7.30, and CAGs A-L the next highest, $7.24, and CAGs H-L the lowest at $5.84.[515] This discrepancy is not problematic, because the six fee groups would ultimately be merged into three according to CAG, with the highest CAG levels in the merged fee groups exhibiting the highest average rental costs and lower CAG levels the lowest.[516]

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[512] Kahn and Shew, *supra* note 40, at 232-234.

[513] Tr. 23/12363.

[514] *Id.* at 12294.

[515] *Id.*

[516] *See* OCA-LR-2 at 15.

b. The OCA's proposed methodology for allocating post office box volume variable cost better reflects costs in larger and smaller offices which constitute the new fee groups.

Both the OCA and the Postal Service separate volume-variable post office box costs into three general categories: Space Support, Space Provision and All Other Costs. These costs so categorized are then allocated to develop test year before rates (TYBR) unit box costs.[517]

The Postal Service allocates All Other costs, which consist primarily of labor costs, proportionately to the number of post office boxes, without regard to office size as measured by CAG.[518] The allocation of an average of All Other costs to boxes is inappropriate where costs vary by office.

Witness Callow alternatively proposes a reasonable allocation methodology for a portion of All Other costs to address the fact that certain post office box volume-variable costs vary by CAG, and should be recognized in setting post office box fees. The remaining share of All Other costs is allocated proportionally to the total number of boxes in the same manner as the Postal Service.[519] With respect to Space Support and Space Provisions costs, witness Callow's allocation methodology is consistent with the methodology presented by the Postal Service.

i. OCA's proposed methodology for allocating a portion of all other costs is reasonable.

Witness Callow proposes an alternative methodology for allocating a portion of All Other costs.[520] With respect to postmaster costs, the absence of average postmaster salaries and other data by CAG required the use of the number of postmasters by CAG

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[517] *See* OCA-T-500 at 37-60, Tr. 12314-37; *see also* USPS-T-24 at 19-27.

[518] *Id.* at 12289.

[519] *Id.* at 12397.

[520] *Id.* at 12319-28.

to distribute costs.[521] The resulting allocation "distributes a larger amount of postmaster costs to boxes in smaller offices than larger offices."[522]

On rebuttal, witness Kaneer states, "It is incorrect, therefore, to allocate [postmaster] costs according to the number of postmasters in each CAG level, as witness Callow does."[523] He concludes, "Since the amount [of postmaster cost] is small, and data to make the theoretically correct allocation are unavailable, it is better to allocate these costs using the simpler Postal Service approach."[524]

However, witness Callow's allocation of postmaster costs using the number of postmasters produces a reasonable result consistent with postmaster responsibilities, as explained by witness Kaneer. Witnesses Kaneer and Callow agree that postmasters' responsibilities vary by CAG level.[525] Moreover, according to witness Kaneer, postmasters in higher CAG offices almost never perform window service while postmasters in lower CAGs must often do so because there is no one else.[526] Moreover, costs for postmasters above EAS-24 are not allocated to boxes.[527]

These variations in postmaster responsibilities and treatment of postmaster costs are reflected in witness Callow's allocation methodology. Under witness Callow's methodology, there are few if any postmaster costs allocated to higher CAG offices that make up Fee Groups A, B, C-I and D-I.[528] Conversely, the varying responsibilities postmasters for providing window service, described by witness Kaneer, are reflected in the allocation, in which lower CAG offices receive a larger amount of postmaster costs.[529]

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[521] *Id.* at 12399.

[522] *Id.* at 12400.

[523] Tr. 32/16963 [citation omitted].

[524] Tr. 32/16963-64.

[525] Tr. 32/16963; Tr. 23/12399.

[526] Tr. 32/16963.

[527] *Id.*

[528] OCA-T-500, Table 13. Tr. 23/12319

It is clear that witness Callow's allocation methodology for postmaster costs better reflects responsibilities of postmasters in higher and lower CAG offices. The adoption by the Commission of this more reasonable allocation methodology should not await Postal Service production of "data on time spent in particular offices [which] do not exist for postmasters."[530] Nor should the Commission be dissuaded from adopting this more reasonable methodology by Postal Service claims that its methodology is "simpler," even though less representative of postmaster responsibilities, or that the "amount is small."[531]

With respect to supervisor costs, witness Callow develops a reasonable allocation methodology to recognize the fact that postal supervisors, and thus supervisor costs, are not found in lower CAG level offices. Post office boxes in offices without supervisors were assigned no costs, with total supervisor costs allocated proportionally to the number of boxes in facilities that incur supervisor costs.[532]

According to witness Kaneer, "[t]his might be a reasonable approach if other, larger cost categories could be properly allocated according to CAG. [footnote omitted] Absent that, however, it is a distortion to do it for just one component . . . [by] not accounting for counterbalancing shifts."[533]

Witness Callow's approach is reasonable. Witness Kaneer makes no attempt to dispute the fact that there are no supervisor costs in lower CAG offices.[534] Moreover, the possibility of "accounting for counterbalancing shifts" was precluded by the Postal Service's unwillingness to provide relevant Cost Segment data by CAG.[535] The

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[529] *Id.*

[530] Tr. 32/16963.

[531] *Id.* at 16963-64.

[532] Tr. 23/12323-28.

[533] Tr. 32/16964.

[534] *Id.*

[535] See Office of the Consumer Advocate Motion to Compel Responses to Interrogatories OCA/USPS-T5-34-36 to United States Postal Service Witness Alexandrovich, September 26, 1997.

Commission should adopt witness Callow's more reasonable allocation of supervisor costs.

ii. OCA's allocation of space support and space provision costs is not in dispute.

Space Support costs are allocated on the basis of equivalent capacity.[536] The percent of total equivalent capacity for each fee group and box size is used to distribute total Space Support costs.[537] This allocation methodology is identical to that of the Postal Service.[538]

Space Provision costs are allocated in direct proportion to equivalent capacity and average rental costs for each fee group. Unlike the Postal Service's methodology, witness Callow's "allocation is formed by the product of the average postal rental cost for each fee group and the equivalent capacity by box size."[539] This allocation methodology produces identical results to those of the Postal Service.[540]

c. The OCA's proposed fees for post office boxes are reasonable and, by better reflecting costs, create a more fair and equitable fee structure.

Section 3622(b) of the Postal Reorganization Act requires "the establishment and maintenance of a fair and equitable schedule" and consideration of "the effect of rate increases" on the general public and others. 39 USC §§ 3622(b)(1) and (4). Witness Callow proposes post office box fee increases that reflect differing costs in fee groups composed of different size offices. As a consequence, boxholders in the new fee groups consisting of the highest cost, larger offices from Fee Groups C and D pay the highest

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[536] The term equivalent capacity "represents the equivalent number of size 1 boxes." It is "derived by multiplying the number of boxes in each fee group and box size by a factor reflecting the relative capacity of each box size." USPS-T-24 at 21.

[537] Tr. 23/12332-33.

[538] *Id.*

[539] Tr. 23/12314.

[540] Tr. 23/12337.

fees while boxholders in the new fee groups consisting of lower cost, smaller offices pay lower fees. This fairer fee schedule was accomplished in a manner that limited the impact of fee increases on certain boxholders whose fees are misaligned with costs.

Overall, OCA's fee proposal produces net revenues of $94.3 million, approximately $934 thousand more than proposed by the Postal Service. The resulting cost coverage is virtually the same as proposed by the Postal Service.[541]

i. OCA's proposed box fees reasonably seek to avoid burdensome increases in the context of deaveraging costs and better aligning fees with costs.

Under witness Callow's approach, the effects of deaveraging postal rental costs to create new fee groups was most pronounced in Fee Group D. The highest cost offices in terms of average rental costs from Fee Group D are grouped in new Fee Group D-I, consisting of CAG A-D offices. In Fee Group C, the highest cost offices are in new Fee Group C-I. Fee Group C-I boxholders pay higher fees because they are located in higher-cost CAG offices. New Fee Group D-I boxholders are also located in CAG A-D offices and, in addition, current fees are below cost. Consequently, boxholders in new Fee Groups C-I and D-I have the highest percentage fee increases of all the new fee groups, and new Fee Group D-I has the highest percentage fee increase of any fee group at 100 percent.

Because fees were misaligned with costs and the fact that all boxes in Fee Group D were below cost, witness Callow reaonably limited the maximum fee increases to 100 percent to new Fee Group D-I boxholders. Fee increases of greater than 100 percent were considered burdensome to boxholders.[542]

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[541] Tr. 23/12341.

[542] Tr. 23/12366.

ii. OCA's phased approach to merging the new fee groups minimizes burdensome fee increases.

Witness Callow proposes a phased approach to merging the three new fee groups created from Fee Groups C and D, respectively. Merging Fee Groups C and D and establishing three fee groups based upon CAGs A-D, E-G and H-L was considered, but not proposed in this proceeding, because of concern about brudensome fee increases for Fee Group D boxholders.[543]

Rather, the proposed fees for boxes in the new fee groups constitute a transition to a uniform fee by box size for each CAG groupng comprising the new fee groups. Merging Fee Groups C and D in separate stages would avoid percentage increases larger than 100 percent for boxhodlers in Fee Group D. Differential fee increases for boxes by CAG grouping within Fee Groups C and D until such time as Fee Groups C and D are merged and restructured by CAGs A-D, E-G and H-l would allow more gradual fee increases of boxholders from current Fee Group D.

Given the large difference in fees in current Fee Groups C and D, witness Callow estimated that through a combination of increases, fees for boxholders in new Fee Groups D-I, D-II and D-III could be brought to parity with fees for boxholders in new Fee Groups C-I, C-II and C-III in two more rate proceedings.[544]

3. The Postal Service's decision to extend free post office box service to customers subject to the quarter-mile rule removes an inequity in the current classification schedule.

In Docket No. MC96-3, the Postal Service enunciated a goal of offering one free method of delivery to all customers.[545] However, that goal did not apply to a significant group of customers who could not obtain free carrier delivery service—those subject to the "quarter-mile" rule.[546] That rule, as interpreted by the Postal Service, has precluded

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[543] Tr. 23/12342.

[544] Tr. 23/12405.

[545] PRC Op. MC96-3 at 63.

[546] Postal Operations Manual § 653.2.

the extension of carrier delivery service to customers who reside within one-quarter mile of non-city delivery offices. Nor were these customers eligible for free post office box service, pursuant to the Postal Service's request in that docket, unlike all other customers unable to obtain carrier delivery service.[547]

The Postal Service's recent decision to offer "Group E (no fee) PO boxes to customers located within one quarter mile of a non-city delivery office (quarter mile customers)" is welcomed.[548] The Postal Service is to be applauded for eliminating this inequity from the current classification schedule.

a. The Postal Service's decision is responsive to Commission concerns of fairness and equity.

In its opinion and recommended decision in Docket No. MC96-3, the Commission urged the Postal Service "to re-evaluate the quarter-mile rule in an expedient manner and rectify any inequities caused by this rule."[549] It added, "This record is devoid of any reason or justification for why customers should be charged for box service when that service is their only means of receiving mail."[550]

Not only would eliminating the quarter-mile rule remove a bar to one free method of delivery for certain postal customers, thus making the classification schedule more fair, it would also create a simpler and more understandable schedule for postal customers.[551]

With its request in this proceeding, the Postal Service acknowledged the need to address the Commission's concerns, stating

> The Postal Service recognizes that further accommodation of [ ] customers [subject to the quarter-mile rule] is appropriate . . . .[552]

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[547] USPS-T-39, at 67, n.9.

[548] USPS-RT-19, at 24, n.7. Tr. 32/16972.

[549] PRC Op. MC96-3 at 62.

[550] *Id.*

[551] Tr. 23/12438-39.

b. The Postal Service has proceeded in a timely manner to remedy this inequity.

In the span of little more than six months, the Postal Service completed the necessary work to extend free box service to customers subject to the quarter-mile rule. The Postal Service determined that information on the number of customers affected was necessary.[553] On August 28, 1997, the Postal Service signed a contract with Foster Associates "to gage the impact of offering alternative delivery options to customers affected by the 'Quarter Mile Rule.'"[554] Pursuant to the contract, Foster Associates submitted the "Quarter Mile Study Final Report" on December 31, 1997.[555] Since that time, "The necessary management approvals have been obtained, and the Postal Service expects that appropriate Federal Register and Postal Bulletin notices will be published in as little as a few weeks."[556]

B. The Commission Should Use The Costs Of The Standard B Special Rate Subclass As A Proxy For The High And Unreliable Costs Calculated For Library Rate.

1. The small number of IOCS tallies from which the library rate is derived is an extremely thin sample that does not allow calculation of truly representative costs for the subclass.

Library mail[557] is a low volume subclass with a small number of IOCS tallies. The thin sample of tallies from which the library rate costs are derived causes statistical distortion and prevents assurance that the library rate cost estimates are truly representative of that subclass.[558] In 1995, there were only 152 tallies for library rate, or

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552 USPS-T39 at 67, n.9.

553 *Id.*

554 Tr. 3/622.

555 *See* US Postal Service Library Reference H-329.

556 USPS-RT-19, at 24, n.7. Tr. 32/16972.

557 Library Mail is described at DMM 52, E620.5.0.

558 Tr. 24/13086.

tallies per dollar of unit cost of 80.4. This is less than one-half the tallies per dollar of unit cost generated by classroom,[559] another small subclass, which the Commission recently merged with the Nonprofit Periodicals subclass because its cost instability was unreliable for ratemaking.[560]

Postal Service witness Degen testified that "Library rate costs, like Classroom, suffer from some instability due to the small volume and the nature of the IOCS sampling procedure."[561] In other words, cost instability does not refer to fluctuating costs but the method used to calculate the underlying costs. The IOCS sampling system leads to erratic cost results that are not truly representative of the subclass. It is a limitation inherent in the nature of the sampling process that cannot be remedied economically by simply increasing the sample size.[562] Witness Collins, a postal rate and classification analyst in OCA, testifying for her proposal to remedy the impact of the low number of library rate tallies stated, "I don't believe that the costs for library rate are what the Postal Service says they are."[563]

The Postal Service recognized the crux of the library rate problem in this case when its initial rate calculation derived a cost which would have resulted in a 53 percent library rate increase.[564] To mitigate the "rate shock," Postal Service witness Adra reduced the first pound library rate to only one cent above its calculated attributable cost which nevertheless resulted in a proposed rate increase of 25 percent.[565] However, the remedy is insufficient. Because the proposed special rate subclass rate is somewhat less than the library rate suggested by the Postal Service,[566] approximately 95 percent of the library rate mail would migrate to the lower special rate subclass rate.[567] The

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[559] Witness Degen, Response to POIR No. 2, question 1.

[560] PRC Op. R90-1, paras. 5356-61, PRC Op. R94-1, paras. 5212-16, and Docket No. MC96-2, USPS-CT-2.

[561] Tr. 24/13089, *See* witness Degen's response to POIR No. 2, question 1.

[562] *See* Tr. 24/13088 referencing Docket No. MC96-2, USPS-CT-2 (at 5, 7).

[563] Tr. 24/13130-1.

[564] *Id.* 13087.

[565] *Ibid.*

remaining 5 percent of the library rate mail could not migrate to the special rate because it does not qualify for special rate mail. Wholesale migration would create a de facto merger of the two subclasses thereby eliminating by administrative fiat a preferred rate category created by Congress. Therefore, the proposed 25 percent increase in the Library Rate is also undesirably excessive for this legislatively favored subclass.[568] Commission action is needed to ameliorate the excessive rate impact caused by the thinness of the library rate sample.

2. Use of a proxy for library rate is consistent with past Commission practice.

Recently in Docket No. MC96-2 the Commission solved a problem involving the instability of classroom costs due to low tallies.[569] In that instance, the Commission merged the classroom rate with nonprofit periodicals. Certain aspects of that case vary from the present case but in significant part it is applicable.[570]

Several reasons recognized by the Commission for combining classroom and nonprofit periodicals for cost estimation apply here:[571]

- the rate structure for library rate and special standard mail is identical;[572]

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[566] The proposed special rate and library rate are $1.24 versus $1.44 for the first pound, $0.51 versus $0.52 for two through 7 pounds and $0.21 versus $0.25 for over eight pounds, respectively. Direct Testimony of witness Adra, USPS-T-38 at 15 Table 4, and 22 Table 7.

[567] Tr. 24/13087, 13090-1.

[568] The Revenue Foregone Reform Act of 1993 (RFRA) specifies the Standard B library rate subclass after 1998 shall be one-half the markup proposed for the most closely corresponding regular-rate category—in this case, the Standard B special rate. Public Law 103-123, 107 Stat. 1267, 39 U.S.C. §3626(a).

[569] Tr. 8/4319. Tr. 24/13088, 13090. *See* PRC Further Recommended Decision, Docket No. MC96-2 at 17, 19.

[570] The distinctions, if anything, weigh in favor of the proposed application of a proxy here. In Docket No. MC96-2, the two combined subclasses were to have the same cost coverage as required under RFRA. On the other hand, RFRA compels the library rate to be set at one-half the cost coverage of special rate. Tr. 24/13091. Without the proxy, library rate and special rate would be effectively merged whereas the import of RFRA is that the library rate would be less than the special rate, the result proposed here by OCA.

[571] Tr. 24/13093.

- the composition of both subclasses is very similar and the predominant items mailed in both subclasses are books, sound and video recordings;[573]
- each subclass is normally processed in the same mail processing operations;[574]
- the mail processing cost component is volatile and unstable due to small IOCS samplings;[575]
- the low volume likely results in increased variance so that the coefficients of variance for special rate mail are better on the whole than those of library rate;[576]
- the variations in direct costs cause problematic variation in total unit cost estimates which was recognized and ameliorated by the Commission in regard to classroom mail;
- the cost coverage provisions of RFRA would be better met; and
- the preferred library rate category under RFRA would not be effectively eliminated by migration to a lower priced subclass.

Additionally, Postal Service witnesses Degen and Adra apparently did not focus on this issue until after preparation of the Postal Service's case. However, their testimony indicates they would seriously consider correcting the library rate cost problem by using special rate as a proxy.[577]

For these reasons, use of a proxy for library rate costs is consistent with past practice and reasonable and appropriate.

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572 Tr. 8/4274.

573 *See* DMM 52, E620.5.2, 5.4. *See also*, Tr. 8/4293-96.

574 Tr. 24/13093, 12/6336-37.

575 POIR No. 2, Question 1, and Tr. 8/4305.

576 Tr. 7/3359, 3523-29, Tr. 8/4307.

577 Tr. 8/4309, 4310 -11.

3. The Commission should recommend library rates calculated using the methodology of witness Adra, only substituting special rate costs as a proxy for his calculated library rate costs.

The Commission should therefore recommend the rates proposed by OCA witness Collins to calculate the library rate using the same methodology as witness Adra, but substituting special rate costs as a proxy for the library rate costs.[578] This would result in a first pound library rate of $1.13 versus $1.44 proposed by the Postal Service, additional pound rates of $.40 for two pounds through eight pounds versus $0.52 proposed by the Postal Service, and for all pounds over eight pounds, $0.19 versus the $0.25 rate proposed by the Postal Service.[579] The revenue impact of this proposal is only approximately $9 million.[580]

OCA's proposal also "produces rates which preserve historical rate relationships and are reasonable."[581] The statutorily favored library rate subclass would continue de facto because the rate would be below the special rate. It would also permit the 5 percent of library rate mail that could not migrate to the special rate to avoid the high library rate proposed by the Postal Service (because it could not qualify for the special rate) to enjoy the same favorable statutory benefits available to other library rate mail. The special rate costs should therefore be used as a proxy for library rate costs.

C. The OCA Supports Witness Carlson's Proposal Regarding Stamped Cards.

Witness Carlson's testimony regarding the classification, rate and costing for stamped cards stands unrebutted. He clearly demonstrates that the current 20-cent rate for stamped cards will produce a 263 percent cost coverage under his proposals. Because the unit costs for stamped cards are so low in comparison to private post cards,

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[578] Tr. 24/13097.

[579] A full comparison of the current rates with the OCA proposal appears at OCA Exh. 706, Tr. 24/13116-7.

[580] Tr. 24/13097.

