

DOCKET SECTION

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

POSTAL RATE & FEE CHANGES, 1997

Docket No. R97-1

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TRIAL BRIEF
OF
ALLIANCE OF NONPROFIT MAILERS,
AMERICAN BUSINESS PRESS,
COALITION OF RELIGIOUS PRESS ASSOCIATIONS,
DOW JONES & COMPANY, INC.,
MAGAZINE PUBLISHERS OF AMERICA,
NATIONAL NEWSPAPER ASSOCIATION,
THE MCGRAW-HILL COMPANIES, INC.,
AND
TIME WARNER INC.

February 10, 1998

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INTRODUCTION

There is little we need to add to the title of this brief to demonstrate the unusual nature of this case and the threat that it poses to the Periodicals publishing industry. The irony of this threat being wrapped in the smallest *proposed* increase in Periodicals rate history is not lost on the parties to this brief, and, by the same token, the Commission should not allow that reasonable, small and acceptable *rate* proposal to mask the irreparable damage that could flow from this case in both the short and longer run.

We will show below that, as outlined in the direct testimony of Keith Crain (ABP-T-1) and Christopher Little (MPA-T-1), magazine publishers have for years fought an unsuccessful battle both in the Commission's hearing room and at Postal Service headquarters to obtain Postal Service recognition that there is a costing

problem with Periodicals--as is illustrated by Figures 1 and 2 below--and to secure a Postal Service effort to address it.

Figure 1

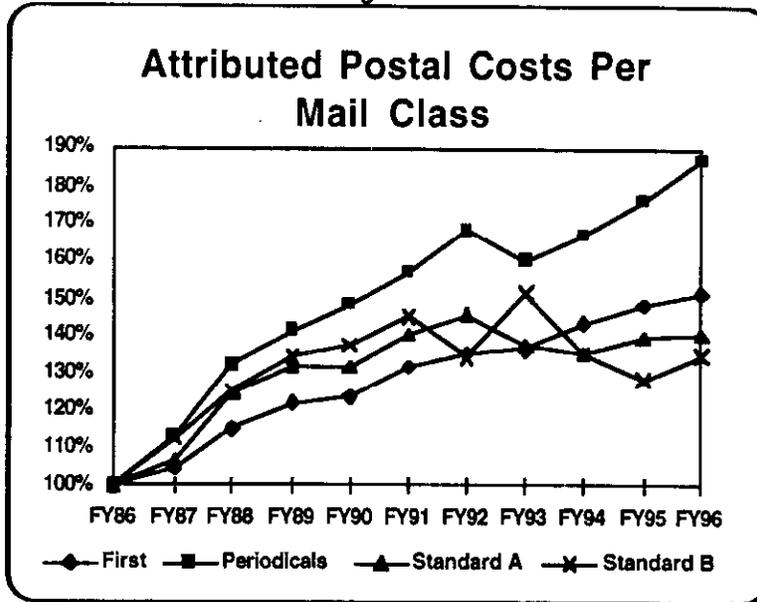
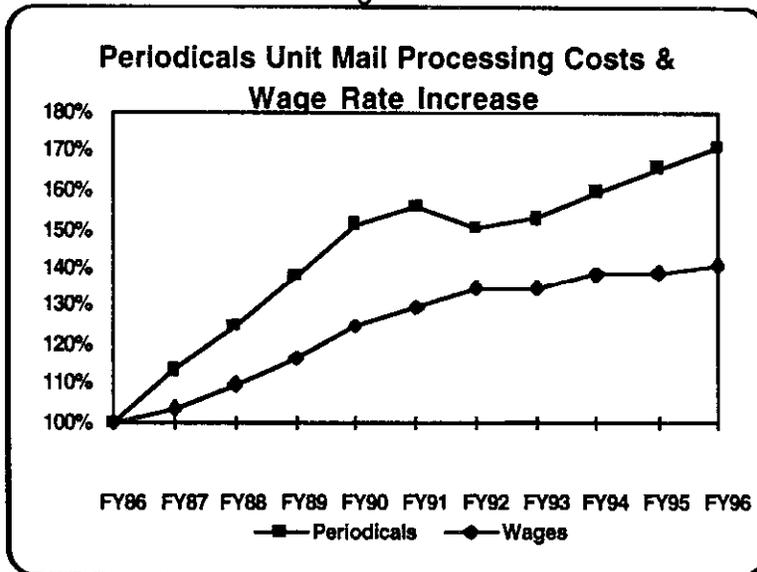


Figure 2



Source: Figure 1: MPA-T-1 at 2; Figure 2: MPA-T-1 at 5.