[581] *Id.* at 13098.

this high coverage is achieved even after he separately applies a 200 percent markup to manufacturing costs and then adds these to the FY 1996 CRA unit costs for postal cards.[582]

Witness Carlson proposes to keep the rate for a stamped card (postal card) at the current 20 cents per card. Under his proposal, the three types of cards (stamped, regular and automation presort) would be separate rate categories with separate costing and rates. He proposes conforming DMCS language and does a complete revenue analysis.[583]

The costing that witness Carlson proposes for stamped cards is a two-step process. First, he applies the markup proposed for regular cards to the attributable costs of stamped cards. Next he applies the Postal Service proposed markup of 200 percent to the manufacturing costs. He then adds the two together. In this docket, the result is a 16-cent rate. However, witness Carlson, having no prior omnibus rate case experience, fears that the revenue effects of this rate reduction would be too severe. Therefore, although he has shown that the current rate is at least four cents too high, witness Carlson proposes keeping the current 20 cent rate until it can be shown, in a future case, that the cost/revenue ratio needs an adjustment. Because the attributable costs of stamped cards already include manufacturing costs, his approach has a slight methodological (although in this case not practical) problem in that it marks up these costs twice.

Many points witness Carlson makes are well taken. As OCA witness Collins demonstrated in Docket No. MC96-3, the unit attributable cost for postal cards is much less than that of regular post cards.[584] Witness Carlson shows that the FY 1996 unit cost for postal cards for both manufacturing and processing is only 7.6 cents, whereas the unit cost for regular post cards is 18.7 cents. The effective cost coverage for the stamped card, under the Postal Service's proposal, would be over 300 percent.[585]

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582 *Id.* at 12801, 12805.

583 *Id.* at 12803, 12807.

584 Docket No. MC96-3, OCA-T-400 at 23.

Witness Carlson shows that stamped cards are much more compatible with automation than are private cards. By design (and under the control of the Postal Service), stamped cards meet the physical automation compatibility requirements of the DMM, while some (maybe most) of private cards do not (these include background reflectance and color). Picture post cards are often too glossy for the orange RBCS ID tag or the black barcode to adhere to the surface. These cards then must be processed through an LMLM or manually, thus costing more because of extra processing steps. Stamped cards also are more automation compatible because they are less likely to have non-address information on the address side. This also provides more space for the barcode.

The cost differences cited above are real and they are attributable to differences in automation compatibility. In the past, the Postal Service has proposed and the Commission has adopted rates that reflect discounts for mail pieces that are compatible with automation. Carlson's proposal follows this precedent, in a manner that reflects the concerns of the OCA, i.e., allowing individuals to share in the savings accruing to the Postal Service by virtue of less costly, automation mail.

The OCA concurs with witness Carlson that his proposals meet the requirement of the Act's criteria for both rates and classifications. He has clearly demonstrated that customers who use stamped cards instead of private cards will be using a product which has a higher cost coverage and dramatically lower costs than those who use regular cards. Thus, his proposed classification will lower costs and benefit both customers and the Service. It should be adopted by the Commission.

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[585] Tr. 24/12797-8. In two dockets, Postal Service witnesses have provided interrogatory answers which seek to explain the large cost differential between regular post cards and postal cards. Witness Alexandrovich addresses this subject at Tr. 13/6991-5.

V. THE COMMISSION SHOULD RESOLVE ALL METHODOLOGICAL AND CLASSIFICATION ISSUES ON THEIR MERITS

As OCA stated in the first section of its initial brief,[586] the Commission should refuse to raise rates in this proceeding. The sole exception to this course is that any subclasses or services known to be falling short of attributable cost recovery under the present rate schedule must be subject to increases in rates that recover attributable costs in full. This is necessary to avoid cross-subsidization by other classes of mail. The first question that arises from the determination not to raise rates, is what action should be taken on methodological and classification issues that have been introduced in this proceeding. It is OCA's position that such issues should be resolved on their merits in the Commission's opinion and recommended decision, although, in some cases, actual rate implementation must be deferred to the next omnibus rate case.

Section 3622(b)(3) of title 39 requires that the rates for each subclass and service fully recover the attributable costs of that service. The Commission made this point forcefully in Docket No. MC96-2 when it refused to recommend Classroom rates that were below the costs of the subclass: [587]

> A central rate policy of Title 39 is "the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type."
> . . .
>
> [T]he Act requires that rates recommended by the Commission cover costs.

Since each subclass and service must be evaluated to see whether costs will be fully recovered in the test year, the next question becomes, "What source of cost information must be examined to determine if revenues are sufficient to cover attributable costs?" The answer to that question should be sought in the CRA for FY

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[586] Filed March 16, 1998.

[587] PRC Op. MC96-2 at 40.

1996. Apart from a handful of exceptions discussed in this section of the brief, no other information on or off the record is available to determine the most recent cost/revenue relationship for a specific class of mail.[588]

A review of the CRA for FY 1996 reveals that rates need be increased for only one subclass of mail that did not cover its costs in FY 1996, namely parcel post.

Rates for parcel post should be increased to the point that costs equal revenues, and that point is determined by reference to the FY 1996 CRA. Parcel post produced $691.4 million in revenues in FY 1996, falling $32.7 million short of its attributable costs of $724.1 million. Therefore, its rates must be ratcheted upward in this proceeding so that parcel post yields approximately 5 percent more revenue than it did in FY 1996.

OCA is cognizant that single-piece third class, classroom mail and library rate mail were also not covering their costs in FY 1996. However, circumstances unique to each of these subclasses make it unnecessary to increase their rates at this time. With respect to single-piece third class, the Postal Service proposes a classification change to remedy the longstanding problem that single-piece third class revenues persistently fall below costs.[589] OCA supports the Service's proposal, which would merge single-piece third class into First Class. If First-Class rates are not increased (as OCA argues), then third-class single piece mail would pay current First-Class rates along with the rest of First Class.

Rates for classroom mail were very recently increased in Docket No. MC96-2,[590] so the shortfall identified in the FY 1996 CRA has already been rectified by that opinion.

OCA addresses the issue of properly determining library rate costs in the testimony of witness Collins (OCA-T-700). Witness Collins recalculates the costs of library rate mail using special rate costs as a proxy for library rate costs. This procedure demonstrates that library rates are almost certainly covering their costs even in the TYBR. The reasoning runs thus: (1) Witness Collins proposes rates for the TYAR of

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[588] *Accord* Joint Comments of AMMA, Advo, DMA. MOAA, and PSA in Response to NOI No. 5, February 13, 1998, at 3.

[589] Testimony of Postal Service witness Ashley Lyons, Tr. 9/3373, Docket No. MC96-3.

[590] PRC Further Op. MC96-2, May 14, 1997.

$1.13 for the first pound, $0.40 for the second through eighth pounds, and $0.19 for weight tiers over eight pounds; (2) these rates cover attributable costs and generate a cost coverage of approximately 120 percent;[591] (3) current rates are very close to these—$1.12 for the first pound, $0.41 for the second through eighth pounds, and $0.20 for tiers over eight pounds. It may be reasonably inferred that current rates also recover attributable costs (as calculated by witness Collins) and contribute a small amount to the recovery of institutional costs. In the interest of administrative simplicity, mailer convenience, and consistency with OCA's position that no rates should be increased in this proceeding, we propose that library rates remain at their current levels.

A. Methodological Issues.

Several major changes in costing methodology have been proposed in this case, the most important of which are presented in the testimonies of Postal Service witnesses Bradley (USPS-T-14 and USPS-RT- 5), Degen (USPS-T-12 and USPS-RT-6), and Baron (USPS-T-17, USPS-RT-1, and his response to Notice of Inquiry No. 3). The aggregate volume variability of segment 3 mail processing labor costs produced by Bradley's analysis is 76.4 percent,[592] rather than the 100 percent variability always accepted by the Commission. This spurred the filing of several additional pieces of testimony, some challenging his methodology, some endorsing it. For example, OCA witness Smith (OCA-T-600 and OCA-RT-1000) and UPS witness Neels (UPS-T-2) are very critical of Bradley's efforts. Dow Jones witness Shew (DJ-T- 1), DMA witness Buc (DMA-T- 1), MPA witness Higgins (MPA-RT-2 and his response to NOI No. 4), MPA witness Cohen (MPA-T-2), and TW witness Stralberg (TW-T-1) commended his efforts; OCA witness Smith's first piece of testimony generated rebuttal by Postal Service witness Ying (USPS-RT-4). This vehement exchange of views must not be ignored, but should be decided by the Commission even if the outcome cannot be reflected in the rates issuing from this proceeding.

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591 OCA-Exh. 701.

592 USPS-T-12, table 4.

Witness Degen's distribution of mixed mail costs using MODS data evoked almost an equally fierce debate. MPA-RT-1, the rebuttal testimony of Rita Cohen, and TW-RT-1, the rebuttal testimony of witness Stralberg, both on behalf of ANM, ABP, CRPA, DJ, MPA, MH, NNA, and TW, express strong opposition to Degen's distribution procedure, while UPS witness Sellick (UPS-RT-2) and OCA (Trial Brief) approve his approach. This must also be resolved in the Commission's opinion.

The testimony of Postal Service witness Baron (USPS-T-17), as characterized by the Commission in NOI No. 3, "redefine[s] one of the traditional components of load time as access time, and . . . change[s] the way that remaining coverage-related load time is analyzed." Witness Baron, however protests this characterization in his statement in response to the NOI and in his rebuttal testimony (USPS-RT-1). Advo witness Crowder appears to advance a third point of view, differing both from the Commission and the Postal Service (Crowder's response to NOI No. 3 and Advo-RT-1). This disagreement should also be settled in the opinion.

Aside from Postal Service proposals, several participants have presented new theories of pricing. For example, ABA/NAA witness Clifton would reduce the second- and third-ounce rates of First-Class workshared mail by increasing the cost coverage of Standard A mail. NAA witness Chown presents a new theory for allocation of institutional costs. OCA witness Sherman "review[s] [the] theoretical foundations of the Postal Service pricing proposals," including a comparison to Ramsey prices (correctly calculated) using long-run elasticities instead of the short-run elasticities used by Postal Service witness Bernstein.

The above identification of methodological and theoretical disputes is by no means complete. Other debates about preferred costing and pricing approaches should be decided just as they would be in any other rate case. Any decision not to increase postal rates at this time has no bearing on the merit (or lack of merit) of any of these proposed changes. Every methodological and theoretical issue raised in this proceeding should be approved/rejected on its merits.

B. Classification Issues.

Several new services and fees are propounded in this case, both by the Postal Service and by other participants. These should also be decided on their merits. If the rates involved fully recover the costs of the service and make an appropriate contribution to institutional costs, and the Commission finds the proposed rates in harmony with the Postal Reorganization Act, both the new classification and the rate ought to be recommended at this time. If the new classification is not deemed worthy of recommendation, then the proposal should be rejected. Other classifications that are found to have merit, but would produce significant revenue losses because other rates are not being raised at this time, should be recommended as shell classifications, to be given rate effect in the next omnibus rate case.

Below is a list of new services/charges proposed by the Postal Service:

- Prepaid Reply Mail
- Qualified Business Reply Mail
- Hazardous Materials Surcharge
- Delivery Confirmation
- Oversize Parcel Post proposal
- Bulk Insurance
- Re-configuration of First-Class Cards

Each of these new services or charges could be recommended by the Commission and implemented by the Governors without significant erosion of postal revenues. In the case of new services, it is appropriate to base rates upon the Postal Service's test year cost projections.[593] The basis for this conclusion is that, since the new services and charges will be implemented for the first time in the test year, the most

[593] This assumes that the Commission succeeds in estimating test year costs based on an appropriate revenue requirement and appropriate costing methodologies. If the Commission cannot do this, then these proposals should only be recommended as shells, if at all.

current test year cost estimates serve best as a platform for revenue estimation and rate design.[594] OCA does not specifically endorse the adoption of any proposed new service or charge. We merely contend that each should be decided on its merits, and if any is found to be beneficial, it may be recommended and given full rate effect.

Discounts, on the other hand, if implemented in the test year without raising other rates, could cause serious revenue deficits in the test year. Below is a list of the major discount proposals of the Postal Service:

- BMC Presort, OBMC, and Barcoded Discounts in Parcel Post
- Barcoded Discount for Bound Printed Matter, Special Standard B, and Library Rate

These should also be decided on the merits. If they are found worthy of approval, they should be recommended only as shell classifications to be given rate effect in the next omnibus rate case, when increases in other rates can be used to offset any revenue deficiencies.

There is another group of classifications that essentially "de-average" existing categories into an even larger number of new rate categories. They are the following:

- Separate rate categories for Three-Digit and Five-Digit Presort in Periodicals Class (including Preferred Rate)
- Residual Shape Surcharge in Standard Mail A
- Re-definition and addition of rate categories in Parcel Post

The "de-averaged" rates of the Postal Service are predicated upon new costing methodologies discussed above (e.g., the new volume variability estimates of segment 3 mail processing costs by witness Bradley and the MODS-based distribution of these costs by witness Degen)[595] and test year revenue requirement proposals.

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[594] Of course, OCA's suggestion that test year cost estimates be used should not be construed as an endorsement of the Bradley volume variability analysis nor of the test year revenue requirement developed by the Postal Service. On the contrary, it is OCA's earnest wish that the Commission reject both of these proposals. However, if the new services/charges listed above are found to be of sufficient benefit, on balance, it is best to recommend and implement them now, rather than deferring their introduction to the next omnibus rate case.

Consequently, it is impossible to separate the costing methodology and test year revenue requirement influences from the "de-averaged" rates.[596] As is true of discounts, the most prudent course of action is to decide these classification proposals on their merits, and recommend them as shell classifications if warranted, but defer rate implementation until the next omnibus rate case.

C. OCA Classification Proposals.

OCA presents two rate/classification proposals in this proceeding—a discount for CEM mail, presented by witness Willette, and a restructuring of post office box fees, presented by witness Callow. In addition, witness Collins proposes new rates for library rate mail that reflect her cost methodology using special rate costs as a proxy for library rate costs.[597] In light of OCA's recommendation that the Commission not raise rates in the instant proceeding because the Postal Service has not met its burden of proof for the increased revenue requirement, it is necessary to look at each of OCA's rate proposals to determine whether they properly reflect that position.

Although OCA relies upon the four-cent cost difference calculated by witness Miller as the basis for the CEM discount, we must stress that our reliance in no way signals approval or acceptance of the costing methodologies embedded in the unit cost calculation. The chain of evidence for the cost differential is the following:

(1) witness Fronk proposes to pass through 3 cents of the avoided cost difference of 4 cents for CRM meeting the criteria for CEM (as well as PRM and QBRM). He obtains the 4-cent figure from witness Miller. USPS-T-32 at 40.

(2) the cost avoidance for CEM (and PRM and QBRM) is "calculated as the difference in mail processing costs between a prebarcoded First-Class reply mail piece and a handwritten First-Class reply mail piece." USPS-T-23 at 2 (testimony of witness Miller). Model inputs come from Exh. USPS-T-23B. *Id.*

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[595] Witness Crum, for example, furnishes unit cost differentials that witness Mayes uses to determine "de-averaged" parcel post rates. USPS-T-28 at 1. According to witness Crum, "[t]he costs were calculated in a slightly different way because of the new volume variability/cost pool approach incorporated into the Base Year CRA." *Id.* at 2.

[596] OCA did manage to do so for witness Callow's post office box proposal, *infra* on page 164.

[597] This is discussed at length above.

at 5. Exh. 23B notes that a CRA Adjustment Factor of 1.1586 is obtained from USPS-T-25 (testimony of witness Hatfield). This adjustment is explained in greater detail in response to BUG/USPS-T23-3 (Tr. 3/758): the 1.1586 CRA adjustment factor was applied to handwritten letters and PRM. Its source is witness Hatfield's Exh. USPS-25A, p. 1. The productivity inputs employed by witness Miller are the same as those employed by witness Hatfield in USPS-T-25, p. 8, lines 23-24. Witness Miller's response to BUG/USPS-T23-9 (Tr. 3/765).

(3) Witness Hatfield explains that the mail processing costs he develops in his testimony are based upon new mail processing volume variability data, new productivity data (which reflect the new mail processing volume variability estimates), and new partitions of mail processing costs into MODS cost pools. USPS-T-25 at 1. Witness Bradley's lower volume variability estimates for certain mail processing operations have a marked impact on the development of mail processing unit costs. *Id.* at 8.

Mail processing benchmark costs fall considerably as a result of Bradley's lower volume variability estimates, due to an overall reduction in the attribution of mail processing costs allocated to each class and subclass in the test year CRA. *Id.* at 8-9. Furthermore, model costs, which are the means of "de-averaging" benchmark costs, are modified to incorporate the new mail processing variabilities. These new variabilities are given effect through the use of new productivity estimates (*id.* at 9), i.e., the same productivity inputs used by witness Miller. The majority of the productivity estimates are calculated using MODS data, and the merging of new volume variabilites with MODS productivity figures produces higher productivity figures with resulting lower unit costs. *Id.*

It is apparent from the description of changes to the new method for determining First-Class unit mail processing costs that their calculation under the former 100-percent variability assumption would tend to make the differential between the First-Class benchmark and CEM (or PRM and QBRM) somewhat larger than the 4 cents computed by witness Miller. The new partitions into MODS cost pools, together with new distributions by witness Degen, may pull the differential in the opposite direction, i.e., tending to make it smaller. OCA's arguments that the Commission should reject the Postal Service's unsubstantiated enlargement of the revenue requirement also tend to pull the CEM differential in that direction. OCA does not have the technical resources to

measure precisely the effects of each of these phenomena. Therefore, we respectfully request that the Commission make adjustments to the CEM cost differential where appropriate and reflect those adjustments in the CEM discount, if necessary.

If the Commission accepts OCA's arguments that no rate increases are warranted in this proceeding, OCA's fee proposal for post office boxes would differ slightly from that originally presented in witnesses Callow's testimony (OCA-T-500). We reason that it would be unfair to single out post office boxes for fee increases when other classes and services are spared.

OCA's proposal for post office box fees would be changed in the manner presented below. To make post office box fees consistent with the treatment of other classes and services that are not called upon to generate additional revenues, current post office box fees that fully cover the new unit box costs resulting from "de-averaging" by witness Callow would not be raised. However, there are several post office box fee cells for which current fees would not cover the re-estimated unit box costs. These fees must be raised so as to be consistent with principles articulated by the Commission in Docket No. MC96-3.

The Commission expressed particular concern about the fiscal position of "rural," i.e., non-city-delivery boxes. At the time Docket No. MC96-3 was being litigated, these boxes paid rates that were far below their unit attributable costs. Two reasons were cited by the Commission for increasing the fees for certain segments of the post office box population: (1) the risk that overall revenues for boxes would not cover total attributable costs in the test year, and (2) the need to take "remedial steps . . . to reduce inequities among the fee categories within the post office box subclass."[598]

The first reason given looms as a possibility in this proceeding, as the cost coverage TYBR is estimated to be 99.6 percent by witness O'Hara.[599] Even after

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[598] PRC Op. MC96-3 at 18.

[599] Exh. USPS-30A. A note inserted at the bottom of Exh. A states that the attributable cost figures cited for FY 1998 BR include a 1 percent contingency. The attributable cost set forth for post office boxes is $613,811,000. Revenues are estimated to be $611,375,000, yielding the 99.6 percent cost coverage figure. If the 1 percent contingency is removed from the attributable cost figure ($613,811,000/1.01), then the attributable cost of post office boxes in FY 1998 BR is $607,733,663; and cost coverage rises slightly to 100.6 percent.

removing the 1 percent for contingencies (which is consistent with OCA's position), cost coverage hovers at about 100.6 percent.

Moreover, inequities, such as those cited as the second reason, persist. To remedy both of these ills, OCA presents an alternate fee schedule in which all fees are set to recover 100 percent or more of the estimated underlying attributable unit costs to the extent feasible, while avoiding severe rate shock. In OCA-T-500, witness Callow's starting point is to propose fee increases that produce net revenues nearly equivalent to the net revenue proposed by the Postal Service,[600] while "de-averaging" to reflect better the cost of boxes in offices with higher costs.

Table 1 shows an alternate fee schedule that preserves the restructuring of post office boxes proposed by the OCA, while limiting fee increases only to boxes that are below cost in the test year before rates. Since new Fee Groups D-I, D-II and D-III are below cost under both the OCA *and* Postal Service's proposal, the fee increases proposed by witness Callow are preserved. Other boxes below cost also face fee increases in order to cover costs, or do so as nearly as is practicable. No increases are proposed for boxes whose fees are above cost in the test year. Under this alternative schedule, post office box net revenues increase by $40.9 million in the test year.

The fees presented below reflect an increase in all current Fee group A fees and for box sizes 3, 4, and 5 in Fee group B because the cost coverage of those cells fell below 100 percent of the new unit costs calculated by witness Callow.[601] Fees for groups C-I, C-II, and C-III were not changed[602] since they currently generate cost coverages ranging from 106 to 166 percent. Fees for groups D-I, D-II, and D-III were raised substantially (from 25 percent for group DIII to 100 percent for group DI).[603]

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[600] OCA-T-500, Table 19, Tr. 23/12341.

[601] The maximum fee that can be imposed for any post office box is $451, which is the weighted average fee for caller service.

[602] With the sole exception of box size 5 in group CI.

[603] If the Commission does not accept OCA's arguments that the Postal Service's rate increase proposals must be rejected, then OCA's post office box proposal reverts to those fees proposed at Tables 11A and 11B of OCA-T-500 (Tr. 23/12312-13).

Table 1: Summary of Revenues and Costs, OCA Proposed New Fee Groups, TYBR and TYAR
(based upon OCA Initial Brief assumptions)
New Fee Groups

Fee Group	Box Size	OCA TYBR Boxes	Current Box Fees	OCA Proposed Box Fees	Percent Change	OCA TYAR Boxes	TYBR Revenues	TYAR Revenues	OCA TYBR Total Costs	OCA TYAR Total Costs	OCA TYAR TTL Rev - TTL Costs	OCA TYAR Cost Cov.
		[a]	[b]	[c]	[d]	[e]	[f]	[g]	[h]	[i]	[j]	[k]
A	1	72,138	$48	$58	21%	64,294	$3,462,625	$3,729,074	$3,780,583	$3,717,133	$11,941	1.00
	2	4,501	$74	$76	3%	4,428	$333,056	$336,506	$335,645	$335,054	$1,452	1.00
	3	2,524	$128	$165	29%	2,147	$323,090	$354,284	$356,100	$353,051	$1,233	1.00
	4	242	$242	$360	49%	181	$58,595	$65,207	$66,363	$65,870	-$663	0.99
	5	69	$418	$451	8%	66	$28,713	$29,717	$37,100	$37,078	-$7,361	0.80
Total A		79,474				71,116	$4,206,080	$4,514,787	$4,575,792	$4,508,186	$6,602	1.00
B	1	124,912	$44	$44	0%	124,912	$5,496,107	$5,496,107	$5,419,447	$5,419,447	$76,661	1.01
	2	29,996	$66	$66	0%	29,996	$1,979,763	$1,979,763	$1,830,893	$1,830,893	$148,871	1.08
	3	10,802	$112	$117	4%	10,553	$1,209,804	$1,234,663	$1,231,292	$1,229,274	$5,389	1.00
	4	1,561	$218	$224	3%	1,539	$340,285	$344,679	$343,241	$343,062	$1,617	1.00
	5	1,524	$372	$451	21%	1,357	$566,923	$611,906	$657,910	$656,556	-$44,650	0.93
Total B		168,795				168,356	$9,592,883	$9,667,118	$9,482,783	$9,479,230	$187,887	1.02
C-I	1	3,202,901	$40	$40	0%	3,202,901	$128,116,026	$128,116,026	$106,108,004	$106,108,004	$22,008,022	1.21
	2	1,463,355	$58	$58	0%	1,463,355	$84,874,580	$84,874,580	$66,790,269	$66,790,269	$18,084,311	1.27
	3	495,338	$104	$104	0%	495,338	$51,515,132	$51,515,132	$41,202,875	$41,202,875	$10,312,257	1.25
	4	116,404	$172	$172	0%	116,404	$20,021,558	$20,021,558	$18,422,200	$18,422,200	$1,599,358	1.09
	5	28,158	$288	$339	18%	25,582	$8,109,453	$8,672,173	$8,684,387	$8,663,471	$8,702	1.00
Total C-I		5,306,156				5,303,579	$292,636,749	$293,199,469	$241,207,734	$241,186,817	$52,012,651	1.22
C-II	1	1,944,781	$40	$40	0%	1,944,781	$77,791,222	$77,791,222	$54,837,586	$54,837,586	$22,953,637	1.42
	2	758,767	$58	$58	0%	758,767	$44,008,463	$44,008,463	$29,778,194	$29,778,194	$14,230,269	1.48
	3	243,090	$104	$104	0%	243,090	$25,281,331	$25,281,331	$17,597,305	$17,597,305	$7,684,026	1.44
	4	45,357	$172	$172	0%	45,357	$7,801,448	$7,801,448	$6,290,119	$6,290,119	$1,511,329	1.24
	5	6,262	$288	$288	0%	6,262	$1,803,345	$1,803,345	$1,698,513	$1,698,513	$104,832	1.06
Total C-II		2,998,256				2,998,256	$156,685,809	$156,685,809	$110,201,717	$110,201,717	$46,484,092	1.42
C-III	1	151,459	$40	$40	0%	151,459	$6,058,375	$6,058,375	$3,826,400	$3,826,400	$2,231,976	1.58
	2	47,532	$58	$58	0%	47,532	$2,756,864	$2,756,864	$1,665,052	$1,665,052	$1,091,813	1.66
	3	15,375	$104	$104	0%	15,375	$1,598,978	$1,598,978	$989,052	$989,052	$609,926	1.62
	4	1,612	$172	$172	0%	1,612	$277,319	$277,319	$198,200	$198,200	$79,119	1.40
	5	532	$288	$288	0%	532	$153,165	$153,165	$127,705	$127,705	$25,461	1.20
Total C-III		216,510				216,510	$10,844,702	$10,844,702	$6,806,408	$6,806,408	$4,038,294	1.59
D-I	1	36,301	$12	$24	100%	34,356	$435,608	$824,544	$1,113,576	$1,097,768	-$273,224	0.75
	2	22,069	$20	$40	100%	20,542	$441,377	$821,698	$925,982	$913,575	-$91,877	0.90
	3	7,552	$36	$72	100%	7,279	$271,869	$524,117	$572,479	$570,264	-$46,147	0.92
	4	1,096	$53	$106	100%	1,070	$58,107	$113,378	$157,328	$157,111	-$43,733	0.72
	5	180	$83	$166	100%	178	$14,978	$29,495	$50,327	$50,304	-$20,809	0.59
Total D-I		67,198				63,425	$1,221,940	$2,313,232	$2,819,693	$2,789,022	-$475,790	0.83
D-II	1	1,131,135	$12	$18	50%	1,100,837	$13,573,626	$19,815,069	$32,447,603	$32,264,050	-$12,448,981	0.61
	2	493,926	$20	$30	50%	476,845	$9,878,524	$14,305,338	$19,759,988	$19,656,504	-$5,351,166	0.73
	3	132,154	$36	$54	50%	129,769	$4,757,533	$7,007,536	$9,774,906	$9,760,461	-$2,752,925	0.72
	4	15,190	$53	$80	51%	15,001	$805,088	$1,200,115	$2,155,308	$2,154,163	-$954,049	0.56
	5	1,655	$83	$125	51%	1,642	$137,377	$205,283	$459,678	$459,600	-$254,317	0.45
Total D-II		1,774,061				1,724,095	$29,152,148	$42,533,342	$64,597,483	$64,294,778	-$21,761,436	0.66
D-III	1	2,868,513	$12	$15	25%	2,830,096	$34,422,158	$42,451,433	$76,306,951	$76,091,761	-$33,640,328	0.56
	2	1,060,532	$20	$25	25%	1,042,194	$21,210,646	$26,054,849	$39,353,669	$39,250,949	-$13,196,101	0.66
	3	269,261	$36	$45	25%	266,832	$9,693,407	$12,007,445	$18,478,102	$18,464,495	-$6,457,050	0.65
	4	16,184	$53	$66	25%	16,087	$857,763	$1,061,762	$2,130,823	$2,130,280	-$1,068,518	0.50
	5	1,769	$83	$104	25%	1,762	$146,827	$183,260	$455,926	$455,888	-$272,627	0.40
Total D-III		4,216,260				4,156,971	$66,330,801	$81,758,749	$136,725,470	$136,393,373	-$54,634,624	0.60
E	1	599,685	$0	$0		599,685	$0	$0	$16,808,809	$16,808,809	-$16,808,809	0.00
	2	231,140	$0	$0		231,140	$0	$0	$9,047,734	$9,047,734	-$9,047,734	0.00
	3	60,501	$0	$0		60,501	$0	$0	$4,385,562	$4,385,562	-$4,385,562	0.00
	4	6,078	$0	$0		6,078	$0	$0	$845,883	$845,883	-$845,883	0.00
	5	840	$0	$0		840	$0	$0	$228,933	$228,933	-$228,933	0.00
Total E		898,243				898,243	$0	$0	$31,316,921	$31,316,921	-$31,316,921	0.00
TOTAL		15,724,952				15,600,552	$570,671,113	$601,517,208	$607,734,000	$606,976,452	-$5,459,244	0.99
Caller Service		90,747	$451	$451	0%	90,747	$40,926,917	$40,926,917			$40,926,917	
Reserve Number		182,113	$30	$30	0%	182,113	$5,463,379	$5,463,379			$5,463,379	
GRAND TOTAL		15,997,812				15,873,411	$617,061,409	$647,907,504	$607,734,000	$606,976,452	$40,931,052	1.07

Cost Segment 3, clerk and mailhandler costs, are included in the All Other category of post office box costs.[604] Witness Degen has proposed an alternative method for the distribution of Cost Segment 3 costs to components. As a consequence, segment 3 costs attributed to post office boxes in the base year are lower than they otherwise would be using the Commission's previous methodology. This effect rolls forward to the test year.

OCA witness Callow, in developing his post office box proposal, relies on the volume variable costs presented by witness Patelunas,[605] which were based on the changes proposed by witnesses Brehm and Degen. However, segment 3 costs represent slightly more than 68 percent ($71,527/$104,579) of the All Other cost category, and only 11.8 ($71,527/$607,773) percent of total post office box volume-variable costs, in the TYBR.[606]

Should the Commission decide to reject all the changes in costing methodologies proposed by the Postal Service, the effect on OCA's post office box costs would be small because the relative amount of volume-variable clerk and mailhandler costs is small. In addition, adjustments to the post office box workpapers of OCA witness Callow would be small. Changes in clerk and mailhandler costs can be incorporated into Table 13F, "Post Office Box All Other Costs," in OCA-LR-10.

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[604] The other two categories of cost allocated to post office boxes are Space Support and Space Provision. *See* USPS-T-24 at 20.

[605] *See* OCA-LR-10 at 36-38.

[606] *Id.*

VI. METHODOLOGICAL ISSUES

A. Ramsey Pricing And The Efficient Component Pricing Principle.

In Docket No. R94-1,[607] the Commission paid considerable attention to the appropriateness of various pricing strategies such as Ramsey pricing, an issue which OCA witness Sherman first addresses in his direct testimony. He also addresses worksharing discounts and the "efficient components pricing" (ECP) principle of access pricing.

Dr. Sherman describes Ramsey prices and notes the data needed to estimate them. He illustrates welfare measures and presents a summary of Ramsey prices and their effects. His testimony explores Ramsey prices in detail by defining various degrees of Ramsey pricing, depending on the different constraints that may be imposed, and by presenting prices and their effects for the main subclasses of mail and comparing them with Postal Service proposals. He also presents welfare effects of Ramsey prices compared with rates proposed by the Postal Service in Docket R97-1. Some highlights from his testimony are set forth in this section of the brief.

1. Dr. Sherman's Ramsey pricing analysis improves upon the Postal Service analysis.

From a given starting point, the costs and demand functions estimated by the Postal Service can be used to estimate Ramsey prices, and such prices are presented by Postal Service witness Bernstein (USPS-T-31). While using the same long-run elasticities in Ramsey price formulas as witness Bernstein, Dr. Sherman differs in his approach by using long-run elasticities in forecasting volume responses, which affects the contribution that will be raised to cover other costs. Witness Bernstein used short-run elasticities in those volume forecasts. However, which elasticity is best to apply depends on the time period the application will be in effect. Ramsey pricing formulas would appear to be properly based on long-run elasticities, which should yield correct prices for the period over which the prices are to be effective.[608]

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[607] PRC Op. 94-1, Appendix F.

2. Ramsey prices minimize welfare losses.

If postal prices were set equal to marginal (volume variable) costs, the Postal Service would not cover all of its costs. To prevent a deficit, postal prices must exceed average volume variable costs. Indeed, they are supposed to raise enough revenue to cover all costs. But there are losses in economic welfare when prices exceed marginal costs. The advantage of Ramsey prices is that they minimize such welfare losses.

Equation (3) in Dr. Sherman's testimony indicates that large differences between price and marginal cost are to be avoided, if possible, because the welfare loss rises with the square of the price difference. On the other hand, the purpose of the rise in price is to make a contribution to fixed cost, so a greater contribution should justify a greater difference between price and marginal cost. Ramsey prices balance these two considerations, making the marginal welfare loss per unit of marginal contribution equal across all services.

3. The Commission should consider that departures from Ramsey prices have important welfare loss consequences.

Departures from Ramsey prices have important consequences for welfare losses. Dr. Sherman presents various summaries of how such departures affect the consumer.

The Ramsey prices Dr. Sherman presents in Table 1 of his direct testimony take into account the Revenue Forgone Reform Act ("RFRA"), which imposes prices on so-called preferred services, and they comply with incremental cost tests that avoid cross subsidy. Table 1 also reports levels of contribution to other costs that are obtained from each mail class.

Table 2 reports estimated welfare losses for the classes, and relates those losses to their contribution burdens. Whenever a price is raised above marginal cost in order to

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[608] As one should expect, the short-run response to price change tends to be less strong than a long-run response will be. Short-run elasticities will ordinarily be smaller in absolute value (at least not larger) than long-run elasticities, because they allow less time for consumers to adjust to the new prices, so that volume forecasts for price increases based on short-run elasticities will be greater than those based on long-run elasticities. Thus, using the long-run elasticities will tend to forecast smaller volumes than use of short-run elasticities would, and that will make it harder to raise money as contribution to costs other than volume variable costs.

raise money as contribution to support other costs, a welfare loss results. At the higher price there is a loss in consumer surplus that equals the product of the price-minus-marginal-cost difference times the volume at that higher price. This product is not counted as a loss because it is offset by an exactly equal contribution to other costs that is raised by the higher price. But, at the higher price, there is a welfare loss that is not offset by contribution. Consumption is reduced by the difference between volume at the marginal-cost price and volume at the higher price. The area below the demand curve and above the marginal cost curve over that lost volume range represents the welfare loss, which would have been consumer surplus but for the price increase. Table 2 shows that the overall welfare loss is greater under the Postal Service's proposed rates than under Ramsey prices by more than $1 billion, as the last entry in the middle (Ramsey Advantage) column of Table 2 shows.

Dr. Sherman then presents Ramsey prices in four phases, to show effects of pricing modifications.[609] Phase 1 represents unadulterated, Ramsey prices that take no other consideration into account, such as the RFRA. They are useful as a reference point. Such prices are shown in column (1) of Table 3.

Phase 2 reflects RFRA requirements, which prescribe markups for six preferred classes of mail. These prices appear in column (2) of Table 3, identified by PFD in the column heading and marked by asterisks where prices are affected.

Phase 3 accounts for the possibility that a Ramsey price may lie below the average incremental cost of a service subclass. Modified Ramsey prices that take into account both the RFRA and certain incremental cost requirements are shown in column (3) of Table 3, denoted IC + PFD in the column heading and marked by asterisks. Dr. Sherman presents such prices because if the price is below average incremental cost for any subclass, eliminating that subclass would benefit other mail service users. The cost saved (total incremental cost) by eliminating the service would exceed the revenue that had been raised, which means that the service was being subsidized by other services. To avoid such cross subsidy, the price of each service should be set to cover the incremental cost of that service. Dr. Sherman observes that the Ramsey prices for

[609] The calculations are described in OCA-LR-5.

Express Mail and Registry are below their average incremental costs, and modified prices are introduced for those services in order to avoid cross subsidy.

Dr. Sherman presents welfare loss estimates in Table 4 that show consequences of modifying Ramsey prices in different degrees. The total welfare loss, in the first row of Table 4, increases every time more constraints force prices farther from their pure Ramsey levels, with the difference in welfare loss between pure and most constrained Ramsey prices amounting to $300 million. Unconstrained Ramsey prices cause a total welfare loss of $1.866 billion, while the most constrained Ramsey prices impose a total welfare loss of $2.166 billion. As shown in the right most column of the first (Total) row of Table 4, the prices proposed by Postal Service (in the right most column of Table 3) impose a welfare loss of $3.159 billion, or about $1 billion more than constrained Ramsey prices.

4. Dr. Sherman's perspectives on worksharing discounts should be considered in future cases.

Dr. Sherman offers perspectives on worksharing discount analysis that should be considered in future cases. He observes that worksharing discounts compare to "access" charges that allow one supplier of a service to use the resources of another supplier (e.g., one railroad uses another railroad's tracks). The "efficient component pricing" (ECP) principle of access pricing calls for the resource owner to be compensated for its own cost, including opportunity cost (such as lost profits), when granting access to others, thus motivating the resource owner to allow access and inviting low cost suppliers to participate in supplying the service. However, ECP assumes that volume shifts will be made abruptly. But when cross elasticities are not infinite at the crucial access price, then the cross elasticities should be taken into account in setting optimal prices. A ready-made means of doing so exists in Ramsey prices. The Postal Service had examined this possibility by treating worksharing as another service, applying Ramsey principles in choosing prices to maximize welfare.

Several problems complicate the estimation of Ramsey prices using information presently available. The wide range of mail pieces in the two mail streams complicates cost estimation for single-piece and worksharing letters. Another problem arises in the

use of demand elasticity and cross elasticity information for the calculation of Ramsey prices.

Dr. Sherman concludes that other formulations may be important to examine. One could focus on the single-piece letter price as determinant of the total volume of letter mail. The discount from that price for worksharing would invite some fraction of that letter mail volume to become worksharing letters. The relevant discount elasticity would then be a supply elasticity, a willingness of mailers to provide worksharing effort in response to changes in the discount. With this formulation, there would be no need for a single-piece letter discount elasticity. Nor would there be any role for an own-price elasticity of demand for worksharing letters. The volume of letters would depend on the price of letters and other factors, including the prices of other services that had nonzero cross elasticities with letters, but not on the level of the discount. By focusing on the demand for letter mail, together with the supply of worksharing, the problem can be formulated more simply and solved more effectively.

B. OCA Witness O'Bannon Establishes That The Postal Service's Method of Distributing Volume To Individual Rate Cells of Parcel Post Violates Basic Tenets of Economic Theory And Generates Unrealistic Revenue Estimates.

OCA witness John O'Bannon, in OCA-T-200, proves that the Postal Service's method of distributing volume to the rate cells of parcel post implies positive own-price elasticities and is, therefore, economically untenable. Through two demonstrations—one using Marshallian demand analysis, the other using Hicksian compensated demand analysis—witness O'Bannon establishes that, [610]

> Under typical assumptions (many of which the Postal Service itself invokes) positive implicit own-price elasticities are a theoretical and empirical impossibility.

Using data for the DBMC rate category presented in witness Mayes' workpaper H197, i.e., TYBR volume, TYAR volume, R94-1 rates and phase four final rates (WP I.N.,

[610] Tr. 25/13475 (OCA-T-200 at 2).

pages 5-6), witness O'Bannon computes a theoretically implausible positive own-price elasticity for this category.