The industry has contended that if the costs are not measured accurately, they should be, and if they are measured accurately, the causes of the rapid escalation must be identified and eliminated. But for the historically modest overall increase requested and the historically low cost coverage proposed for Periodicals, those chickens would surely have come home to roost in this case in the form of very large rate increases.

But the threat to publishers goes beyond the seemingly out-of-control costs identified by witnesses Crain and Little, and beyond the questionable attribution of transportation costs to Periodicals addressed by witness Hehir (MH-T-1). The Postal Service has introduced through its witness Degen a new method of assigning processing costs to subclasses that would pile still greater cost responsibility on the Periodicals subclasses on the basis of testable but untested--and to a great extent unreasonable--assumptions about cost incurrence. Witnesses Rita Cohen (MPA-T-2), William Shew (DJ-T-1), and Halstein Stralberg (TW-T-1) offer testimony demonstrating that the deficiencies in witness Degen's analysis require that it be either corrected or rejected.

These witnesses also conclude that the other major change in the approach to processing costs--USPS witness Bradley's econometric demonstration that the historic assumption of nearly 100% volume variability is erroneous--represents a major step forward in the effort to refine postal cost measurement. This change has now been strongly reinforced by separate statistical tests of Bradley's "fixed-effects" econometric model reported by Bradley and by MPA witness Paul Higgins in responses to Commission "Notice of Inquiry No. 4 on Mail Processing Variability" (issued January 16, 1998). The results of those tests, which compare the variabilities produced by Bradley's model to site-specific variabilities calculated for each site, show that average site-by-site variability is lower than the fixed-effects variability calculated by Bradley, so that any bias due to the restrictive assumptions

of the fixed-effects model is toward an *overstatement* of variability. The results provide no support for a more restrictive or "pooled" model, or for the view that average mail-processing volume variabilities are any higher than that estimated by Bradley, much less at 100% as traditionally assumed in past ratemaking dockets.

The danger that an inappropriate rejection of reduced variability could contribute significantly to inappropriate rates is displayed in the rate proposal of United Parcel Service witness Henderson, who shows that a combination of rejecting Bradley, accepting Degen, and using the Periodicals markup from Docket No. R94-1 would result in a 25% rate increase for Periodicals. It should thus be evident why the publishing industry's prior concerns with such rate design issues as the shape of the editorial rate and the size of presort discounts have taken a back seat in this case to the substantial and permanent harm that would be done to the industry by witness Degen's proposed new methodology for distributing mail-processing costs.

In the sections that follow, we will explain in greater detail why the industry is acting collectively, why the Commission should reject the Postal Service's mail-processing cost distribution methodology, and why the Postal Service must engage in serious study to permit the interim solutions appropriate here to be replaced by supportable, quantitative analyses in the future.

I. WHY PERIODICALS MAILERS ARE ACTING COLLECTIVELY IN THIS CASE.

The Periodicals publishing industry has joined together in this brief, and in planning and coordinating its testimony in this case--that sponsored jointly and by individual intervenors--in order to focus on a single overriding issue that has an immense, continuing adverse effect on all of us, an effect that would be made substantially and permanently worse by approval of the Postal Service's proposed new methodology for distributing mail-processing costs. That methodology

purports to be a solution to the concerns we (and the Commission)¹ have been raising about the existing system for years. But it is in fact just a newly sophisticated entry in the long history of Postal Service evasions of the real issue. As witness Stralberg states:

Despite testimony by myself and others in the last two rate cases, despite admonitions by the Commission, despite numerous other attempts by the Periodicals industry to draw management's attention to this very serious issue, there has been no meaningful effort by USPS management to address the problem.²

The reason that the Postal Service has allowed this issue to fester for years-- and has, unfortunately, again managed in this docket to make its adequate resolution impossible--is that facing up to it would require acknowledging two unpleasant facts:

- (i) that the implementation of automation has produced hidden costs that mitigate the Postal Service's exaggerated estimation of the program's success;³ and

¹ See PRC Op. R90-1, App. J, ¶¶ 121-23; Docket No. RM92-2, Order No. 1002 ("Order Terminating Docket No. RM92-2") (January 14, 1994), at 3-4; PRC Op. R94-1, ¶¶ 3023-25, 4055.