The source of this unreasonable outcome is the Postal Service's longstanding practice of applying "the fixed distribution of volume to weights and zones to the new estimate of total volume."[611] Witness Mayes explains this process in the following way:[612]

> I do not have separate elasticities or forecasting models for individual weight and zone combinations. Thus, I cannot say what the volume response associated with any particular rate cell will be. Nor do I have market research that would allow me to map particular mailers to particular rate cells and forecast their individual responses to rate changes. . . . In Docket No. MC97-2, I responded to a series of interrogatories posed by the OCA which related to this topic, I repeat my response to OCA/USPS-T13-18b.-e:
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> "It is beyond the realm of possibility and plausibility to consider independently calculating, establishing and defending a unique elasticity estimate for every rate element in every subclass of mail. In the absence of additional information such as market research, the generally accepted means of estimating the volumes for revenue estimation and rate design has been to apply the fixed distribution of volume to weights and zones to the new estimate of total volume. The before- and after-rates volume forecasts for Parcel Post were performed at an aggregate level for Inter-BMC separately, and for DBMC and Intra-BMC together. The volume figures appearing in each cell for revenue estimation purposes are not volume forecasts, per se, for each cell. They simply represent the distributions of the aggregate forecasted volumes according to the base year distribution."

Witness Mayes' view is an unfortunate example of the maxim: "the perfect can be the enemy of the good;" i.e., because the Postal Service lacks "perfect" data on own-price and cross-price elasticities for all relevant rate cells, it refuses to take any action at all, preferring to perpetuate irrational volume and revenue results.

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[611] Witness Mayes' response to interrogatory UPS/USPS-T37-31 (Tr. 8/4110).

[612] Tr. 8/4055-56 (response to FGFSA/USPS-T37-13c.).

The Postal Service appears to believe that a complete defense to the charge that its volume distribution method violates fundamental economic theory is that witness Tolley forecasts a small increase in DBMC volumes despite a small overall increase in DBMC rates, and he passes along this total volume result to witness Mayes for distribution.[613] The 1-million-piece increase in DBMC volume is apparently due to a significant cross-price elasticity effect between Priority Mail and DBMC mail.[614] However, witness O'Bannon very carefully points out that this fact is irrelevant to the issue raised in his testimony:[615]

> This statement is true, but it does not address the same issue I addressed in my testimony. I was asserting that Witness Mayes distributed the total volume in such a way that resulted in positive implicit own price elasticities being computed for some cells. Her use of the pre-rate change proportions does not take into account the effects of relative changes in rates between the cells in any one category. In effect, she ignores the cross-price elasticities among the cells in a given category.
>
> . . . .
>
> I did not take into account cross-price effects of Priority Mail rates with regard to Parcel Post volumes in my theoretical analysis. The first portion of my testimony is purely theoretical. When constructing most economic theories one must operate under the ceteris paribus assumption. Thus, the prices of all other classes and categories of mail, other than the one under examination, remain unchanged. However, as mentioned above this was not the emphasis of my testimony. The more important issue is how the total volume is treated at the level of the individual category of Parcel Post.

During oral cross-examination, witness O'Bannon outlined a procedure which, while not perfect, is far more reasonable than the one employed by witness Mayes. Dr.

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[613] *See* the Postal Service's interrogatory USPS/OCA-T200-1 to witness O'Bannon (Tr. 25/13511).

[614] *See* the Postal Service's interrogatory USPS/OCA-T200-8 to witness O'Bannon (Tr. 25/13522).

[615] *Id.* at 13512 (witness O'Bannon's response to subparts h. and k. of interrogatory USPS/OCA-T200-1).

Tolley forecasts a DBMC volume increase of 1 million pieces. Witness O'Bannon explains that it makes considerably more sense to allot most (or at least a disproportionately large share) of this increase to the 2 DBMC cells that experience a reduction in price, rather than to distribute the entire number of pieces, insensibly, according to a rigid historic scale. [616]

The point made by witness O'Bannon can be summed up by a statement he made near the end of his oral cross-examination:[617]

> [P]reviously I've stated [witness Mayes] should have put more of the volume increase into the cells in which the rates declined, but she could have still had some volume increase in the cells in which the rates increased. She just needed to examine the relative rate changes or the cross-price elasticities between the cells. She did not take that into account.

In other words, the Postal Service approach to forecasting volume shares for individual cells of parcel post would be greatly improved if a little bit of judgment and a larger measure of common sense were used to reflect the widely varying magnitudes of price increase (or decrease) in the volume responses to the discrete price changes.

The Commission should give serious consideration to allocating after rates volumes to rate elements in a way that takes account of relative changes in price among rate elements. The Postal Service's current methodology (and not just in parcel post) produces revenue estimates that have no basis in reality or common sense. One possible alternative would be to apply the overall subclass elasticity at the rate element level. Another alternative would be to change positive implicit rate element elasticities to zero. Neither of these alternatives is theoretically pure or perfect, but both are more realistic than the Service's current approach to revenue estimation.

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616 *Id.* at 13534.

617 *Id.* at 13542.

C. The Costs Reported For Special Handling Suffer From Defects Similar To Those Which Affect Library Rate Mail And Are So Severe As To Render Them Unusable For Ratemaking Purposes.

The Postal Service, through its witness Needham, proposes a 220 percent increase in the fees for Special Handling. According to witness Needham, this is appropriate, fair and equitable because an increase of this magnitude is needed to cover the purported costs of Special Handling, which, she says, have *more than tripled* since the last rate case in 1994. Her direct testimony provides no clue as to the reasons for this precipitous cost increase.

The American Beekeeping Federation first learned of the proposal for Special Handling in mid-January when Ms. Needham gave a public address to the Queen and Package Bee Breeders meeting in conjunction with a Federation convention in Colorado Springs. There, she gave a talk which presented various data about Special Handling, including declining revenues and volumes but massively increasing costs.

In its brief, filed February 16 along with a Motion for Intervention and Affidavit, the Federation said "It strains credulity that, as Needham states . . . Special Handling volume declined 72% from 1995 to 1996 yet Total Special Handling Costs . . . are increasing. When questioned about that issue in Colorado Springs Ms. Needham stated that the cost numbers were so suspicious that the Postal Service was planning a special study of Special Handling Costs."[618] It continues that "[d]espite these doubts and obvious inconsistencies, the Postal Service predicates an exorbitant rate increase on suspicious cost figures. At best the Postal Service's proposed Special Handling rate increase is premature. The Postal Rate Commission should forestall any action on Special Handling rates until the Postal Service completes the planned Special Handling cost study."[619] The Supreme Court of the United States agrees. In an appeal by The National Association of Greeting Card Publishers, the Court stated: "(W)hen causal analysis is limited by insufficient data, the statute envisions that the Rate Commission will 'press for

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[618] The American Beekeeping Federation, Inc. Brief in Opposition to the Special Handling Rate Increase at 2.

[619] *Id.*

better data' rather than 'construct an attribution' based on unsupported inferences of causation."[620]

The Presiding Officer also found the Postal Service's data regarding Special Handling perplexing. In Presiding Officer's Information Requests 8 and 12 (POIR), he posed a series of questions relating to the data, its sources and derivation. These POIRs seek a rational explanation for irrational Special Handling costs and revenues. In answer to these questions, some new information emerged.

Because Special Handling has such little volume, there are few IOCS tallies. The sample is thin, as in the case of Library Rate Mail. In 1996, there were only 9 tallies and in 1990 there were only 3.[621] Also, witness Alexandrovich stated in response to POIR 8, Item 7: ". . . It should be noted that fluctuations [in costs] are common in categories with very few tallies." This alone should be a flag for caution in using any cost figures produced from the IOCS.

Witness Degen provided the estimated coefficients of variation, and the lower and upper 95 percent confidence limits for Special Handling, using both the "Old Methodology" and his "New Methodology." His Table shows that the costs of Special Handling under the "Old Methodology," at the 95 percent confidence level, could vary between $ -3,000 and $486,000, and under the "New Methodology" could vary between $ -7,000 and $370,000.[622] These variances are very large and very speculative, so much so as to even include *ZERO*. Clearly, these costs are not sufficient for ratemaking—especially when they produce rate increases of the magnitude proposed here.

As stated by the Ohio Poultry Association,[623] The American Beekeeping Federation, Inc. and admitted by the Postal Service,[624] those customers now using

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[620] *National Ass'n of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 827 (1983).

[621] POIR 8, question 6.a.

[622] POIR 8, question 10.

[623] Statement by Intervenor Pursuant to Rule 92, also representing the poultry industries of Nebraska, Iowa, and Texas on this issue.

special handling have few, if any, alternatives for transporting live animals. The Postal Service has a monopoly in this area as no other service ships live animals.

Given the flawed and unreliable data, the Postal Service's proposed fee increase for Special Handling is unconscionable. The Commission should reject this intolerable proposal and keep the fees as they are now.

D. The Postal Service Fails To Meet Its Burden Of Proof With Regard To Its Proposal To Impose A Surcharge On Hazardous Medical Materials ("HMM").

As the proponent of change, the Postal Service has the burden of proof regarding its HMM surcharge. It has failed to meet that burden.

Lab*One* witness Crowley factually rebuts all of USPS witness Currie's assertions promoting the institution of a surcharge for HMM. He methodically lays out the reasons why this surcharge proposal must fail.

- In economic terms, a surcharge may be applicable as a short term adjustment to revenues, to address special situations where unusual costs are incurred, or to recognize other market conditions. The proposed HMM surcharge does not meet the criteria needed from an economic perspective.[625]

- In past dockets, the Commission has based surcharges on quantified costs.[626] However, when asked to identify and quantify the attributable costs associated with the proposed surcharges, to "recognize the special costs of handling these material, [and] improve alignment of prices with costs,"[627] Postal Service witness Currie responds that "the Postal Service has not been able to quantify the costs associated with these two types of hazardous materials."[628]

- To apply a surcharge, costs and volumes need to be known or realistically estimated. Witness Currie states that "the Postal Service has no precise estimate of the volume of such materials it currently handles."[629] And, in

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[624] POIR 8, Item 3.

[625] Tr. 30/16294.

[626] PRC Op. R87-1, at 450-451; PRC Op. R84-1, Op., at 330-331.

[627] USPS-T-42, at 1.

[628] Docket No. MC97-2, OCA/USPS-T1-1.

regard to added handling costs for these materials, he says: "Although the Postal Service has not been able to quantify these costs, it is my judgment that they are of the same order of magnitude as the proposed surcharge."[630]

- In his direct testimony, witness Currie admits that greater handling costs are not associated with all medical mailings, specifically those of Lab*One*, et al.[631]

- The costs witness Currie claims are related to training and handling HMM are not quantified.[632] In his testimony, he admits that training costs are "generally not 'attributed' to individual mail subclasses and special services, but rather are accounted for as institutional costs."[633] Yet, without further explanation, witness Currie proposes to attribute these costs via a surcharge.

- The amount of revenue witness Curries estimates will be generated by the surcharge ($5 million per year) is far too small to have an impact on First-Class mail rates, but will have a large impact on the medical labs.[634]

- Witness Crowley reviews both the classification and rate criteria specified by the PRA. He evaluates each and demonstrates how witness Currie is in error.[635]

- Witness Crowley asserts that the Postal Service's claim that a surcharge will facilitate data collection on hazardous materials is unsubstantiated and that better communication with the industry would be a more fruitful route.[636] He also notes that "[w]itness Currie has not studied whether or not these surcharges are justified, and that is the basis for my criticism. He has presented no evidence to support his proposed surcharge."[637]

The industry witnesses demonstrate the Postal Service's lack of clear thought and erroneous assumptions regarding the HMM surcharge proposal.

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[629] USPS-T-42, at 17.

[630] *Id.* at 15.

[631] *Id.* at 9.

[632] Tr. 30/16294.

[633] USPS-T42, at 11.

[634] Tr. 30/16291.

[635] Tr. 30/16304-307.

[636] Tr. 30/16308.

[637] Tr. 30/16320.

- Witness Bourk persuasively testified that his lab's packages are delivered via First-Class business reply mail (BRM). Normally, this would require each piece to be weighed and rated. However, this became too cumbersome a procedure for the Postal Service due to large volumes. The Postal Service now takes a monthly sample of pieces and from it calculates a pound rate (currently $8.75) which includes both the postage and the BRM fee. Thus, payment is assessed on bulk weight, not on a piece basis. The proposed surcharge, however, would be levied on a per piece basis.[638] The cost-effective bulk method would have to be changed back to the old time-consuming method or at great cost to both the Service and the customer.

- Witness Bourk convincingly argues that there are several aspects of witness Currie's testimony that are misconstrued or incorrect. He believes witness Currie has relied on stale or old information to support his contention that USPS personnel are in a situation of constant danger as a result of leaking packaging. This, he states, is incorrect: ". . . there is no evidence of leakage in today's environment. Our local Post Office maintains a leaker log to track leaking packages in our local processing center, and I have no knowledge that our local representatives have contacted us regarding leaking packages caused by inadequate packaging."[639] Witness Rastok testifies to similar experience.[640] Witness Rastok also testifies that "[i]n the risk-assessment business the specimens are not known to be infectious, and in 99.99 percent of the cases, there is no possibility" that they are.[641] So witness Currie's concentration on hazardous waste cleanup is misplaced at best.

- Contrary to the assertions of witness Currie, the industry witnesses adamantly state that *no* other carrier charges them a surcharge for these medical samples. [642]

- Witness Currie makes an assumption that the cost of the majority of clinical/diagnostic specimens average $2-$3.00 in postage and states that the level of the surcharge has been set with these typical prices in mind. The industry witnesses show that this assumption is grossly in error with regard to these types of packages.[643]

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[638] Tr. 30/16340.

[639] Tr. 30/16340-41.

[640] Tr. 30/16365.

[641] Tr. 30/16371.

[642] Tr. 30/16303, 16341, 16366.

[643] Tr. 30/16291, 16342, 16381.

In evaluating the need for the surcharge and the evidence supporting it, the Commission should consider that the Postal Service advanced its plan without consulting the industry. On questioning by the Presiding Officer, witness Bourk testified that although his company is the second largest insurance testing lab in the country, he only found out about the proposed HMM surcharge in late January of 1998.

> CHAIRMAN GLEIMAN: So the Postal Service didn't come visit you in 1997 before they filed a case that was subsequently withdrawn, the parcel reclass case that had surcharges in it?
>
> THE WITNESS: No.
>
> CHAIRMAN GLEIMAN: And you're the second biggest business in the industry pretty much?
>
> THE WITNESS: Yes.
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> CHAIRMAN GLEIMAN: And they never talked with you about what the situation was and that they were going to file this case?
>
> THE WITNESS: No, sir.[644]

The Postal Service, including the Postmaster General, has spoken at length about its partnership with its customers, customer outreach and service, and customer satisfaction. (*See*, e.g., the 1997 Comprehensive Statement on Postal Operations and the 1997 Annual Report, *Taking care of business, EveryOne, EveryWhere, EveryDay.*) However, if the Postal Service truly desires gruntled customers, it must do more than pay lip service to the idea and improve communications. The lack of consultation with the industry here is likely the cause for the proposal's shortcomings.

OCA agrees with Lab*One*, et al. that there are serious shortcomings to the HMM surcharge proposal. These shortcomings are so numerous that this proposal should not be recommended for implementation by this Commission. The Postal Service's burden of showing that the preponderance of evidence supports its proposal has not been met.

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[644] Tr. 30/16358.

VII. VOLUME VARIABILITY

A. The Postal Service Has Not Met Its Burden Of Proof To Demonstrate The Appropriateness, Usefulness And Applicability Of Its Volume Variable Cost Methodology For Mail Processing In Favor Of The Commission's Previously Approved "100 Percent" Volume Variability Methodology For Mail Processing.

The Postal Service has introduced a new method for calculating the volume variability of various components of mail processing costs. The Postal Service offered this model in response to concerns expressed by the Commission in the previous rate proceeding that the complex effects of automation had not been analyzed and that the IOCS system may no longer be well-suited for the operating system.[645] Witness Bradley has attempted to produce econometric estimates of the variability of mail processing labor costs at the activity level.[646] He computed cost elasticities for twenty five mail processing activities, and by proxy applied his conclusions to additional activities.

Traditionally the Postal Service has assumed 100 percent volume variability for mail processing costs; witness Bradley's computations produced variabilities ranging from 15 percent to 100 percent, depending on activity.

Direct testimony in support of witness Bradley's volume-variability study was offered by Dow Jones & Company, Inc. witness Shew,[647] Time Warner Inc. witness Stralberg,[648] and Magazine Publishers of America witness Cohen.[649]

Evidence opposed to witness Bradley's testimony was filed with OCA's case-in-chief as direct testimony and exhibits by Dr. J. Edward Smith, Jr., an economist with extensive experience in econometric modeling of industrial and regulated utility operations, who discusses the deficiencies of witness Bradley's methodology.[650] Dr. Smith's testimony explained in detail why witness Bradley's methodology is flawed.

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[645] See PRC Op., R94-1 at III-8.

[646] USPS-T-14.

[647] Tr. 28/15501 (DJ-T-1).

[648] Tr. 26/13811 (TW-T-1).

[649] Tr. 26/14022 (MPA-T-2).

The method is not derived from a production function and does not have an adequate analysis of capital/labor tradeoffs, expansion paths, and economies of scale. He testified that witness Bradley does not adequately specify capital, technological change, and time trends in his cost equations. The estimation of the cost equations focused on the use of a fixed effects approach with capital excluded, which produced short run coefficients, but a longer run approach is needed. Dr. Smith advocates the use of a pooled approach run on the means of the data. Finally, Dr. Smith indicates that additional analysis of the data scrubbing effort is needed.[651]

Witness Bradley's methodology was also criticized by witness Neels testifying for United Parcel Service.[652] Witness Neels raised many of the same criticisms mentioned by Dr. Smith, raised detailed objections to witness Bradley's data scrubbing methodology, and advocated the use of a cross-sectional econometric approach.

Rebuttal testimony was filed for the Postal Service by witnesses Bradley[653] and Ying[654] and for the Magazine Publishers of America by witness Higgins.[655] Dr. Smith filed rebuttal testimony in response to certain comments of witness Shew.[656]

Witness Bradley's study does not reliably measure cost variability. The numerous problems with witness Bradley's methodology are discussed in the following sections. A large number of changes would be needed before the study could be used, and implementation of the study at this time would be inappropriate. The shortcomings are

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[650] Tr. 28/15818-15861, (OCA-T-600). Dr. Smith sponsored exhibits OCA-T-601 (Tr. 28/15863-9), OCA-T-602 (Tr. 28/15870-77) and OCA-T-603 (Tr. 28/15878-96). He also sponsored library references OCA-LR-8 and OCA-LR-9. Dr. Smith also submitted rebuttal testimony focusing on the direct testimony of Dow Jones & Company witness Shew discussing the characterization of witness Bradley's body of data and cost function. Tr. 33/18075-81.

[651] Tr. 28/15825-39.

[652] Tr. 28/15597-15639 (UPS-T-1). Witness Neels also submitted testimony in response to NOI No. 4, Tr.28/15642-49.

[653] Tr. 33/17875-17913 (USPS-RT-5).

[654] Tr. 33/18137-58.

[655] Tr. 33/17986-18038.

[656] Tr. 33/18075-81.

more than sufficient grounds for the Commission to reject the study and to sustain the Commission's established policy for attributing mail processing costs.

B. The Burden Is On the Postal Service To Justify The Commission's Altering The Method Previously Used By The Commission For Determining Mail Processing Cost Variability.

1. The Postal Service is the proponent of change with regard to proposed new rates for existing classifications.

In ratemaking proceedings of the type exemplified by this docket, the Postal Service, seeking adjustments to the rate structure, is the proponent of change.[657] The Administrative Procedure Act states that "[e]xcept as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof."[658] "Burden of proof" in this context refers to the burden of going forward with the evidence.[659] The general evidentiary rule is that "the party who has the burden of pleading a fact will have the burdens of producing evidence and of persuading the jury of its existence as well."[660] The McCormick treatise on evidence notes that the "burdens of pleading and proof with regard to most facts have been and should be assigned to the plaintiff who generally seeks to change the present state of affairs...."[661]

The Postal Service implied in cross-examination of Dr. Smith that even if there should be concerns about the study, the appropriate approach for the Commission is to determine which of the two methods, 100 percent volume variability or witness Bradley's results, is the better methodology.[662] The Postal Service indicated the previous

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[657] 39 U.S.C. §3622(a).

[658] 5 U.S.C. §556(d).

[659] Edles and Nelson, *Federal Regulatory Process: Agency Practices and Procedures* (1994), at 151-52. The burden of going forward is to be distinguished from the burden of persuasion (e.g., by a preponderance of the evidence). *Id.* at 152. *See also* Stein, Mitchell and Mezines, *Administrative Law*, §24.02 (1996).

[660] *McCormick on Evidence* (4th ed. 1992), at 427 (citations omitted).

[661] *Id.* at 428.

[662] Tr. 28/15944.

methodology used by the Commission was untested and used mainly as a matter of convenience in the absence of any other tested method and that “common sense” suggests that “100 percent” volume variability is not correct. The Postal Service misreads the law. It is clear that to overturn an agency practice the proponent bears the burden of persuasion that the present policy is not as favorable as the one offered. The underlying reasoning for the present policy is not at issue. The newly offered policy must stand on its own. The 100 percent mail processing cost volume variability policy has been approved several times by the Commission.[663] Those who would overturn that policy bear the burden to justify the rejection of a previously accepted policy.

It is the Postal Service's burden to demonstrate that its volume variability method attributes mail processing costs to the appropriate classes. The prerequisite is that the costs it attributes to a given class be reliably identifiable with that class. If the costs attributed are not first reliably identified with a particular class under the methodology applied, then the method the Postal Service would have the Commission adopt does not meet the requirements of the Act. The Supreme Court has set the standard on the cost attribution issue:

> The Act does not dictate or exclude the use of any method of attributing costs, but requires that all costs *reliably identifiable* with a given class, by whatever method, be attributed to that class. (Emphasis supplied.)[664]

The test for determining whether attributed costs are reliably identified with a particular class is whether those costs are "demonstrably related" to the class of service in question.[665] The Supreme Court has looked favorably on this Commission's holdings that the Act requires "a sufficient causal nexus" before costs may be attributed.[666] Legislative history supports the view that:

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[663] *See* for example, PRC Op. Docket No. R94-1, R90-1, R97-1 and R84-1.

[664] *National Association of Greeting Card Publishers v. U. S. Postal Service*, 462 U.S. 810, 820 (1983).

[665] *Id.* at 824.

[666] *Id.* at 826. Other similar standards applied by the Commission and noted favorably by the Supreme Court are "reliable principle of causality," "reasonable confidence," and "reasonable analysis of cost causation."

> when causal analysis is limited by insufficient data, the…Commission will "press for…better data," rather than "construct an 'attribution'" based on unsupported inferences of causation. PRC Op. R74-1, pp. 110-111.[667]

It is OCA's contention that witness Bradley's method does not reliably identify costs for attribution and that lacking a demonstrably causal connection as a result of insufficient data, the Commission must press for better data and reject the analysis.

C. The Data Used By Witness Bradley Is Insufficient And Not Properly Scrubbed.

1. The data were obtained for activities from MODS and PIRS sources.

Witness Bradley used Total Piece Handlings (TPH) as the driver of costs. He measured cost by labor hours. The Postal Service has two accounting systems which track data. In the cases of sites which report data to the Postal Service through the Management Operating Data System (MODS), the sites are known as "MODS offices." Sites not reporting through the MODS system are denoted as "non-MODS offices." Data are unavailable for non-MODS offices, which account for approximately 25 percent of labor used in processing mail.[668] The Bulk Mail Centers (BMCs) report data through the Productivity Information Reporting System (PIRS). Two activities—registry activity and the remote encoding activity—were handled by witness Bradley as special cases.

Both the MODS and PIRS systems collect data at the factory floor level, with data being available on an Accounting Period (A/P) basis; there are 13 accounting periods in a year. Accordingly, at the activity level, hours and TPH data are, in general, available at each mail processing facility for which the activity is utilized. For MODS sites, up to 117 observations are potentially available over a time period of 9 fiscal years, depending on the utilization of the activity. As delineated in Library Reference H-148-1, the total number of potential observations is 30,828.[669] Witness Bradley determined that a

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[667] *Id.* at 827, 833 note 29.

[668] Tr. 12.6354 (OCA/USPS-T12-64.)

[669] Library Reference H-148, witness Bradley USPS-T-14, Electronic Data Input.

variety of data scrubs would be appropriate to eliminate possibly inaccurate data. After various types of data scrubs the number of observations remaining for MODS facilities for each activity is generally in the 20,000 range with the exceptions of Mechanized Parcel, SPBS Non-priority, and SPBS Priority. Witness Bradley used a variety of data scrubs to eliminate what he viewed as possibly inaccurate data.

2. The choice of two variables "hours" and TPH for modeling the projected cost relationships is inappropriate; the data are not homogenous.

The homogeneity of labor hours (i.e., hours being comparable between sites and over time) and TPH (similar comparability) are key assumptions for witness Bradley's study. Without homogeneity, the use of a cost equation based on hours rather than dollars is meaningless. Witness Neels testified that both hours and TPH were the wrong variables for the measurement of cost elasticity.[670]

Witness Bradley indicated that witness Neels is incorrect in his concern that labor hours in an activity are not comparable through time, asserting that witness Neels does not understand Postal service staffing.[671] Witness Bradley stated that supervisory personnel and skilled craftsmen are not assigned to work in basic mail processing, concluding that the type of labor used within a given mail processing activity is homogeneous through time. Witness Bradley testifies:

> Over time, supervisors don't start running OCRs and mail handlers do not start sorting mail. Hours within an activity are comparable through time.[672]

However, it became clear during cross-examination that witness Bradley did not fully account for Postal Service labor practices. For example, witness Bradley indicated that he had not even considered whether variations in mail volume cause variations in the mix of labor among full-time, part-time, and casuals at any point in a given activity.[673]

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[670] Tr. 28/15594-15600.

[671] Tr. 33/17884.

[672] Tr. 33/17884-85.

[673] Tr. 33/17935.

Accordingly, witness Bradley has not established that there is a homogeneity of labor hours.

It is reasonable to expect that variations in the mix of workers would have a very significant impact on the productivity of an activity, impacting the assumption of homogeneity of labor hours as used in the study. Witness Bradley quoted Professor Adam Smith extensively in his direct testimony for the proposition that increased specialization of tasks increases productivity and that an increase in the size of an activity will allow for more coordination economies among the various tasks.[674] However, such specialization cannot occur if there is a changing mix of labor as volume varies.

Similarly, the use of the TPH variable is highly questionable, yet homogeneity of that variable is also crucial to the validity of the study. Witness Bradley mentions that there are volumes of mail that bypass mail processing.[675] However, it is clear that at least in some minimal way the mail is on postal premises; accordingly, we are left wondering where the hours are accrued, for apparently all of the labor is accounted for in one of the activities. Witness Neels explains at great length that total piece handlings are not a suitable proxy for volume[676].

3. The data bases on which the study is based are known to be inaccurate.

The U.S. Postal Inspection Service found large variances between the piece handling figures contained in the MODS system and actual piece counts. These variances were attributed to a variety of different causes, including inadequate conversion factors, improper data input, and out-of-tolerance scales.[677] The inaccuracies of the data were confirmed by witness Neels, who indicated that an examination of the actual data in witness Bradley's data sets reveals many problems.

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[674] USPS-T-14 at 56.

[675] Tr. 33/17999.

[676] Tr. 28/15598.

[677] Tr. 28/15601.

There are hundreds of instances in which a site reports piece handlings for a specific activity for only a single period out of the nine years covered by the data set. As witness Neels indicated, it is difficult to imagine actual operational practices that would bring an activity into an operational mode for a single accounting period. Witness Neels indicated alternative explanations--such as data entry errors in recording piece handlings under the wrong activity or with the wrong identifier.[678] As witness Neels indicated, it may also be common for the data simply not to make their way into the MODS system.[679] Witness Neels cited a total of 1,821 gaps in the data--many of which would appear to be associated with inaccurate reporting. Tables 2 and 3 of his testimony highlight the problem.[680]

Recognizing the inadequacy of the databases with which he was working, witness Bradley attempted an extensive data scrubbing procedure.

4. The data scrubbing procedures used by witness Bradley were inadequate and may have eliminated large quantities of good data, whose inclusion might have significantly changed the study conclusions.

Witness Bradley engaged in a variety of data scrubbing procedures. The testimony of witnesses Neels and Smith show that witness Bradley's data scrubbing procedures were incorrect, and that witness Bradley has excluded large amounts of data which should have been considered in the analysis. Apparently, the Postal Service is aware of these problems. According to USPS witness Ying, Dr. Smith has a few good comments about the data.[681] Dr. Smith's comments uniformly criticized the data. The study has an inadequate database and is, accordingly, unsuitable for implementation.

First, witness Bradley indicated that with tens of thousands of data points, he just did not look at every one in performing a data scrub. Instead, he chose the standard of 1 percent tails.[682] The problem is that witness Bradley's rule of thumb is exactly that: an

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[678] Tr. 28/15602-3.

[679] Tr. 28/15603.

[680] Tr. 28/15604.

[681] Tr. 33/18140.

arbitrary rule of thumb. As witness Neels indicates, witness Bradley cites no external evidence that could be used to provide independent verification of the accuracy or inaccuracy of any of his data.[683] It is very possible that such "unusual" observations contain the most information about the true relationship between cost and volume. A site that has experienced an enormous increase in volume may well be unusual, but it may also provide the clearest possible picture of how processing costs vary with volume.[684] Accordingly, witness Bradley's decision to eliminate observations involving low levels of piece handlings raises questions about the representativeness of the results.[685]

During cross-examination, witness Bradley was asked whether the introduction of investment in automation equipment would tend to eliminate a site from consideration. Witness Bradley indicated that the introduction of new equipment usually goes to larger sites first, and that "those are sites through which we've collected data over a long period of time."[686] Witness Bradley's answer highlights a prime deficiency of his approach. The larger, important sites apparently receive the major investments--which can affect the economies of processing; these economies were discussed by witness Bradley in his direct testimony.[687] Since the sites are large, a substantial amount of data exists for them. However, witness Bradley did not collect or use data from a site during the times that it was "ramping up" as would be the case following a major investment.[688] According to witness Bradley's testimony, a large site could apparently have a long chain of data observations prior to a major investment in equipment, then experience a break in the observations for a number of accounting periods during installation of equipment and "ramping up," and then observations on mail processing with the new equipment would again be collected. However, it is clear that witness Bradley's data scrubbing,

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682 Tr. 33/17972.

683 Tr. 28/15612.

684 Tr. 28/15613.

685 Id.

686 Tr. 33/17916.

687 USPS-T-14 at 56-57.

688 USPS-T-14 at 30.

which eliminates data from a site if there are not 39 consecutive observations, could very well eliminate the post-investment operations at sites which had participated in major investment and automation from the analysis. Only if there were three years of observations subsequent to the installation of the new equipment would the site be included in the analysis, for witness Bradley did not consider sites with less than three years of data. Accordingly, witness Bradley's data scrubbing procedures guarantee that his study is not representative of activities at any major processing site which has had major investments for an activity within the past three years. This is a major deficiency of the study, probably rendering it useless in examining mail processing in view of major pending Postal Service investments in automation.

In addition, Dr. Smith indicated that there needed to be a discussion and statistical justification of the relevant number of observations per site.[689] As previously mentioned, witness Bradley required 39 accounting periods of observations (i.e., three years) for data from a site to be used in the study. Witness Bradley indicated that his judgement that three years of data would be sufficiently long to model the behavior at the facility. He admitted that he did not use any specific statistical technique in determining the length of time period for data to be considered.[690]

In contrast, witness Neels indicates that much more data could have been collected and used—a key point in view of the major investments in automation equipment. Witness Neels indicated that in order for a data point to be included in the estimation of witness Bradley's fixed effects model it is necessary only that complete data be available for two consecutive accounting periods. In order for a data point to be included in the estimation of the fixed effects model with serial correlation, it is necessary only that complete data be available for three consecutive accounting periods.[691] None of Witness Bradley's programs or calculations inherently required data for 39 consecutive accounting periods. In addition, witness Neels indicated that the estimation of accurate seasonal effects requires simply that the data set contain adequate numbers

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[689] Tr. 28/15853.

[690] Tr. 33/17916-17917.

[691] Tr. 28/15616.

of usable observations in each of the different seasonal periods. It is not necessary that they occur consecutively. In fact, witness Bradley himself indicated that it was 26 consecutive observation may be sufficient.[692] Accordingly, witness Bradley provides no statistical analysis of the number of periods that a data set should be, but witness Neels makes a compelling case for 3, not 39.

Furthermore, witness Neels indicated that he reran witness Bradley's equations using all available data and that he obtained conclusions significantly different from those of witness Bradley.[693] As indicated by witness Neels, witness Bradley's decision to discard huge volumes of data has had a substantial effect on his results.[694]

Based on the testimony it is clear that there are significant data problems. Data problems occur in much empirical work, and Dr. Smith, who during his career as an economist has managed major market research operations faced with data problems, indicated that the correct approach to data verification is follow-up via telephone or on-site inspection. As Dr. Smith has indicated, when one finds an outlier variable or a variable called into question in data scrubbing, it is necessary to actually contact the respondents to verify the accuracy of the data. Dr. Smith indicated that the examination of questionable data via contact with the personnel from whom one is attempting to obtain answers is routine.[695] Furthermore, where the respondents are not available, it is customary to attempt to examine the records associated with the data to determine accuracy.[696]

5. The attenuation problem.

As witness Neels indicated, econometric studies are especially sensitive to data errors. It is a well established econometric principle that measurement error in an

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[692] Tr. 11/5450, UPS/USPS-T14-12.

[693] Tr. 28/15616-15617.

[694] Tr. 28/15618.

[695] Tr. 33/18091-2.

[696] Tr. 33/18095.

independent variable causes downward bias in coefficient estimates. Witness Neels raises this as another problem with witness Bradley's study.[697]

6. Conclusions on data.

Based on the testimony it is clear that there are significant data problems at the very foundation of witness Bradley's study. Witness Bradley's data suffer from inaccurate data collection procedures, inadequate data scrubbing and an inappropriate selection of the dependent and independent variables.

D. The Postal Service Methodology Is Not Based Upon A Proper Economic Framework.

Having completed his data analysis, witness Bradley attempted to model the mail processing activities. Witness Bradley hypothesized a translog cost equation with a variety of variables: TPH, Hours, a segmented time trend, a manual ratio (which is the ratio of manual letter TPH to the sum of all manual letter TPH, mechanized letter TPH, and automated letter TPH), and a variety of variable cross-products. Dr. Smith contends that witness Bradley should have included a measure of capital in estimating the translog cost equation. Dr. Smith also stated a preference for the use of a production function and cost function approach which would have eliminated a number of economically meaningless variables in witness Bradley's specification.

Witness Bradley estimated the translog cost equation using a fixed effects approach. He considered alternative estimating procedures for the cost equation: a pooled model, a fixed effects model, and a random effects model. Dr. Smith explained how the use of a pooled or cross-sectional model would more accurately capture the longer-run nature of the data. The pooled model might not have failed the Gauss Newton test if capital had been one of the variables. Also, assuming that a cost function were used, many of the variables in witness Bradley's equation would be meaningless.

[697] Tr. 28/15604-15608.

1. The cost equation is incomplete, as it ignores capital investment which is a key factor in determining costs.

Witness Bradley specifies his econometric model of mail processing cost using a translog cost equation.[698] In his direct testimony Dr. Smith raised his concerns over the exclusion of capital from the analysis.[699] Dr. Smith advocated the examination of the interaction of capital with labor in determining costs.[700] The analysis of capital is a key issue in view of the Postal Service's major capital investment program.[701] Dr. Smith advocated the consideration of a production function in order to model capital explicitly.[702]

Dr. Smith indicated concern over the limited explanatory power of Witness Bradley's equations:

> Although TPH is correlated in the accounting system to hours worked, it is not shown to be the only or even the major driver of costs. Other cost drivers such as the types and age of equipment, arrangement of the production process, product demand, and types of processing activities could have a causal impact on the hours/TPH relationship. Significant issues not considered in the cost equation include: (1) the explicit treatment of the achievement of economic cost minimization; (2) the analysis of tradeoffs between capital and labor; (3) the choice of technologies; (4) scale economies as related to the production process; (5) the interplay of capital choices (for example, production relationships between activities); (6) age of equipment; and (7) types of equipment.[703]

Witness Bradley used the Gauss Newton test to determine the impact of site-specific effects. He found that in every case the GNR tests rejected the null hypothesis, indicating that the facility-specific effects are important and that both the pooled and the

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[698] Tr. 28/15827.

[699] Tr. 28/15825.

[700] Tr. 28/15830-3, 15964.

[701] Tr. 28/15830.

[702] Tr. 28/15828.

[703] Tr. 28/15825.

simple cross-sectional models are not appropriate.[704] As has been noted, Dr. Smith indicated that capital has not been included as one of the cost factors.[705] This inappropriate specification of the cost equation may have led to the rejection of the pooled regression approach.[706] In subsequent rebuttal, even witness Bradley responded by presenting an analysis with capital allegedly as one of the variables.[707] However, the key capital variable -- the value of plant and equipment -- was missing from the analysis. None of the capital variables used by witness Bradley actually measured invested capital accurately, although the variables may have use in modeling the plant facilities. For example, age, number of stories, and square feet of space are not necessarily related to the value of the capital equipment actually at a facility, particularly mail processing equipment. Witness Bradley did not establish any correlation or correspondence between the variables he used as alleged measures of capital and the actual value of plant and equipment.

Postal Service capital investment will be an increasingly important means of reducing mail processing costs and improving productivity. Additional funds have recently been allotted for large future capital investments.[708] Considerations of capital deployment are essential in analyzing capital/labor substitutions and choices, and in examining changes in production, changes in factor prices, choice of technology, and changes in technology.[709]

Witness Bradley's specification of the cost equation is inappropriate. In a response to USPS/OCA-T600-6, Dr. Smith confirmed that the appropriate variables to be included in a cost function were output, a vector of input prices, and t, denoting time.[710]

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[704] USPS-T-14 at 42.

[705] Tr. 28/15828.

[706] Tr. 28/15963.

[707] Tr. 33/17909-17913.

[708] The Board of Governors has approved capital expenditures and improvements to achieve increased efficiency, such as plans to invest $17 billion over the next five years for capital improvements. *See* Board of Governors Minutes, Meeting October 7, 1997, at 62-67.

[709] Tr. 28/15826-15827.

In discussing the implications for witness Bradley's model if it were based on a cost function, Dr. Smith indicated:

> [i]n the case of Witness Bradley's model, which is on his testimony at page 36, that would therefore exclude such variables as log of MANR, log of MANR square, plus possibly delta sub 8 and its subsequent variable, delta sub 10 and its subsequent variable, delta sub 11 and its subsequent variable, delta sub 12 and the variable, delta sub 14 and the variable, delta sub 15 and the variable.[711]

Witness Ying has indicated that witness Bradley is not measuring a cost function to describe costs but, rather, is estimating a cost equation:

> As described in the testimony of Dr. John C. Panzar (USPS-T-11), estimation of a Postal Service cost function (or Dr. Bradley's cost equation) only requires the existence of "a reasonably well-defined set of operating procedures which determine the steps taken and resources used to process a given volume of mail." The operating plan need not be optimal nor cost-minimizing, but must be reproducible and relatively stable.[712]

Accordingly, it would appear that witness Ying believes witness Bradley's cost equations for the Postal Service are non-optimal, do not deal with cost minimization (efficiency), but are reproducible.

In fact, even reproducibility, at least in the scope of uniqueness, is subject to question. The Chairman's Exhibit PRC/USPS-XE-2 shows that it is possible to obtain a wide variety of values in comparing witnesses Bradley's and Neels' econometric elasticity results.[713] As indicated by the Chairman:

> In the past the Commission has taken the view that it is desirable for econometric results to be robust and stable. For me this means that minor and plausible changes in econometric models, data set, or estimation methodology do not yield major changes in econometric results.

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[710] Tr. 28/15909-15910.

[711] Tr. 28/15963.

[712] Tr. 33/18142.

[713] Tr. 33/15785.