² TW-T-1 at 7-8. The Postal Service's protracted, resolute resistance to numerous efforts to prompt serious inquiry into this issue is reviewed in some detail in the testimony of witnesses Crain (ABP-T-1 at 3-4), Little (MPA-T-1 at 1-6), and Cohen (MPA-T-2 at 5-12).

³ As witness Shew states:

[P]ersonnel routinely observed "not handling mail" in manual operations could represent a hidden cost of mail normally processed by automated sortation, rather than of the mail normally found in manual operations. In that event . . . the subclasses that now account for relatively few of the direct tallies in manual sortation could nevertheless be responsible for a large proportion of the costs of staff "not handling mail" in manual operations. [DJ-T-1 at 23-24 (footnote omitted).]

The General Accounting Office has repeatedly reached that conclusion, as noted by witness Cohen. MPA-T-2 at 10-11. Witness Stralberg (TW-T-1 at 30-31) provides a simple hypothetical that makes clear why such exaggerations tend to emerge spontaneously from the IOCS statistical system as automation is implemented and how, "under the Postal Service's
[footnote continues]

- (ii) that supervision of mail-processing operations has been lax, wasteful, careless and complacent, because managers who try to eliminate excess labor capacity are likely not to receive rewards but only an increase in grievances, whereas they suffer no penalty for simply tolerating it.⁴

However unpleasant they may be, these facts plainly have considerable import for determining the causal relationship between mail-processing costs and the individual subclasses of mail. Their recognition is therefore not just desirable but necessary to any faithful implementation of the statutory attribution requirement of § 3622(b)(3). The Supreme Court has made clear the role of the Commission in apportioning postal costs:

costing methods (old and new), the least automated mail will inevitably be held responsible" for cost increases that "it did not cause" but are "a natural consequence of increased automation." TW-T-1 at 26.

4 Witness Stralberg comments:

[The] category of general overhead not handling costs represents . . . 28.3% of all accrued mail processing costs. . . . The existence of such large and still growing not handling costs unrelated to specific productive activities is clear evidence of considerable slack time in the postal system, reflecting an inability of USPS managers to manage their workforce efficiently in the automated environment. [TW-T-1 at 35-36.]

The current incentive system for postal managers consists of bonuses awarded annually to approximately 65,000 supervisors and postmasters under the Postal Service's so-called "economic value added" program. "For postal executives, incentive pay from the program is based on the Postal Service's net income, minus a set of accounting costs for capital expenses, with mail delivery performance factored in. Postal managers' and supervisors' bonus payments, however, depend almost exclusively on local mail service and safety performance." *AMMA Bulletin* 06-98 (January 23, 1998), at 3. Thus, at the supervisory and managerial level where staffing decisions are made for individual mail-processing facilities and operations, the "economic value added" program provides virtually no incentives to eliminate unnecessary labor costs and actually constitutes an inducement to overstaff in order to insure against possible service failures.

Moreover, despite powerful evidence that this incentive structure is seriously unbalanced, such as a long-term decline in mail-processing productivities, the Postal Service is reportedly thinking about making things even worse. "New goals for 1999 already are under discussion. The Postal Service is considering including a measurement of how well managers treat employees and comply with craft union contracts according to labor sources." *Id.* at 4.

Congress' broad policy was to mandate a rate floor consisting of all costs that could be identified, in the view of the expert Rate Commission, as causally linked to a class of postal service. . . .

The statute requires attribution of any cost for which the source can be identified, but leaves it to the Commissioners, in the first instance, to decide which methods provide reasonable assurance that costs are the result of providing one class of service.⁵

Moreover, it seems unlikely that the Postal Service will be able to begin addressing the core underlying problem, to the ultimate benefit of all classes of mail, unless it is willing to acknowledge its nature. Witness Stralberg describes this self-perpetuating, and self-defeating, cycle:

If the Postal service, at long last, would take Periodicals mailers' concerns about rising costs seriously and launch a real investigation into why those costs have risen so much, the results might benefit more than just Periodicals mailers, by revealing the large inefficiencies in today's postal system and suggesting ways to use postal employees' time more efficiently. Instead, the Postal Service has chosen an approach that loads even more costs onto the least automated mail, thereby avoiding unpleasant questions about the efficiency of its management of its workforce and supporting its exaggerated claims of automation savings.

TW-T-1 at 39.

⁵ *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 833 (1983) (*NAGCP IV*). Witness Cohen adds:

The Supreme Court and the Commission agree that costs should not be attributed until the Commission has established a "reasonable confidence" that costs are the consequence of providing a particular service, or a "reasoned analysis of cost causation." [MPA-T-2 at 35.]