> Now the question is, in your opinion, are any of the econometric results shown in the table robust and stable?
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> THE WITNESS (NEELS): Not in my opinion. I've actually said to my associates that work with me on econometric studies that a good study should be like shooting elephants. It should be a really big target and easy to hit no matter how you do it. And if differences in methodology give you pretty drastic differences in results, that is always to me a warning sign that we don't fully understand what's going on, and it's really – that's the basis of my unease with this line of analysis, and I think, you know, the information that's presented in this table to me amply demonstrates the fact that, you know, we haven't yet figured out what the relationship is between labor – mail-handing labor costs and volume.[714]

Dr. Smith advocated the use of a production function. Witness Higgins indicates that a production function is in a dual relationship with the cost function. The two functions are alternative ways of obtaining information about production technology.[715] Accordingly, since capital explicitly enters the production function as a quantity, some analysis of tradeoffs would have been possible. By indicating the duality of production and cost functions, witness Higgins implicitly endorses the inclusion/exclusion of variables based on economic theory: for example, the MANR variable has no place in the analysis, for it would not be produced in the derivation of a translog cost function from a translog production function.

In conclusion, assuming that witness Bradley is estimating a cost *equation*, as indicated by witness Ying, then we have noted that for a meaningful measurement, capital and other variables need to be included. Alternatively, if witness Bradley were estimating a cost *function*, he has too many variables, and the wrong ones. In commenting on the need for additional variables in the cost equation, Dr. Smith indicates:

> By not analyzing additional variables across the facilities and over time for their potential interactions with labor usage, witness Bradley's analysis is limited. It fails to explain poten-

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[714] Tr. 28/15786-15787.

[715] Tr. 33/18041.

> tially major causal factors over the period during which the rates will be in effect. Witness Bradley needs to investigate additional variables affecting mail processing labor expense. These variables include the age of the facility, the magnitude of the facility support costs, the size of the facility (square feet of space and/or number of people employed), the space utilization, the number of processing activities, the types of mail processing equipment, the value of the equipment located within a facility, and the quality of work force.[716]

These comments are also substantiated to a significant degree by witness Bradley's own article "Measuring Performance in a Multiproduct firm: An Application to the U.S. Postal Service."[717]

2. Witness Bradley presents a short run analysis, but a longer run analysis is needed.

The economists in this case seem to be in universal agreement that the long run is theoretically defined by the variability of input factors. In view of the Postal Service's ongoing capital investment plans, which are presented on a yearly basis, it would appear that the long run could be defined on an applied basis in terms of a period of time somewhat longer than a one year time frame but occurring within the period of years over which rates will be in effect. To quote witness Higgins:

> In the context of Postal rate-making, the appropriate length of run to consider is not a mystery: it is the period of time during which the proposed rates are expected to be in effect. This point was made quite succinctly by Professor Panzar on this record when he said that rates should be based "on the marginal costs that will actually be incurred… to serve a sustained increase in volume over the time period during which the prices will be in effect."[718] [Footnote Omitted].

As witness Higgins also indicates:

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[716] Tr. 28/15850-51.

[717] Tr. 28/15851.

[718] Tr. 33/18008.

> In economics calendar time is not what determines length of run. Rather, length of run has to do with which inputs are variable and which are fixed.[719]

As witness Neels has indicated:

> In past proceedings the Commission has relied upon evidence of the long-run volume variability cost in its findings regarding the attribution of costs. "Long-run" in this context has been interpreted as changes that occur over periods longer than a year. The eight week adjustment period provided for in Bradley's fixed effects model falls well short of this threshold.[720]

As recognized by witness Bradley, economists generally define the long run in terms of the variability of factors of production.[721] It is useful, however, on a practical basis to consider the long run in terms of a time period. On a short run basis, one would expect to find variabilities significantly less than one. To quote witness Bradley's direct testimony:

> The first reason is the existence of relatively fixed functions within the activity. Certain functions, like setting up mail processing equipment or tying down a manual case are done for each sorting scheme and are not sensitive to the amount of volume sorted. As volume rises, the hours in these functions do not rise much, if at all. Similarly, these hours do not fall when volume falls. The existence of these relatively fixed functions in an activity will cause the activity's variability to be less than one hundred percent. Moreover, the greater the degree of fixed functions in an activity, the lower its variability will be.[722]

It has already been noted that capital is not a variable in the study. As previously mentioned, the fixed effects approach handles capital and facilities in the alpha coefficient, and by assuming away capital effects in the fixed effects alpha coefficient the study becomes a short run study. Variabilities less than 100 percent would be expected

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[719] Tr. 33/18007.

[720] Tr. 28/15626.

[721] Tr. 33/17917.

[722] USPS-T-14, 55-56.

on a short term, monthly basis, and this is exactly what witness Bradley obtains. However, on a longer run basis – the period in which rates are in effect and decisions are made on levels of hours and TPH – one might very well see variabilities of 100 percent.

To highlight this argument, Dr. Smith presented a number of graphs in his testimony. The two major variables of witness Bradley's study are hours and TPH; other variables are of minor importance, for example, a time trend, the AP variables, a variety of cross-products, etc. Accordingly, plots of the two key variables are relevant.

The plots in OCA Exhibit 602[723] are visually compelling in suggesting longer run variabilities approaching 100 percent; the data plotted are based on the study's total data set after scrubbing — stretching over a time frame of 9 years. In contrast, many of the short run plots in OCA Exhibit 603[724] are quite different. These plots are on a facility-by-facility basis and provide three types of conclusions. First, some of the data are in the form of a blob, suggesting no relationship whatsoever between hours and TPH. Second, some of the data agree with the fixed effects conclusion of less than 100 percent variability: this is exactly what one would expect on a facility-by-facility basis, investment held constant. It should be noted that the slopes are different, from facility to facility, as was indicated in responses by witnesses Bradley, Higgins and Neels to Commission Notice of Inquiry No. 4. Witnesses Bradley, Neels, and Higgins are in agreement that the slopes of TPH and hours vary from facility to facility.[725] Nonetheless, witness Bradley chose a model which assumed the equality of steps. Finally, some of the data even on a facility-by-facility basis suggest variabilities in the 100 percent range.

Recognizing the need to address capital issues, witness Bradley presented an elasticity study involving capital in his rebuttal.[726] Under cross-examination, witness

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[723] Tr. 28/15870-77.

[724] Tr. 28/15878-96.

[725] Tr. 28/16070-16093, USPS-ST-55; Tr. 28/15642-15649, UPS-ST-1; Tr. 29/16121-16140, MPA-NOI-1.

[726] Tr. 33/17909.

Bradley indicated that relatively little effort had gone into the study, which may explain some of its limitations:

> The total time to prepare the rebuttal testimony was considerably less than the total time to prepare the direct testimony, yes.[727]

Witness Bradley used the three alleged capital variables discussed earlier. Under cross-examination, witness Bradley admitted that capital data on machines could be collected for the mail processing machines in a facility. Referring to the availability of information on capital equipment at the activity level, however, he indicated that such a data collection effect would be time consuming and dependent on a survey of facilities.[728]

According to witness Bradley, relevant capital data are available only at the facility level.[729] As has been discussed, such data would need to be gathered. It is well known that the Postal Service has an accounting system, and the nature of an accounting system is that records of investment expenditures are maintained. Accordingly, the gathering of accounting data on investments at the activity level should be feasible.

In conclusion, witness Bradley's study is short run because it fails to consider capital, and this failure results in the generation of short term cost variability estimates.[730] The estimates are not relevant to the time period during which the rates will be in effect.

3. The choice of the fixed effects approach in lieu of a pooled or cross-sectional approach was wrong.

Witness Bradley used the fixed effects model with up to nine years worth of accounting period data to estimate his cost equations. Other witnesses in this case have advocated the consideration of different estimating techniques. Witness Neels

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[727] Tr. 33/17920.

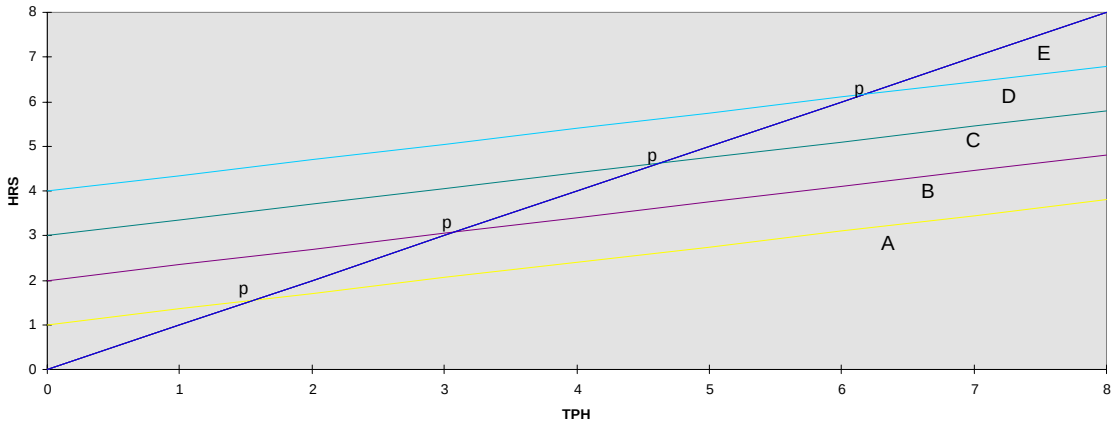
[728] Tr. 33/17919.

[729] Tr. 33/17909.

[730] Tr. 28/15625-15626.

presented a cross-sectional model rerun on witness Bradley's data set but using all of the data.[731] Dr. Smith has advocated the examination of the pooled regression model.[732] His diagram, "Potential Cost Relationships," shows the type of pooled regression line that might be obtained from such a plotting, and the connection of the p data would be equivalent to a cross-sectional analysis.[733]

Diagram 1: Potential Cost Relationships



It is clear that neither Dr. Smith or witness Neels have provided a definitive analysis; the status of the work at this point is of an incomplete nature, because data on such information as capital equipment are missing.

A visual inspection of the actual plotting of the data[734] leads to the conclusion that a pooled regression approach is a better modeling of the data than the fixed effects approach. In specifying the equation, the graph of which is presented on Diagram 1, Dr. Smith advocates a pooled regression on data averages; this is similar to witness Neels' approach. Tr. 28/15845.

Witness Bradley eliminated the pooled regression on the basis of the Gauss Newton test He concluded that the Gauss Newton test showed that important site specific variables were omitted from the equation. The omission of relevant variables

[731] Tr. 28/15592.

[732] Tr. 28/15839.

[733] Tr. 28/15845.

[734] Tr. 28/15841-2 (OCA 602).

from witness Bradley's study resulted in the Gauss Newton results as a foregone conclusion, for the test is simply confirming the omission of variables, for the test is simply confirming the omission of variables. As Dr. Smith has indicated, a number of key variables need to be considered, including capital. In specifying the equation witness Bradley did in fact eliminate an important explanatory variable--capital, and of course the Gauss Newton test showed that, in fact, the variable was missing. Under cross-examination witness Bradley admitted that the capital variable could, in fact, be used:

> More generally, if one would have a variable which was a facility-specific characteristic that was non-volume—let's say age of the facility—one could, if one had that data, enter a variable such as age—as age of the facility as another—let's call i Z variable—and estimate its own coefficient in place of the alpha (I), yes.[735]

Accordingly, based on witness Bradley's comments a capital variable could have been used in the equation. If the variable had been used, the Gauss Newton test could have produced different results. This is an area for additional research.

Having rejected the Gauss Newton approach, witness Bradley went to a fixed effects model, which assumed away capital in an alpha intercept, thereby making the equation a short run equation, as previously discussed.

In contrast, Dr. Smith advocated a longer run analysis. In his testimony, he presents a diagram, "Potential Cost Relationships."[736] The diagram shows the relationship of a pooled model with a fixed effects model. A number of fixed effects regressions, one per site, are presented, relating hours and TPH. Dr. Smith indicates that for each individual site there would be an equilibrium point—the size of operations for which the site is sized. He indicates that for each site and corresponding regression that the equilibrium point can be denoted by a "p." He indicates that the "p" points for each fixed effects regression equation can be connected. He indicates that such a regression would be measured via a pooled regression: it is clear from a theoretical point of view that the equilibrium points for a set of fixed effects regressions can be

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[735] Tr. 11/5549-50.

[736] Tr. 28/15845.

connected among the regressions and can be estimated or approximated by a pooled regression.

There has been concern that the simple plotting of data is inadequate in arriving at conclusions. To quote witness Ying:

> Such plots show little or nothing, and are subject to selective interpretation.[737]

Given the amount of disagreement between witnesses Neels, Bradley, and Higgins in this case about the application and computation of regressions, it would seem that up to this point the regression analysis has been subject to controversy. At the very least, the generation of data plots presents in two dimensions whatever relationships that exist.

One set of plots mentioned in Dr. Smith's testimony in OCA Exhibit 603 and not specifically disputed by witnesses Bradley, Higgins, or Shew are the IDNUM 9999 plots. As indicated in the testimony, IDNUM 9999 is not a specific location but, rather, it is a plotting of a number of points, each of which represents a summation of all of the hours and all of the TPH data for a given location by activities. Accordingly, a point on the IDNUM 9999 plot for a specific activity is representative of the total hours and total TPH at a given site. The plotting of all of the points together is representative of hours as a function of TPH, across sites for a given activity. This could be measured as a pooled regression, suggesting constant return to scale during expansion. The plots are visually compelling, suggesting 100 percent variability. As has been noted, these plots have not been disputed in any of the evidence.[738] Assuming that a specific facility may operate either bellow or above capacity, then total data for a site should be representative of the overall operations at the site.

The plots show cost variability across facilities for different sizes of facilities—i.e., the relationship between hours and TPH for increments of TPH. The plots are based on the summation of actual hours and actual TPH, not regressions. They measure the variability in the longer run the time frame during which rates will be in effect. As one

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[737] Tr. 33/18145.

[738] Tr. 28/15848.

moves from one facility to another, bigger ones having more TPH, one encounters facilities with a larger scale of operation, i.e., more capital. In contrast, the fixed effects model by ignoring capital is a short-run model, exhibiting short-run behavior.[739]

According to witness Neels, the adoption of a cross-sectional approach de-emphasizes the effects of short term increases and decreases in volume, focusing the analysis instead on the long run effects of changes in mail volumes. A cross-sectional approach emphasizes the contrast between facilities that differ systematically in the volume of mail they process and that have had the chance to adjust fully to those systematic differences. "Indeed, one would expect decisions regarding staffing levels, degree of automation, layout of the processing flows, and other significant factors affecting the volume variability of processing costs to be closely related to the volumes typically processed at a facility."[740]

Witness Bradley is also aware of the use of a cross-sectional analysis. As witness Bradley indicated:

> However, another approach which is widely used perhaps even more so for the type of analysis I'm doing is to for a cross section of facilities or in this case contracts collect the information on costs and cubic foot miles and use the variability between the small contracts, that is small cubic foot miles, and the large cubic foot miles to measure how it is costs vary with cubic foot miles.[741]

In his direct testimony Witness Neels indicated that the cross-sectional results are closer to the long run volume variabilities and are less subject to attenuation effects caused by measurement error in the piece handlings variables.[742]

During cross-examination he indicated:

> ...it's generally held that cross-sectional analysis comes closer to giving you long-run effects, because you're comparing different types of facilities with different levels of volume.

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[739] Tr. 28/15848-15849.

[740] Tr. 28/15628.

[741] Tr. 7/3813-14.

[742] Tr. 28/15629.

> I mean, as you know, my cross-examination earlier today indicated there are systematic difference in volume across facilities, and you get a chance to see what the operation looks like as it's adopted to those different levels of volume.[743]

In conclusion, the omission of capital as an explanatory variable, as is customary in cost analysis, the incorrect specification of the equation, the focus on a short-run rather than longer run analysis, and the use of a fixed effects time series rather than cross-sectional econometric approach results in major deficiencies in the study.

E. The Study Does Not Meet Traditional Standards For Acceptability.

1. Witness Bradley's approach fails to meet generally accepted regulatory standards.

Witness Bradley's study fails to meet several of the standards which Professor Bonbright, a renowned commentator on regulatory practices, has stated a regulatory study should meet.[744] Witness Bradley's model fails on at least five of eight evaluation criteria.[745] In the first instance, it fails to meet a group of certain "practical" attributes such as simplicity, understandability, public acceptability and feasibility of application. The understandability criteria is not met where the study is incomplete. As discussed more fully elsewhere in this brief, the study fails to adequately consider all the alternatives, and the conclusions are not consistent with the data.[746] Second, interpretation of the results should be free of controversy. Dr. Smith testified that a common sense review by simply "eyeballing" the data suggests a volume variability of approximately 100 percent.[747] Several other witnesses including witness Bradley have

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[743] Tr. 28/15788.

[744] Tr. 28/15856, citing James C. Bonbright, *Principles of Public Utility Rates,* New York, Columbia University Press, 1961 at 291.

[745] Tr. 28/15856.

[746] Tr. 28/15856-7.

[747] Tr. 28/15857.

various interpretations at odds with this conclusion. Additional controversies among the various witnesses, even among those supporting the same conclusion, are discussed in the section below. The interpretation of witness Bradley's results are thus controversial. Third, the stability of the rates must be considered. The stability of the rate structure is affected if changes in the underlying methodology are permitted which are not predicated upon the appropriate allocation of costs. In this case, the allocation of costs is predicated upon the causal connection between hours and TPH which has not been satisfactorily demonstrated.[748] Fourth, fairness in the apportionment of costs of service should be considered. Fairness here is not assured where some classes or services may bear more than their fair share of the costs of service based upon an incomplete and inadequate methodology apportioning costs incorrectly.[749] Last, rates should promote efficiency by discouraging the wasteful use of resources through the proper pricing of products. Rates determined without a proper foundation and upon conclusions at variance with the underlying data do not meet this criterion. For these reasons, witness Bradley's study fails to meet the regulatory standards outlined by Dr. Bonbright.[750]

Dr. Smith also testified that the application of the study's conclusions would be contrary to the requirement of the Postal Reorganization Act:

> ....its failure to quantify reliably the analysis of the causal connection between labor hours and TPH, I believe the study apportions mail processing costs incorrectly. If costs are not correctly attributed to the mail classes and services, unfair and inequitable schedules could result. Also, the provision of the Act requiring that each class or type of mail bear the direct and indirect postal costs attributable to that class or type of mail would not be met. If witness Bradley's methodology results in a failure to attribute correctly the direct and indirect costs to the appropriate class or type of mail, then there would be no compliance with the provision of the Act.[751]

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[748] Tr. 28/15857-8.

[749] Tr. 28/15858.

[750] Tr. 28/15858.

[751] Tr. 28/15859-60.

2. Additional controversy among the witnesses about witness Bradley's study.

Traditional regulatory standards have required that a study should not produce unexplainable or inconsistent results, and that the study should be so well defined that disagreements over conclusions and methodologies are at a minimum. Witness Ying expressed some concern over the standard of non-controversy:

> Dr. Smith claims that a second criterion is that a study be free of controversy, but it is hard to avoid when relevant parties' interests diverge.[752]

In fact, the "free from controversy" standard is not even met among the major three proponents of the study—witnesses Bradley, Ying, and Higgins. For example, Witness Higgins was asked if he were aware of Postal Service plans to spend $17 billion on investment in the next five years.[753] He indicated that he was casually aware of the plans, having not studied them. He then went on to indicate:

> ...I think that perhaps if what you are asking is in a more general sense do I think that the capital expenditures, the net changes to capital by the Postal Service, would that influence in general estimates of the type that were produced in these, in this regard, I would say sure.[754]

Subsequently witness Higgins continued:

> ...but the net level of capital expenditure, additions to capital, change the relationship between costs or hours and piece handlings, so to that extent they certainly do influence the results. Yes.[755]

When asked if capital equipment should be taken into account in witness Bradley's model beyond the extent to which he had already done so, he indicated, "No, I don't."[756] Apparently, witness Higgins believes that future capital expenditures will have

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[752] Tr. 33/18147.

[753] Tr. 33/18042.

[754] Tr. 33/18043-44.

[755] Tr. 33/18044.

[756] Tr. 33/18045.

an effect on the applicability of witness Bradley's results, but shouldn't be taken into account. In contrast, witness Bradley has consistently maintained that the alpha term in this fixed effects equation accounts for facility differences.

Witness Higgins also appears to be in disagreement with Witness Bradley on the cost equation/cost function specification.[757] Witness Higgins hypothesizes a long term cost function without the "t" variable for technological change. He then decomposes the vector of input prices into time-varying and cross-sectional components, performs a substitution, and alleges "[t]his expression, is, in effect, witness Bradley's cost equation."[758] Apparently, witness Higgins is endorsing the use of a cost function and also alleges that he has represented witness Bradley's cost equation. That being the case, the earlier discussion of cost functions indicated that many of the variables used by witness Bradley were theoretically inappropriate for inclusion in a cost function. This is further substantiated by witness Higgins' contention that the variable MANR is not in his cost function: it was a key variable developed by witness Bradley.[759] Accordingly, the consideration of cost functions and equations by witnesses Bradley and Higgins appears to be internally contradictory: witness Higgins appears to prefer one approach, witness Bradley another. This controversy is important because it focuses on the fundamental structure of the model. The conclusions could be expected to change significantly depending upon the choice of function or equation.

Witness Ying seems to be in disagreement with witness Bradley on the fundamental specification of the model to be estimated. Witness Ying indicates in response to Dr. Smith's testimony that only outputs, input prices, and a time trend should be in a cost function:

> The neoclassical cost function has been extended to include a vector of "technological conditions," such as the route structure of a railroad, and a vector of output qualities or attributes.

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[757] Tr. 33/18009.

[758] Tr. 33/18009.

[759] Tr. 33/18046.

> Such variables are so commonplace these days that one would have to wonder when Dr. Smith has last read a paper on the subject.[760]

It can be noted that witness Bradley did not meet the standards proposed by witness Ying. To be specific, in presenting his direct testimony with the model of cost elasticity, witness Bradley has no information on output qualities and attributes, no variables equivalent to route structure—nor even a discussion of what the Postal equivalent would be.

Witness Higgins even disagrees with witness Bradley on terminology:

> Bradley performed what he termed a "Gauss-Newton regression (GNR)" test for individual facility effects. *Ibid.* at 41-43. More commonly termed a LaGrange multiplier (or "LM") test in the econometrics literature, it involves the estimation of the restricted (in this case, pooled) model to obtain the residuals, which are subsequently analyzed for evidence of misspecification...."[761]

It is clear that both witnesses Ying and Bradley are supportive of witness Bradley's conclusions, and witness Higgins has strongly endorsed witness Bradley. Nonetheless, there are substantive divergences of opinion among the three of them.

It has already been well documented that there is strong disagreement between witnesses Bradley, and witnesses Neels and Smith. For example, witness Neels uses witness Bradley's fixed effects approach but without the inappropriate data scrubbing, and obtains very different conclusions.[762] Witness Bradley's study is clearly very sensitive to the data used.

Witness Neels also indicated that witness Bradley's study produces implausible patterns of technological change.

> The results presented in Figures 3 and 4 are indicative of the general patterns that appear in Bradley's time trend results. In Bradley's world, technological progress is neither gradual nor smooth. Nor does it always move in a positive direction.

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[760] Tr. 33/18144.

[761] Tr. 33/18021-22.

[762] Tr. 28/15618.

> At the same points in time one finds some activities rapidly gaining in efficiency, while others show losses. One also finds discontinuous jumps and declines and rapid alterations between increases and decreases in productivity.[763]
>
> The pattern of witness Bradley's time trend results causes me to question his interpretation of their meaning. Although he has alluded to a "major restructuring" that took place in FY 1993, he has not explained the nature or significance of this change. I am hard pressed to envision a pattern of technological change that would produce such variations in productivity, and hence I do not believe that his time trend coefficients are really picking up the effects of technological progress.[764]

As Dr. Smith indicated in discussing the time trends analysis, the signs of the estimated coefficients of the time trend variables present questionable results. Some estimated coefficients are positive, and some are negative. In addition, there is no consistency between the first time period and the second.[765]

Dr. Smith concludes that witness Bradley believes that one or more external effects can affect a mail processing activity positively or negatively, but from an explanatory point of view witness Bradley has not delineated the external effects or why they are positive or negative. As indicated by Dr. Smith:

> At a minimum, additional explanation is required, and it may also be the case that additional analysis is necessary.[766]

In summary, the underlying data for the study appears to be unreliable, subject to issues of actual reliability of the data base as well as scrubbing. The availability of adequate data (e.g., capital investment) has not yet been resolved. The underlying cost equation is incorrectly specified. The estimating procedure is wrong—use of a fixed effects times series approach instead of a cross-sectional or pooled approach. The study is excessively short run, and the conclusions are varied depending on whatever

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[763] Tr. 28/15624.

[764] Tr. 28/15624-25.

[765] Tr. 28/15832.

[766] Tr. 28/15835.

assumptions are made, as shown in "Comparison of Bradley and Neels Econometric Results." For these reasons the study is incomplete and inappropriate for implementation at this time. The continuing controversy among even the witnesses who are proponents of the Bradley method demonstrate that the regulatory standard that the interpretation of the results be "free from controversy" is not met.

F. Without Justification, Witness Bradley's Volume-Variability Study Applies MODS Data To Non-MODS Activities.

Those facility sites not reporting electronically to the Postal Service corporate data base through the Management Operating Data System (MODS) are termed "non-MODS" offices by the Postal Service.[767] Witness Bradley conceded at the outset that he cannot estimate cost elasticities for activities within non-MODS offices,[768] because non-MODS offices do not submit piece handling data.[769] Witness Bradley claims he does not ignore the non-MODS data deficiency. He provided "proxy variabilities to witness Degen "[b]ecause there are similar activities in MODS offices.[770] In doing so he applies the average or system variability from MODS offices to the overall mail processing costs for non-MODS offices.[771]

The application of proxies from MODS facilities is not sufficiently substantiated to justify the application of witness Bradley's volume variability calculations to non-MODS facilities. Dr. Smith testified the use of proxies potentially biases witness Bradley's conclusions.[772] There is a reasonable question whether the MODS facilities are representative of non-MODS facilities.[773] This is another aspect of that study which

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[767] Testimony of witness Bradley, USPS-T-14 at 7.

[768] "At present, I can estimate cost elasticities for activities within MODS offices and BMCs, but not for non-MODS offices." *Ibid. See also,* Tr. 11/5357.

[769] *Ibid.*

[770] *Id.* at 7-8, 90. Tr. 11/5438.

[771] Tr. 11/5395. He does this even though he recognizes the distribution of costs across activities in MODS and non-MODS offices may be questioned where, for instance, the amount of automated and mechanized equipment varies between MODS and non-MODS offices. Tr. 11/5358.

[772] Tr. 28/15854.

must be corrected before witness Bradley's model may be utilized by the Commission for determining mail processing variability.[774]

MODS offices represent a significant portion of the offices where mail processing activity occurs. For instance, in FY 1996, Non-MODS offices comprised 16,463 of 17,367 total[775] of the offices and accounted for 96,447 out of 386,617 employees in certain classifications [776] This is approximately 25 percent of the employment in certain classifications for which no electronic data has been collected for witness Bradley's purposes.[777]

In order to use a proxy to solve the problem of the lack of data, sufficient justification must be demonstrated for the selection of any particular proxy. The justification offered on this record is skimpy and, in fact, not rational.[778] Witness Moden testified that because the “equipment” and “mail flows” are similar at the two types of facilities, it is appropriate to use MODS as a proxy. [779] The degree to which mail-processing equipment must be similar at MODS and non-MODS facilities in order to justify the use of a proxy is not explained. However, it is not likely that the largest of the mail processing equipment is ever utilized at the smaller non-MODS offices. Moreover, witness Moden knows of no studies comparing mail processing flows between MODS and non-MODS facilities.[780] In addition, witness Moden's testimony readily concedes there are numerous differences between the two types of facilities. His direct testimony states that at non-MODS facilities:

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[773] Tr. 28/15855.

[774] Tr. 28/15854-55.

[775] Tr. 12/6251.

[776] Tr. 12/6354 (OCA/USPS-T12-64) cited by Dr. Smith at Tr. 28/15855.

[777] Tr. 28/15855.

[778] One purpose of witness Moden's testimony is to support witness Bradley and, “The appropriateness of applying the MODS-based cost pools to non-MODS facilities.” USPS-T-4 at 3. Witness Moden devotes only one six-line paragraph at the very end of this testimony to this subject. USPS-T-4 at 22.

[779] USPS-T-4 at 22.

[780] Tr. 11/6053.

> sorting schemes are often *simpler*, the workroom floor is *smaller*, clerks have *greater personal knowledge* of the local delivery area, and their *very size* makes it easier to keep a steady flow of mail to operations such as manual letter and flats. (Emphases supplied.)[781]

These differences clearly impact the degree to which mail volume affects mail processing.

Witness Bradley says the "operational mix varies" between MODS and non-MODS offices but says there is not a substantial difference "in the nature of the activities themselves."[782] Although the activities already do not differ substantially, both witnesses Moden and Bradley agree the operational characteristics vary as between all MODS offices as a group and all non-MODS offices, as a group.[783] Given these differences, as a group, a response to changes in mail volume in the non-MODS offices probably does differ significantly from the response to like changes in volume in the MODS offices. This is because of differences as a group in size, simplicity, floor size, personal knowledge, and ease of mail flow. Therefore, witness Moden's conclusions as to the similarity of MODS and non-MODS offices for purposes of measuring mail processing costs and witness Bradley's use of a proxy are not justified. In this event, and in the absence of non-MODS data, the Commission's alternative is to assume a 100 percent variability for the non-MODS offices as witness Bradley testified is an approach available to the Commission.[784]

In addition to the non-comparability of MODS and non-MODS offices, there are problems with witness Bradley's comparison of mail processing activities for which he has no data with activities for which variabilities have been computed.[785] For example, he compares mail processing activities without recorded piece handings at MODS

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[781] USPS-T-4 at 22.

[782] Tr. 11/5438-9.

[783] Witness Bradley testified that non-MODS offices mail processing facilities are smaller on average than MODS offices. Tr. 11/5350.

[784] Tr. 11/5357.

[785] USPS-T-14, pages 88-90.

offices with a number of activities which allegedly provide proxy variability. However, MODS and BMC locations are different. It is not at all clear that Mechanized Sack Sorting, Mechanized Parcel Sorting and Manual Sack Sorting at a MODS office are in any way similar to the proposed BMC proxies, nor has witness Bradley provided any substantiation for such an allegation. Furthermore, the equivalence of Bulk Presort, ACDCS (Scanning), and Business Mail Reply/Postage Due appears unlikely in comparison to the proposed proxies: Opening Units, Pouching, and Manual Letter Sorting. Accordingly, witness Bradley's conclusions in Table 19 are highly questionable.

Similar problems of equivalence between activities within the MODS system requiring a proxy variability and the activity providing the proxy variability appear likely for the following activities: Automated Sorting, Mechanized Sorting, and Mail Markup and Forwarding. The corresponding proxies, OCR & BCS, LSM & FSM, and Average of Mechanized Activities are not obvious choices, and again there is no study or substantiation for the assertions.

G. Conclusions.

The divergence of opinion among economists in this proceeding can be highlighted by a contrast of quotes by witnesses Shew and Smith. Witness Shew indicates:

> The new study, which was performed by Professor Bradley of George Washington University, provides many interesting insights into cost causation, and one can only hope that its replacement of assumptions with extensive data analysis will provide a model for future studies of postal service costs.[786]

In contrast, Dr. Smith indicates:

> I do not believe that witness Bradley has substantiated his conclusions concerning volume variability.[787]

As has been indicated, the major problems associated with witness Bradley's study are substantial:

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[786] Tr. 28/15512.

[787] Tr. 28/15861.

- The study is based on a database of highly questionable reliability;
- The data scrubbing efforts were incorrect, biasing the conclusions;
- The underlying data themselves are visually compelling in suggesting variability approaching 100 percent;
- The analysis of the relationship between TPH and hours in the study is not in good agreement with the actual underlying data. The model assumes identical slopes at each facility between TPH and hours; such is not the case.
- The economic theory for the underlying translog model does not substantiate the form used by witness Bradley;
- The estimation procedure is wrong; cross-sectional or pooled approaches appear to be more appropriate than the times series fixed effects approach;
- The study is focused on the short run rather than time period during which rates will be in effect;
- Even if the study were correct, which it is not, the study should not be extrapolated to non-MODS offices; there is no substantiation for such an extropolation;
- Certain postal activities for which data are unavailable are modeled by proxy activities; however, there is no substantiation for such extrapolation, and the conclusions appear to be dubious.

In short, the study in its current form does not meet the accepted standards for a regulatory study as outlined by Dr. Bonbright and is not ready for implementation. Recognizing that witness Bradley's testimony is related to witness Degen's testimony, it should be noted that the implementation of witnesses Bradley's and Degen's studies is separable and that one could be implemented without the other. For example, witness Christensen indicated that witness Degen's cost distribution methods could be used even if a 100 percent variability were the case.[788]

The law is clear that the burden of proof resides with the proponent of change. The Postal Service has not made its case in terms of cost elasticity. Accordingly, given the lack of substantiation for witness Bradley's study, we urge the Commission to reject the study.

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[788] Tr. 34/28258.

VIII. COSTING ISSUES

A. The New Methodology For Distributing Component 3.1 Mail Processing Costs Constitutes An Important Step Forward And Should Be Adopted By The Commission.

1. The challenges to the distribution method proposed by Postal Service witness Degen are ineffectual and do not undermine the clear advantages of exploiting the strong associations between subclasses and MODS cost pool data.

Postal Service witness Degen has made a solid case for the use of the new distribution method he utilizes in this proceeding and his position is fortified by the analysis of UPS witness Sellick.[789] Together, they easily withstand the feeble challenges of Time Warner witness Stralberg and MPA witness Cohen.

Witness Stralberg's assessment of the Degen approach is summarized in his first piece of testimony:[790]

> By insisting on distributing all mixed mail and not handling costs within a large number of cost pools, Degen ignores all cross-pool relationships and introduces significant distortions. His mixed mail method is basically the same method that both the Commission and the Postal Service concluded should not be used in Docket No. R94-1.

Stralberg presents an alternate distribution of mail processing costs, carefully eschewing any distribution within MODS cost pools.[791] Instead, he distributes mixed mail costs based on direct subclass costs, either by shape, or by all direct costs.[792]

One of witness Cohen's primary criticisms of the Degen approach is that it is "a departure from the IOCS/LIOCATT methodology used by the Commission since the early 1970s."[793] This is a trifling charge at best and applies equally to the Bradley

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[789] For previous OCA discussion of this issue, please see section IV.B. of OCA's Trial Brief, February 10, 1998, at 25-30.

[790] Tr. 26/13818 (TW-T-1 at 4).

[791] *Id.* at 13819 (and at 5, respectively).

[792] *Id.*

volume variability analysis that is praised so warmly elsewhere in Cohen's testimony.[794] To a large extent, witness Cohen relies on the Commission's decision in Docket No. R94-1, which expressed concern that counted mixed-mail observations were not made randomly and, therefore, could not be considered statistically representative.[795]

Witness Degen effectively parries each of these attacks in his rebuttal testimony, pointing out the material advantages of his approach over traditional LIOCATT distributions of mixed-mail costs and the Stralberg/Cohen proposals in this proceeding. According to Degen, the new method—

- substantially reduces reliance on not-handling tallies
- increases accuracy of mixed-mail distribution
- reduces bias in mixed-mail distribution
- exploits strong subclass associations to operations, item types, and container types within MODS cost pools.

Both Cohen and Stralberg dismiss UPS witness Sellick's testimony on the ground that he lacks knowledge of postal operations and has "limited expertise."[796] However, witness Sellick relies, to a large degree, on the descriptions, explanations, and conclusions of Postal Service witness Degen,[797] who is not subject to this criticism and who had open channels of communication with a broad cross-section of Postal Service experts.

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[793] Tr. 26/14027 (MPA-T-2 at 3).

[794] *Id.* at 14039-40 (and at 15-16, respectively).

[795] PRC Op. R94-1, paras. 3061 and 3072.

[796] Tr. 36/19222-23 (MPA-RT-1 at 6-7); also Tr. 36/19280-81 (TW-RT-1 at 1-2).

[797] This is apparent from an examination of both testimonies of witness Sellick in this proceeding—UPS-T-2 (Tr. 26/14157-81) and UPS-RT-1 (Tr. 36/19474-85).

2. No effective barriers to rejecting the Bradley volume variability analysis while accepting the Degen distribution methodology have been erected.

Postal Service witness Christensen was charged with the task of convincing the Commission that it cannot reject witness Bradley's volume variability analysis without also rejecting witness Degen's cost distribution approach.[798] MPA witness Cohen espouses this position, too.[799]

When pressed by Chairman Gleiman during oral cross-examination, witness Christensen was finally forced to admit that it might be possible to reject one but accept the other "in a way that makes sense."[800]

> Chairman Gleiman:
>
> I understand there's a link between Bradley and Degen. What I'm confused about, though, is if Bradley is an improvement, and Degen is an improvement, if someone were to have a problem with one or the other to a varying degree, why would one then not adopt the improvement in one or the other and deal with the concerns that he or she might have about the remaining?
>
> Witness Christensen:
>
> Well, it's a fair question and we want to adopt improvements where we can. I think overall is where we get the biggest improvement is to have a consistent new framework that we can implement. If some part of the overall package is deemed to be flawed, and I don't think it is, then the question is well, how can we correct for that without the notion of let's either throw out Bradley or let's throw out Degen and substitute something that may not be linked in a consistent way with it. I think we have to be very cautious about using either without the other but I wouldn't say it's impossible to do it in a way that makes sense.

In conclusion, it is OCA's view that the advantages of the Degen mixed-mail distribution are indisputable, while the Bradley analysis is deeply flawed and cannot be

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[798] USPS-RT-7 (Tr. 34/18212-46).

[799] MPA-RT-1 at 7-9 (Tr. 36/19223-25).

[800] Tr. 34/18288-89 (emphasis added).

recommended. The Commission should adopt the Degen testimony, but revert to the previous assumption of 100 percent volume variability for mail processing costs. These two actions would be in harmony and consistent with economic principles recognized and applied by this Commission.

B. The Program, Commands And Documentation Provided By OCA Witness Thompson Eliminate The Need For Sophisticated Computer Expertise To Update And Operate The Commission's Cost Model.

In OCA-T-100, witness Thompson updates the Commission's cost model to reflect Postal Service costing methodology changes, then uses it to replicate the Postal Service's Base Year (FY 1996); FY 1997; and the Test Year (FY 1998) data.[801] Her testimony provides the commands for executing the updated model, and gives intervenors a personal-computer-based cost model that may be used to replicate Postal Service costs.[802]

In R84-1, the Commission stated that "the best way to validate the assumptions and data inputs of such a complex [Postal Service] model [is] to independently replicate each series of calculations made by the model." PRC Op. R84-1, Appendix E at 3.[803] The Commission developed and used a separate set of programs to serve as its cost model because the Postal Service failed to provide a cost model program that participants could use to measure the impact adjustments or changes would have on costs.[804] The Commission's model requires a degree of familiarity with the Postal Service's costing methodology.[805] Since the OCA has a mandate to "sponsor[ ] relevant and material evidence which presents needed data or information" (39 C.F.R. §3002.7),

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[801] Tr. 20/10496.

[802] Tr. 20/10497.

[803] Tr. 20/10498.

[804] Tr. 20/10498.

[805] Tr. 20/10498-99.

and in an effort to familiarize more participants with the Commission's cost model, witness Thompson explains the steps required to utilize the Commission's cost model.