II. THE STATUTORY POLICIES THAT WE BELIEVE SHOULD INFORM THE COMMISSION'S APPROACH TO MAIL-PROCESSING COST DISTRIBUTION.

As explained above, the Postal Service's proposed cost distribution methodology is designed to avoid such questions as why, for more than a decade, the proportion of its mail processing time devoted to not handling and other nonproductive activities in manual operations has been increasing uncontrollably and the productivities in those operations have been deteriorating. The Postal Service's proposal to evade these issues again in this docket--and to establish Degen's new methodology as an accepted approach for evading them permanently--would thwart the following policies of the Act.

§ 3622(b)(3) cost attribution. Because important questions about cost causation would be either studiously avoided or answered erroneously, the Commission's application of § 3622(b)(3)'s attribution requirement would be distorted. The average marginal cost base on which markups are calculated would likewise be erroneously elevated because of over-estimated Periodicals volume-variable costs, thereby distorting comparisons across subclasses of markups, cost coverages, and markup indexes. These overestimates of Periodicals mail-processing costs would likely lead also, of course, to higher Periodicals rates than the Commission would recommend if it had a more accurate estimate of these costs.

The § 3622(b) pricing factors. The Commission's exercise of its judgment in applying the remaining § 3622(b) factors would, derivatively, be circumvented or distorted by a false and incomplete picture of patterns and amounts of subclass cost causation. As witness Shew points out:

Simply "assuming" what the costs of services are constitutes a determination not of *cost* but of *cost-recovery*, which usurps the regulator's role of deciding how costs should be recovered that are not clearly identifiable with individual services.

DJ-T-1 at 3.

The Commission's moderation of Periodicals cost coverage in the past two rate cases because of uncertainties about the reliability of the Postal Service's mail-processing costing methodology (PRC Ops. R90-1, ¶ 5246; R94-1, ¶ 4055) exemplifies how the current situation clouds the Commission's application of the § 3622(b) pricing factors and limits the flexibility the Commission would otherwise possess in applying the remaining pricing factors to Periodicals.

§§ 101(a) and 3622(b)(8). 39 U.S.C. § 101(a) provides that the Postal Service "shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people." This purpose is carried into the Act's ratemaking provisions and further particularized in § 3622(b)(8)'s requirement that in recommending rates the Commission consider the "educational, cultural, scientific, and informational value to the recipient of mail matter." Sections 101(a) and 3622(b)(8) have special relevance to Periodicals rates because of the enormous share that periodical publications contribute to the "educational, literary, and business correspondence of the people" and because, of all mail subclasses, it is Periodicals (along with books) whose defining characteristic is "educational, cultural, scientific, and informational value to the recipient."

§§ 101(d), 403(a), 3621 and 3622(b)(1). It is a basic tenet of the Postal Reorganization Act that "the costs of all postal operations [shall be apportioned] to all users of the mail on a fair and equitable basis." § 101(d). The Act directs the Postal Service to "provide adequate and efficient postal services at fair and reasonable rates and fees." § 403(a). The Postal Service Governors "are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees" and are required to recommend changes

in rates and fees that accord with "the establishment and maintenance of a fair and equitable schedule." §§ 3621, 3622(b)(1).

If postal costs are apportioned in a manner that results in unexplained and excessive cost increases for one class of mail, that apportionment, and any rates and fees based on that apportionment, cannot be "fair," "reasonable," or "equitable." The values of fairness and equity would be traduced, because mailers whose mail is mostly manually processed would be made the incidental and innocent victims of the Postal Service's single-minded focus on what it regards as more important priorities--i.e., vindicating its record in designing and implementing the vastly expensive automation program and its ongoing commitment to an ambitious program of continuing capital expenditures for the same purpose.

III. SYNOPSIS OF TESTIMONY.

Given their mutual interest, as explained above, it should come as no surprise that the testimony presented by the parties to this brief is in part jointly sponsored and in all respects coordinated. This effort was undertaken to avoid repetition but, more importantly, to present to the Commission the strongest possible case in support of rates no higher than those requested for Periodicals.

First, the testimony we sponsor establishes:

- (i) a decade-long pattern of excessive and unexplained increases in mail-processing costs for Periodicals;
- (ii) repeated efforts by Periodicals mailers and, indeed, the Commission itself to prompt the Postal Service to generate the data and conduct the studies necessary so these costs may be apportioned fairly and equitably; and
- (iii) the failure of the Postal Service to take the steps necessary to satisfy the requirements of the Postal Reorganization Act and thereby to enable the Commission to apportion these costs in the manner required by the Act.

Second, and most importantly, our testimony shows that the "new" methodology sponsored by Postal Service witness Degen suffers from critical flaws including:

- (i) testable yet untested assumptions;
- (ii) inadequate data for statistically reliable results;
- (iii) some demonstrably erroneous outcomes; and
- (iv) frequently counterintuitive results.

Finally, our testimony proposes two alternatives to the Degen methodology. As one, we offer the "interim" methodology proposed by witnesses Stralberg and Cohen, which is similar to the traditional LIOCATT/IOCS methodology used in the past. That "interim" methodology is based on three fundamental principles:

- (i) the distribution methodology should avoid unsupported assumptions to the greatest extent possible;
- (ii) Distribution procedures should use all verifiable and relevant data collected in IOCS upon which reasonable inferences of causation can be based; and
- (iii) pending the development of more complete information, cost distributions should generally be done as they have in the past, since there is currently no better alternative.

See, e.g., MPA-T-2 at 30; TW-T-1 at 4-5.

As a second alternative, we propose that the Commission treat a portion of the volume-variable costs of mixed mail and not handling as institutional. As the Court in *NAGCP IV, supra*, pointed out: once the Commission "conscientiously has attempted to find causal connections between classes of service and all postal costs--both operating costs and 'overheard' or 'capacity' costs--where data are sufficient," it is free "to assign remaining costs on the basis of the other eight factors set forth by section 3622(b)." 462 U. S. at 834.

The appropriate starting point for a synopsis of this testimony is the jointly sponsored testimony of witnesses Keith Crain (ABP-T-1) and Christopher Little (MPA-T-1). Crain is Chairman of Crain Communications, a leading publisher of

business-to-business periodicals, and serves as Chairman of ABP's Washington Legal Committee. Little is President of the Meredith Corporation Publishing Group, a leading publisher of consumer periodicals, and serves as Chairman of MPA's Government Affairs Council. Together, they describe the severity of the unexplained and excessive increases in reported Periodicals mail-processing costs since 1986 and the disappointment of the industry that the Postal Service has ignored both mailers' and the Commission's pleas for serious examination of the problem.

In its "Order Terminating Docket No. RM92-2" (Order No. 1002 [January 14, 1994]), the Commission characterized the Postal Service's conduct with respect to this issue as follows:

The Postal Service has not acknowledged the importance of the issues involved and there is very little evidence that the Postal Service takes these issues seriously. . . . In effect, it has refused to report or confer on steps being taken to address the questions that have been raised. What's worse, the information that is available suggests very little analysis is underway. Moreover, the Postal Service has been unwilling to provide data that are readily available that might be used by the Petitioners in some type of analysis. . . .

[T]hese phenomena raise serious questions about the Postal Service's success, or lack thereof, in controlling costs, and in managing its operations to fully realize the benefits of automation. . . . The Postal Service is avoiding accountability and sullyng its own interests by pretending that the problem does not exist.

Id. at 3-4.

Unfortunately, the Postal Service's attitude appears to have changed little. Crain points to, among other things, a recent high-level meeting at which the Postal Service again stood by its cost figures, notwithstanding that, as recounted by Little, Periodicals' attributable costs have inexplicably or "unaccountably" increased far more rapidly than the costs of other classes, and processing costs have climbed far

more rapidly over the past decade (71%) than the Postal Service wage rates (41%). MPA-T-1 at 2, 5 (FY 1986--FY 1996 inclusive).

The heart of our evidentiary presentation is found in the testimony of expert witnesses Rita Cohen (MPA-T-2) and Halstein Stralberg (TW-T-1), supported by the testimony of economist William Shew (DJ-T-1). After detailing the history of the industry's and the Commission's concerns with the measurement and distribution of mail-processing costs, Cohen explains her support for USPS witness Bradley's meticulous study performed to replace the untested and intuitively improbable assumption that processing costs are nearly 100% volume variable. MPA-T-2 at 15-17. In contrast, she shows that USPS witness Degen's new method for distributing the volume-variable portion of those costs not only fails to respond to past criticisms but actually exacerbates the problems complained of, and the adverse effect on Periodicals, by relying in major respects upon untested and apparently incorrect assumptions. Focusing on mixed mail and not-handling costs, Cohen demonstrates that major flaws in Degen's assumptions lead him to rely on statistically inappropriate distribution keys. She provides two preferable alternatives for allocating distribution costs and concludes with a call for additional analysis and a statement of her support for the rates and cost coverage proposed here for Periodicals.