Witness Thompson's testimony and library references OCA-LR-4, OCA-LR-6 and OCA-LR-7, provide detailed instructions on operating the updated cost model.[806] In a personal-computer-based environment, parties to a rate and classification case may use the updated cost model to evaluate costs associated with alternative Postal Service proposals.[807] Ideally, parties to a case would examine all Postal Service data. However, the reality of time constraints and limited resources forces participants such as the OCA to rely on the Postal Service's integrity to accurately report its Base Year data as reflected in USPS-T-5, Workpaper A.[808] In OCA-LR-3, the OCA provides intervenors with a SAS program that easily coverts Postal Service data files into a format compatible with the Commission's updated cost model.[809]

If the Postal Service's costing methodology changes, then parties wanting to examine alternative cost proposals can follow the strategy presented in library references OCA-LR-4, OCA-LR-6 and OCA-LR-7 for the base, interim and test years, respectively, to update the input files required by the Commission's cost model. Updating a Commission-cost-model input file does not require sophisticated software nor does it require computer programming expertise. The testimony of witness Thompson and library references, OCA-LR-4, OCA-LR-6 and OCA-LR-7, provide the necessary documentation so that anyone with a text editor can update an input file.

Witness Thompson's testimony and library references OCA-LR-4, OCA-LR-6 and OCA-LR-7 provide Postal Service costing methodology neophytes instructions on operating the Commission's cost model.[810] Intervenors now have the tools necessary to more fully examine Postal Service costs. All parties to a rate and classification case can

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[806] Tr. 20/10504-5.

[807] Tr. 20/10502.

[808] Tr. 20/10617-19.

[809] Tr. 20/10499.

[810] Tr. 20/10499.

make a fuller and a more accurate assessment of whether or not proposed rates meet the statutory criteria set forth at 39 U.S.C. §3622(b).

IX. INSURANCE ISSUES[811]

A. The Commission Should Require The Postal Service To Stop Its Deceptive Insurance Practices Before Approving The Substantial Fee Increases Sought.

1. Summary of argument.

The Postal Service proposes substantial increases in insurance fees in this proceeding – an overall increase of 17.3 percent.[812] Before approving such a substantial increase, OCA believes there are insurance issues affecting consumers that the Commission should address in its opinion and recommended decision. In brief, consumers who use the Postal Service to mail packages may not know that absent the purchase of insurance their mailing is not protected against loss, damage, or theft (even though it is the Postal Service whose actions cause such losses). This is likely surprising to many consumers because one normally expects that a business entrusted with property is responsible for safeguarding it.

If consumers do purchase insurance, they may not be aware that there are significant limitations on coverage. This lack of information distorts the buying process, and hence the competitive market. "For a competitive market to function well, buyers must have sufficient information to evaluate competing products."[813]

The Postal Service has no incentive to disclose such information. Because of the legal protections the Postal Service enjoys in the insurance area, legal protections for consumers are limited. Further, the modest dollar amounts that may be involved (e.g., a $100 item was being sent to Aunt Minnie) would make litigation a prohibitive choice for the consumer. Consequently, the Postal Service should be compelled to give the consumer adequate insurance information: [814]

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[811] OCA raised insurance issues similar to those expressed herein in Docket No. MC97-5. OCA's Brief in this docket was prepared prior to any decision in Docket No. MC97-5.

[812] Direct Testimony of Postal Service witness Plunkett, USPS-T-40, at 3.

[813] Stephen Breyer, *Regulation and Its Reform* (1982), p. 26.

[814] *Id.* at 27.

> "The rationale for governmental action to prevent false or misleading information rests upon the assumption that court remedies and competitive pressures are not adequate to provide the consumer with the true information he would willingly pay for."

We conclude in this section that before these proposed increases are approved, the Postal Service should be required to provide basic information to consumers about the insurance process.

2. Consumers who use the postal service to mail packages may not know that absent the purchase of insurance their mailing is not protected against loss, damage, or theft.

Many consumers who enter a post office to mail a package likely are under the illusion that the Postal Service guarantees safety of delivery, i.e., that if a package entrusted to the Postal Service for delivery is damaged, stolen or rifled, the consumer will be compensated for his/her loss. One can expect this false premise exists in the minds of consumers because in typical retail transactions, the entity to whom property is entrusted owes a certain level of care to its customers under the law of bailment:[815]

> A bailment is created by the delivery of personal property by one person to another for a specific purpose, pursuant to an express or implied contract to fulfill that trust. Inherent in the bailment relationship is the requirement that the property be return to the bailor, or duly accounted for by the bailee, when the purpose of the bailment is accomplished, or that it be kept until it is reclaimed by the bailor.

A hypothetical will illuminate the issue. Suppose a consumer goes to a dry cleaning establishment with a dozen shirts to be cleaned. Upon return to pick up the shirts, the owner of the establishment discloses to the consumer: "Gee, I'm sorry, but we lost four of your shirts. The washing machine damaged four. And one of our workers stole the remaining four – you'll be glad to know we've fired him. That will be $18 please. And, no, I'm sorry, we won't compensate you for the loss and damage[816] to your shirts."

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[815] 8A Am Jur 2d Bailments, §1. [Footnote omitted]

A consumer would rightly expect that such a situation would not be legally permissible under the law of bailment.[817] The delivery of property to another under an agreement to repair it or perform other services on it generally constitutes a bailment. So does the delivery of property for safekeeping, transportation and storage.[818] However, if an equivalent situation occurred with a package entrusted to the Postal Service, the consumer would have no legal recourse unless he/she purchased insurance.

The reasonable consumer perceptions and expectations described above are almost completely at odds with the reality of the insurance regulatory scheme that governs, e.g., parcel service. Consumers receive no protection against damage, theft or loss of the parcel if they do not purchase insurance.[819] As discussed in *Ins. Co. of North America v. U.S. Postal Service*, 675 F.2d 756, 758 (5th Cir. 1982), the Postal Service retains sovereign immunity against claims "arising out of the loss, miscarriage, or negligent transmission of letters or postal matter."[820] Arguments to the contrary receive short shrift from the courts. *See Anderson v. United States Postal Service*, 761 F.2d 527, 528 (9th Cir. 1985) (*per curiam* opinion).

If they do purchase insurance, they receive only limited protection.[821] Consumers receive scant notice of the significant limitations in the insurance "contract," though they are legally presumed to have such knowledge. Under the current state of the law (and given practical limitations against suing for small sums of money),[822] litigation is not an attractive alternative for consumers. Nor will the consumer receive protection from any state insurance commission or federal agency.[823]

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[816] The Postal Service insists upon collecting postage for damaged articles, arguing that the mailer still has gotten the benefit of the bargain – a "delivered" package. *See* Oral Testimony of Postal Service witness Plunkett, Tr. 3/956, lines 18-25.

[817] For a few of many examples of a cleaning establishment's bailee liability see: *Mahallati v. Williams*, 479 A.2d 300 (D.C. Ct. of App. 1984); *Wooton v. Kash dba Oakland Cleaners*, 1982 WL 3121 (Ohio App. 12 Dist.*); Toobert v. Turnpike Cleaners, Inc.*, 439 A.2d 452 (Superior Ct. Conn. 1981); *Thomas v. Cortland Washbowl Laundromat*, 1988 WL 76754 (Ohio App. 11 Dist.); and, *Palace Laundry Dry Cleaning v. Cole*, 41 A.2d 231 (Mun. Ct. App. D.C. 1945).

[818] 8A Am Jur 2d Bailments, at §5.

[819] We note in passing that the favorable treatment given the Postal Service by Congress and the courts with regard to insurance may give it a cost advantage *vis a vis* private firms that provide packaging service (e.g., intervenor CAUUC firms).

3. Even if consumers purchase insurance, it is unlikely they know the extent of coverage being provided.

The Postal Service has the authority to make itself liable for negligence to the extent it offers insurance protection, but it "is only liable to the extent that it agrees to be liable." *Frank Mastolini & Sons, Inc., v. U.S. Postal Service*, 546 F. Supp. 415, 419 (D.C.N.Y. 1982). The Postal Service does offer insurance coverage, and the Domestic Mail Manual specifies the numerous conditions of such coverage.

It should be emphasized, though, that knowledge of the contents of the Domestic Mail Manual is imputed to the consumer. As noted in *Djordjevic v. Postmaster General, United States Postal Service*, 957 F. Supp. 31, 33, n.2. (E.D.N.Y. 1997), the DMM is incorporated by reference in the Code of Federal Regulations at 39 C.F.R. §111.1. Thus, in that case, the plaintiff could not recover for consequential losses because the Postal Service did not consent to coverage of such losses in the DMM. *Id*. at 35. *Accord, Frank Mastolini & Sons, Inc., v. U.S. Postal Service*, 546 F. Supp. at 418, n.4.

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[820] In its Initial Brief ("PSIB") in Docket No. MC97-5, the Postal Service stated that customers who decline postal insurance "would not be left without an opportunity to seek recourse through administrative channels." PSIB at 35. "Witness McGonigle explains that customers may avail themselves of the tort claims process that is currently used for claims relating to uninsured articles." *Ibid.* That plainly was an incorrect statement, as explained in the OCA Reply Brief in that docket. In interrogatory OCA/USPS-T40-18, Tr. 3/892 OCA asked: "Does the Postal Service ever compensate uninsured mailers for items damaged by the Postal Service, for items lost in the mails, or for items rifled or stolen while the item is in the mailstream? Please explain." Postal Service witness Plunkett responded: "I am advised that the Postal Service defends against mailers' claims for loss or damage to the contents of mail matter for which postal insurance is not elected." *Id*., Tr. 2/297. And in OCA/USPS-T40-21, Tr. 3/892, OCA asked: "Has a mailer ever filed a lawsuit against the Postal Service because, though uninsured, the mailer alleged that the Postal Service had a legal responsibility to compensate it for items damaged by the Postal Service, for items lost in the mails, or for items stolen while in the mailstream? Please explain, and please provide citations to all reported court decisions related to this topic." Witness Plunkett replied: "I have no particular expertise in legal research, and am not aware of any particular lawsuits. However, I am told that the Postal Service does receive claims of this nature, and defends against them under an exception to the waiver of sovereign immunity in the Tort Claims Act (28 U.S.C. Š2680(b))." *Id*., Tr. 2/297.

[821] As noted above, the Postal Service proposal encompasses the purchase of insurance "in conjunction with items presented for packaging service . . . ." *See* Request, Attachment A, p. 7.

[822] It would appear that the economical alternative of suing the Postal Service in local small claims courts is not possible, given that Congress in 28 U.S.C. § 1339 has given district courts original jurisdiction to hear civil actions "arising under any Act of Congress relating to the postal service."

[823] OCA is unaware that any such agency has jurisdiction over Postal Service insurance practices.

(DMM is incorporated by reference in the CFR, and is deemed published in the Federal Register; plaintiff is presumed to have notice of its contents pursuant to 44 U.S.C. §1507). The harsh reality is that the consumer is expected to know all the limitations on coverage the Postal Service specifies in the DMM. Perusal of the DMM shows that there are numerous exceptions to insurance coverage. *See* DMM S010.2.14 *et seq*.

Consumers are subject to additional onerous disadvantages. Suppose that a postal employee misstates what postal insurance covers. It has been held that a customer cannot rely on the misstatements of a postal employee concerning insurance coverage. *A.E. Alie & Sons, Inc., v. United States Postal Service*, 897 F.2d 591 (1st Cir. 1990).

In short, a consumer is at a severe disadvantage when dealing with the Postal Service. The entity with which the consumer has entrusted his parcel may lose it or damage it. Indeed, a postal employee may steal the parcel or rifle its contents. Absent insurance, a legal claim against the Postal Service for losing, stealing or damaging a parcel will be unavailing.

If the consumer divines that purchase of insurance is a necessity, [s]he still may not realize that Postal Service insurance contains significant exceptions, exclusions, and limitations.[824] The insurance receipt form given by the Postal Service to a customer, Form 3813-P, contains almost no information about what is covered and what is not covered by the insurance purchased.[825] Yet, as noted, courts state that knowledge of the vast array of insurance regulations is imputed to the consumer. In brief, the consumer is given almost no information about the insurance he is purchasing, yet he

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[824] In Library Reference Number 2, p. 8, it is noted that under the pilot program preceding this proposal 41.7 percent of the total pack-and-send transactions involved a purchase of insurance.

[825] The only relevant coverage information is found on the rear of the form:

> "COVERAGE -- Postal insurance covers (1) the value of the contents at the time of mailing, if lost or totally damaged, or (2) the cost of repairs. It does not cover spoilage of perishable items. Coverage may not exceed the limit fixed for the insurance fee paid. Consult postmaster for details of insurance limits and coverage." PS Form 3813-P, Feb. 1987.

will be held to the numerous terms (advantageous to the Postal Service) set forth in the DMM.

B. Requiring The Postal Service To Provide Consumers With Insurance Information Does Not Intrude Upon Postal Service Management Prerogatives.

1. *Mail Order Ass'n v. U.S. Postal Service* gives the Commission latitude in fashioning remedies.

The Postal Service may object to a requirement that consumers be provided with insurance information, arguing, as it did in Docket No. MC97-5, that such a requirement intrudes upon Postal Service management prerogatives.[826] It therein cited *Mail Order Ass'n v. U.S. Postal Service*, 2 F.3d at 424, for the proposition that the Commission "may not, however, under the statute's ratemaking structure, forge ahead with a recommendation that surpasses its ratemaking function and unduly intrudes upon management." "Marketing and sales practices for packaging service are clearly outside the scope of ratemaking practice; rather, these matters are within the Board's and postal management's purview."[827]

The Postal Service misreads the *Mail Order Ass'n* decision. As discussed previously in this brief, while the Commission's authority is "not without bounds," *id.* at 422, "the Commission is certainly authorized to do more than give a thumbs up or thumbs down on the Governors' request." *Ibid.* If the Commission "puts forward a proposal that it deems necessary for reasons of fairness and equity,"[828] the Postal Service, "[p]ermitted to put on evidence . . . may well be able to demonstrate that a proposed rate or classification is either unworkable or inconsistent with general Postal Service objectives and policies."[829]

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[826] Docket No. MC97-5, Postal Service Reply Brief at 6-7.

[827] Docket No. MC97-5, Postal Service Reply Brief at 7.

[828] *Mail Order Ass'n of America*, 2 F.3d *Id.* at 424.

[829] *Ibid.*

The question then is whether requiring the Postal Service to provide consumers point-of-sale insurance information "unduly interfere[s] in the management and direction of the Postal Service."[830] In other words, will such a proposal "cause an upheaval in the efficient operation of the Postal Service"?[831] The answer is easily "no." The Postal Service now makes available a number of consumer-oriented publications. Requiring it to hand out a brief insurance brochure (or offer such a brochure to the customer) at the point-of-sale will have only a *de minimis* impact on window service operations. Indeed, as discussed below, the use of such a brochure may make such operations more efficient.

That such a remedy does not unduly intrude upon Postal Service management becomes more understandable after reading the Commission's pre-*Mail Order Ass'n* "red-tag" decision, where the Commission also noted that the "management prerogative" argument has its limits:[832]

> Before leaving this issue, we must respond to the argument – made by the Service – that its red-tag regulations are necessary for the preservation of a priority/non-priority mail system which is necessary in order for the Service to meet its statutory responsibility to maintain an efficient system of sorting and delivering mail nationwide. [footnote omitted] The short answer to the Service is that under our recommended scheme there would still be a priority/non-priority system since the evidence on the record indicates that after the classification changes are made, there will still be publications not wanting, or willing to pay for priority service.

Under the OCA proposal, insurance would still be offered and purchased or declined. The only difference would be that consumers would know what they were paying for, and whether the purchase of insurance was necessary or desirable.

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[830] *Ibid.*

[831] *Ibid.*

[832] PRC Op. 79-3, at 73.

2. There is a marked difference between management prerogatives and permitting the Postal service to engage in wholesale deceptive behavior that is unfair to its customers.

There is a marked difference between management prerogatives and permitting the Postal Service to engage in wholesale deceptive behavior that is unfair to its customers and that would likely subject private sector firms engaging in similar behavior to legal action by the federal government. The Postal Service's insurance business is inherently deceptive because of a failure to disclose material information about the lack of protection a purchaser of insurance receives.

The Federal Trade Commission ("FTC"), the federal agency charged with policing marketplace deception, commonly examines commercial transactions (marketing of products and services, and advertisements for such products and services) to determine whether deception is occurring that harms consumers. As part of that examination, it inquires whether an advertisement or a commercial transaction is deceptive through omission of material information.[833] The FTC standard is as follows: "Omissions may also be deceptive where the representations made are not literally misleading, if those representations create a reasonable expectation or belief among consumers which is misleading, absent the omitted disclosure."[834]

OCA is of the opinion that there is a grave omission in the Postal Service's marketing of insurance. We think that if the consumer entrusts the Postal Service with an item, the consumer has a reasonable expectation that if there is a problem with the transaction (e.g., the parcel is lost or the item is damaged in transit) then the consumer will be made whole.[835] After all, that is the normal situation when dealing with businesses under the law of bailment. At a minimum, consumers should be informed

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[833] The FTC's policy on deceptive advertising is summarized in a 1983 letter sent to Congressman John D. Dingell, which was attached to the Commission's opinion in *Cliffdale Associates, Inc., et al.*, 103 F.T.C. 110 (1984). It has become known as "The Deception Statement." *See also Thompson Medical Co.,* 104 F.T.C. 648, 788 (1984), *aff'd*, 791 F.2d 189 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1086 (1987). Deception by omission has been found to occur many times by the FTC. *See Deception Statement*, 103 F.T.C. at 175 n.4. *See also* the *FTC Enforcement Policy Statement on Food Advertising* (May 1994), at 5.

[834] Deception Statement at 175, n.4.

that if they expect protection from loss, damage, or theft, they must purchase insurance. Further, the terms of the insurance contract (i.e., the significant coverage limitations) should be explained to consumers before *every* transaction through a written communication (e.g., a consumer pamphlet). If a private firm were to offer such a service under the conditions proposed by the Postal Service, arguably its advertising and marketing would be subject to adverse FTC action.

3. The Commission should remedy the current situation whereby consumers cannot make meaningful insurance purchases choices.

OCA concludes that consumers need to be informed about their lack of insurance coverage when mailing parcels, and that the nature of the insurance contract with the Postal Service should be explained to them. The simple resolution of the insurance coverage problem is to require the Postal Service to provide or offer to provide consumers with an insurance information pamphlet during every parcel transaction. A small pamphlet should be able to convey critical information, and should not be costly to prepare or disseminate.[836]

Such a solution would not only enable consumers to make an educated choice, but would be efficient. First, the information in a carefully prepared pamphlet is much more likely to be complete and accurate than oral descriptions of insurance coverage by clerks. Second, conveying, assessing and digesting such information via that medium consumes far less clerk time and allows the customer all the time [s]he wishes to consider the insurance purchase. If a customer indicates [s]he wants to study the

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[835] FTC advertising and marketing regulation does not require that *all* consumers be deceived. The act or practice under scrutiny is evaluated from the perspective of the reasonable consumer, but an interpretation may be reasonable "even though it is not shared by a majority of consumers . . . ." *Id.* at 177, n.20.

[836] For guidance on such a solution, the Commission might look to see how the Department of Transportation regulates the insurance of trucking companies that transport household goods for consumers. The insurance business of such carriers (who perform a function not unlike that of carrying consumers' parcels) is subject to federal regulation. 49 C.F.R. §1056.11. Federal regulation prescribes that when purchasing insurance, the shipper shall be furnished with a copy of the insurance contract. *Ibid.* "Carrier issued policies shall be written in plain English and shall clearly specify the nature and extent of coverage. Failure to issue a policy or other appropriate evidence of insurance purchased shall subject the carrier to full liability for any claims to recover for loss or damage attributed to the carrier." *Ibid.*

pamphlet, the next person in line can be waited upon while the reading is done.[837] Third, handing out an insurance information pamphlet once should obviate repeat insurance questions on other occasions with the same customer, since the customer will have a written summary of what postal insurance covers and why it may be a prudent purchase. Finally, the same written information will be made available uniformly to all purchasers and will not be subject to the varying time constraints of each transaction, nor the varying extent to which individual clerks may be trained in the complex coverage provisions and limitations of postal insurance.

[837] It is common experience that Postal Service window clerks instruct customers who need to do something to complete a transaction to step aside briefly. For example, customers may write a return address on a parcel or supply a proper zip code while another person is waited on, and then step back to the window.

RESPECTFULLY SUBMITTED,

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

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