Cohen's testimony is paired with that of Halstein Stralberg, who has studied postal costs for more than twenty years. He focuses in greater detail on the myriad deficiencies in Degen's analysis, and he demonstrates that Degen's insistence upon distributing mixed mail and not-handling costs solely within a large number of individual MODS cost pools ignores cross-pool relationships and thus creates significant distortions. That method, Stralberg shows, is essentially a more extreme variant of the method rejected for good reason by both the Postal Service and the Commission in the R94-1 case.

Stralberg also shows that Degen's new methodology does not inquire into the reasons why not-handling costs have increased so dramatically. Rather, by distributing those costs strictly within the MODS cost pools that employees were "clocked into," Degen assigns an excessive share of not-handling costs to mail that receives most of its handling at platforms and opening units, where productivity is not monitored, and where employees tend to be sent or to gravitate when there are no other assignments--i.e., the mail that is most highly presorted and receives the least automated processing.

Stralberg concludes that the data relied upon by the Postal Service, and the results it obtains with those data, are so unreliable for the purpose of linking mixed mail and not-handling costs with specific subclasses that (1) at least for this docket and until substantial improvements are made, some processing costs should be treated as institutional, and (2) those costs that are to be attributed should be attributed through "an alternative approach that . . . relies on fewer untested assumptions, is closer to the approach traditionally used by the Commission, and makes use of much information that Degen has chosen to ignore." TW-T-1 at 3.

Economist William Shew offers both theoretical and practical support to Cohen's and Stralberg's acceptance of Bradley and criticisms of Degen. Bradley, he shows, substitutes empirical investigation for a traditional but inherently implausible assumption that he now convincingly shows to have been wrong. Degen, unfortunately, does the converse, spinning out extensive, arbitrary and apparently incorrect assumptions instead of relying on measurement for distributing costs. Stralberg and Cohen provide many examples, such as Degen's decision to use counted-item data to distribute the costs of uncounted items, despite the conclusions of both the Postal Service and the Commission in Docket No. R94-1 that these data cannot be relied on for that purpose. As Stralberg further explains:

In R94-1 USPS witness Barker testified that the costs of counted items should not be viewed as sufficiently reliable to use for distribution purposes unless and until the Postal Service had performed a special study to determine why so many mixed mail items remained uncounted and whether there existed a rational basis for distributing their costs based on the counted items. Tr. [3/]1157-58, R94-1. The Postal Service has presented no results from such a special study in this docket. Nor, to my knowledge, has it ever conducted or considered conducting such a study.

TW-T-1 at 17, n. 11.

In sum, these technical experts support a finding that a combination of inexplicably rising Periodicals costs and an ill-conceived distribution method results in an overstatement of Periodicals costs and an understatement of the cost coverage that would be generated by the rates proposed. Recognizing the fact that the defects cannot all be cured on this record, they support the filed rates for Periodicals and the cost coverage those costs produce.

In further support of the proposed rates and a relatively low cost coverage for Periodicals, individual sponsors of this brief have provided the testimony of witnesses Nicholas Cavnar (ABP-T-3) and Joyce McGarvy (ABP-T-2), Max Heath (NNA-T-1) and Patsy Speights (NNA-T-2), Dr. John Stapert (CRPA-T-1) and Michael Hehir (MH-T-1). Speaking on behalf of their own companies and organizations, these witnesses give further support to a low Periodicals cost coverage in this docket by addressing such issues as: the effect of the 1996 rate adjustments, new USPS regulatory initiatives, and rising paper prices on mailing costs for many publishers; delays in deploying automation equipment for tabloids; an unexplained increase in the allocation of purchased highway transportation costs to Periodicals; and perceived service declines.

IV. WHAT WE ASK THE COMMISSION TO DO.

A. Accept Bradley's calculated volume variabilities.

We believe that Bradley's calculated volume variabilities are well supported on the record, and we urge the Commission to accept them. The traditional assumption that mail-processing costs are 100% volume variable, on the other hand, is without substantial evidentiary support on this record. Although witnesses Neels (UPS-T-1) and Smith (OCA-T-600) provide *assertions* in support of the traditional assumption, neither succeeds in discovering any *arguments*, whether by way of minimally acceptable econometric analysis, recognized or orthodox theories of the economics of rate regulation or industrial organization, or sound statutory or policy analysis, that would justify continued reliance on the traditional assumption. In addition to accepting Bradley's first-rate econometric analysis, we urge the Commission to recognize that (contrary to suggestions heard occasionally over the years and reiterated in this docket by witness Bentley [MMA-T-1 at 7-9]) there is no basis either in the policies of the Act or in correct costing theory for any general disposition or aspiration in favor of higher rather than lower levels of attribution. The proper levels of attribution are those that correspond to actual cost causation by subclass, and there is no reasonable way to assess what those levels are, or in what direction they should be moving over time, until actual evidence of actual cost causation is examined.

With respect to policy, we ask the Commission to consider two points. First, only correctly calculated attributable costs allow the Commission to exercise informed discretion and to achieve its intended policy results in applying the judgmental pricing criteria of § 3622. Second, lower variabilities do not constrict the Commission's scope for the exercise of discretion or policy judgment but rather, by increasing the pool of costs assigned under the pricing criteria of § 3622, have the

opposite effect. (If 100% of all costs were attributable, ratemaking under the statute would become a purely mechanical and technical enterprise; *contra* Bentley [MMA-T-1] at 7-9.)

With respect to correct costing theory, we disagree entirely with the notion that, as knowledge and understanding of cost causation within the postal system increase, levels of attribution ought necessarily to increase as well, so that reductions in levels of attribution ought to be viewed as “paradoxical,” or “counterintuitive,” or as representing some sort of failure of analysis (ultimately implying that, with perfect knowledge, it would be possible to attribute 100% of the Postal Service’s costs). On the contrary, the correct level of attribution depends on the proportions of costs that are *in fact* caused by individual subclasses rather than two or more subclasses in common. Thus, as more and more mail enters the system and economies of scale are increasingly realized, the proportion of costs caused by individual subclasses--i.e., attributable costs--should be more likely to *decline* than to *increase*.

- B. Hold the Postal Service to its many broken commitments to study why costs are rising and productivity is falling at seemingly inexplicable rates in manual mail-processing operations, and to its obligation under the Act to develop a costing methodology that takes into account the answers to these questions.

As a consequence of the Postal Service’s decade-long refusal to confront the issues we have discussed here, the scope of what remains undone is daunting. Stralberg forthrightly and, we believe, correctly describes the situation we have come to:

In order to be able to accurately distribute mixed mail costs in the future, what is needed is nothing less than a complete rethinking and redesign of the current IOCS approach to collecting data on mixed mail. The current approach, while elaborate and costly, simply fails to produce information from which reliable inferences can be drawn about the subclass

content of mixed items and containers. The Commission should send the Postal Service back to the drawing board to come up with a better approach before the next rate case.⁶

This rethinking and redesign is not limited to development of a better way to collect information on mixed mail. It needs also to include inquiry into the causes for the still ongoing increases in not-handling costs and study of the criteria applied by postal managers in hiring decisions and decisions to assign employees to specific tasks, including assignment during slack periods when no work is available. None of these efforts, whether of investigation, analysis, operational planning, or statistical system design, although long called for, has yet been undertaken by the Postal Service .

The Supreme Court recognized in *NAGCP IV* the responsibility of the Postal Service in this regard: "For this function [correct cost attribution in determining rates] to be performed, the Postal Service must seek to improve the data on which causal relationships may be identified." 462 U.S. at 833 (footnote omitted). Participants cannot on their own insure that the function of cost attribution under the Act is performed, since "[p]articipants in postal rate cases are largely dependent on Postal Service data for developing direct and rebuttal evidentiary presentations." PRC Order No. 1201 (November 4, 1997) at 15.⁷

⁶ TW-T-1 at 14; see also MPA-T-2 at 38-39; and DJ-T-1 at 29 (Shew: "The USPS should be strongly encouraged to shift its resources from spinning assumptions to developing data that will allow actual service costs to be determined").

⁷ The Commission also noted:

The Postal Service is subject to broad and somewhat unique obligations when it files a rate Request with the Commission. These obligations exist both because the Postal Service is the proponent of changes in rates, and because the Service is the repository for the vast majority of data relevant to rate case issues. Not only the Postal Service, but also the parties and the Commission, have to use and rely on information collected in Postal Service data systems and developed by Postal Service employees and consultants. Neither the participants nor the Commission has access to the Postal Service for the purpose of

[footnote continues]

The Commission should hold the Postal Service to its statutory responsibility to "improve the data on which causal relationships may be identified." It should yet again try to prompt the Postal Service to study the issues of why costs are rising and productivity is falling at seemingly inexplicable rates in manual mail-processing operations. The Commission has exhorted the Service to perform these responsibilities in the past without success.⁸ In those instances, however, the Commission could not, or chose not to, hold the Service responsible for its failure. In this case, we urge the Commission to take a stronger stance.

- C. Reject, therefore, Degen's proposed cost distribution and accept as an interim solution for this case the alternative proposed by Stralberg and Cohen, including classifying as institutional the "general overhead not handling costs" that have sharply increased to more than 28% of all accrued mail-processing costs as automation has been implemented, and that the Postal Service is unable to connect by evidence to specific productive activities, subclasses, or services.

Degen's methodology does not address these issues but simply further extends the unexamined assumptions of the old methodology, whose validity has been at the center of this controversy since the whole matter was first raised in R90-

performing studies or collecting data. Necessarily, the Postal Service is the source of the vast preponderance of the data used in Commission proceedings. [PRC Order No. 1201 (November 4, 1997), at 12.]

⁸ In 1992 the Commission initiated a rulemaking proceeding to investigate the anomalous increases in mail-processing costs. In January, 1994, it terminated the proceeding stressing "[t]he Service, by its actions resisting inquiry, has not only failed to dispel the concerns of the rate payers and the Commission, it has if anything heightened them" PRC Order No. 1002 (January 14, 1994) at 4. In its Opinion in Docket No. R94-1 the Commission noted that it believed the questions raised about mail-processing costs were serious and expressed concern that the Postal Service was not giving them the attention they deserved. The Commission stated:

A number of questions concerning the IOCS and mail processing costs were raised in Docket No. R90-1. There has been virtually no cooperation from the Postal Service with either the Commission or the mailers in dealing with these questions since then, and the record demonstrates that answers have not been found. [PRC Op. R94-1, ¶ 3023.]

1. Stralberg's and Cohen's method is closer to the traditional LIOCATT/IOCS methodology approved by the Commission in the past, is based on more reasonable assumptions than the Postal Service's proposal, is supported by detailed, fully documented analysis and argument, and (unlike the Postal Service's hodgepodge of continually shifting, mutually contradictory, and uniformly unpersuasive explanations over the years) is consistent with the analysis that Stralberg originally presented in R90-1, further elaborated in R94-1, and that has increasingly been borne out with the passage of time.

- D. Retain the existing IOCS/LIOCATT methodology of cost distribution for this docket if the Commission finds it cannot accept Stralberg's and Cohen's proposed alternatives.

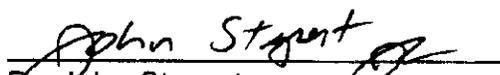
If the Commission finds it cannot accept Stralberg's and Cohen's proposed methodology, it should at least refuse to acquiesce in the Postal Service's proposal to assume these issues away in theory while institutionalizing and exacerbating in practice the resulting distortions in our understanding of cost causation and the adverse and unfair impact on mail that is largely manually processed. Rather than employ Degen's methodology, it should retain the existing IOCS/LIOCATT methodology of cost distribution until the Postal Service presents an alternative that seriously addresses these long-outstanding questions and that is supported by careful analysis and reasoned argument rather than based on unsupported assumptions and mechanical reliance on the generation of data without any searching examination of what the data actually signify.

- E. Approve a mail-processing cost distribution methodology in this case on a provisional basis only, with the stipulation that its future use will depend on the performance of empirical studies such as were declared necessary by witness Barker in Docket No. R94-1 but not undertaken by Degen or the Postal Service in developing the proposal in this docket.

- F. Whatever its resolution of mail-processing cost distribution issues, the Commission should recommend rates for Periodicals no higher than those proposed by the Postal Service.

The low proposed cost coverage is justified by § 3622(b)(8)'s concern for the "educational, cultural, scientific, and informational value to the recipient of mail matter," the other statutory factors discussed in section II above, and by continuing uncertainties about the degree to which the Postal Service is overestimating mail-processing costs that are properly attributable to Periodicals.

Respectfully submitted,


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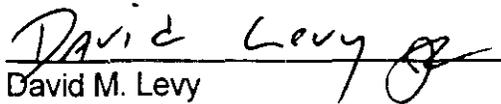
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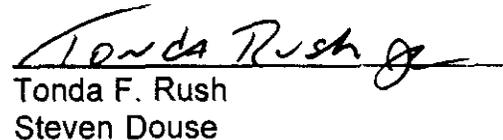

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.


James R. Cregan

February 10, 1998