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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

SPECIAL SERVICES FEES AND CLASSIFICATIONS) Docket No. MC96-3

Direct Testimony of

DR. JOHN HALDI

Concerning

NON-AUTOMATABLE BULK BUSINESS REPLY MAIL

on Behalf of

NASHUA PHOTO INC.,
MYSTIC COLOR LAB, AND
SEATTLE FILMWORKS, INC.

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Seattle FilmWorks, Inc.

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AUTOBIOGRAPHICAL SKETCH

My name is John Haldi. I am President of Haldi Associates, Inc., an economic and management consulting firm with offices at 680 Fifth Avenue, New York, New York 10019. My consulting experience has covered a wide variety of areas for government, business and private organizations, including testimony before Congress and state legislatures.

In 1952, I received a Bachelor of Arts degree from Emory University, with a major in mathematics and a minor in economics. In 1957 and 1959, respectively, I received an M.A. and a Ph.D. in economics from Stanford University.

From 1958 to 1965, I was an assistant professor at the Stanford University Graduate School of Business. In 1966 and 1967, I was Chief of the Program Evaluation Staff, U.S. Bureau of the Budget. While there, I was responsible for overseeing implementation of the Planning-Programming-Budgeting (PPB) system in all non-defense agencies of the federal government. During 1966 I also served as Acting Director, Office of Planning, United States Post Office Department. I was responsible for establishing the Office of Planning under Postmaster General Lawrence O'Brien. I established an initial research program, and screened and hired the initial staff.

I have written numerous articles, published consulting studies, and co-authored one book. Included among those publications are an article, "The Value of Output of the Post Office Department," which appeared in *The Analysis of Public Output*

(1970); a book, *Postal Monopoly: An Assessment of the Private Express Statutes*, published by the American Enterprise Institute for Public Policy Research (1974); and two articles, "Measuring Performance in Mail Delivery" in *Regulation and the Nature of Postal Delivery Services* (1992), and "Cost and Returns from Delivery to Sparsely Settled Rural Areas" in *Managing Change in the Postal and Delivery Industries* (forthcoming).

I have testified as a witness before the Postal Rate Commission in Docket Nos. MC95-1, R94-1, SS91-1, R90-1, R87-1, SS86-1, R84-1, R80-1, MC78-2 and R77-1. I also have submitted comments in Docket No. RM91-1.

PURPOSE OF TESTIMONY

The purpose of this testimony is describe how the business reply functions of counting, weighing, rating and billing non-automatable bulk business reply mail ("BRM") are handled for certain permit holders who use such mail, to explain why the BRM fee of 10 cents per piece which they currently are forced to pay is inequitable and in violation of 39 U.S.C. § 403(c) as applied to these and other similarly situated mailers, and to propose two alternative modifications to the DMCS designed not only to eliminate the inequity and satisfy all requirements of the Postal Reorganization Act, but also to comport with and even enhance the objectives of reclassification as articulated by Postal Service witnesses.

As indicated above, my testimony focuses on and is essentially limited to the treatment of non-automatable bulk BRM. However, in the somewhat extensive motions practice that has preceded submission of this testimony, the Postal Service has alluded to work underway by a cross-functional internal ad hoc task force established sometime "earlier this year [1996]" to conduct "a comprehensive internal management review of Business Reply Mail."[1] In addition, there also exists a working group that includes representatives from Nashua and Mystic. The Postal

[1] Motion of the United States Postal Service for Reconsideration of PRC Order No. 1129 or, in the Alternative, for Severance of Consideration of the Nashua/Mystic Proposal in a Separate Proceeding, p. 5 (August 16, 1996).

Service has argued that the mere existence of the task force and the working group should foreclose present consideration of this testimony by the Commission. In light of this situation, it is pertinent to explain why it is neither necessary nor desirable for the Commission to await a "comprehensive" solution to the various issues and problems associated with BRM and the Business Reply Mail Accounting System ("BRMAS"),[2] and why in this docket the Commission should recommend one of the alternative proposals advanced here. The proposals advanced in this testimony need to be viewed within the structure that the Postal Service has sought to create, which necessitates some ancillary discussion of other BRM issues.

It should be clearly understood throughout, however, that it is not the purpose of this testimony to inject into this docket any issues associated with BRM other than those directly related to the two alternative proposed modifications to the DMCS that are recommended herein (Appendix II), which are within the scope of the enlargement authorized by Commission Order No. 1129 (August 8, 1996).

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[2] Despite the existence of the internal task force, "because the Postal Service, in organizing for this Docket, had no reason to anticipate the need to assemble resources to deal with unrelated Business Reply Mail issues, the usual standard of efficient and expeditious response to discovery is likely to be difficult to achieve." (Motion of the United States Postal Service for Reconsideration of PRC Order No. 1129, p. 9.) It would appear that the task force meets only from time to time, as a sort of collateral assignment (as opposed to being a temporary, but full-time working group). Moreover, based on responses to NM/USPS-28, 29, 30, 32, 35 and 36, the task force seemingly has no resources available for operational studies or surveys of business reply mail.

INTRODUCTION

This testimony is presented on behalf of three intervenors, which are (i) Nashua Photo Inc. ("Nashua"), which does business as York Photo Labs, (ii) Mystic Color Lab ("Mystic"), and (iii) Seattle FilmWorks, Inc. ("Seattle" or "Seattle FilmWorks").[3] Each firm is a through-the-mail film processor, as all three companies - principally using Business Reply Mail - receive exposed film through the mail, and all three companies thereafter use the postal system to return developed film and prints to their customers.

Overview of the Film Processing Industry

Collectively, through-the-mail film processors account for approximately 6 percent of the domestic film processing market. The remaining 94 percent of the market is divided among a large number of local, regional and national (*e.g.*, Kodak and Fuji Film) film processing companies that rely on the general public taking their film to a drop-off location and then returning to the drop-off location to pick up the finished prints. In some localities competitors do on-site developing and printing, and offer turn-around times as short as 1 hour.

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[3] The three firms collectively also will be referred to herein as NMS.

Nashua, Mystic and Seattle compete vigorously with each other, but they compete even more with the multitude of local, regional and national film processors described above.

Mailing Practices of Nashua, Mystic and Seattle

Mystic and Seattle supply all their customers and prospects exclusively with specially designed business reply envelopes ("BREs") to use when placing an order. Some of the reply envelopes that Nashua distributes require the customer to pre-pay the postage, but a substantial majority of Nashua's orders now arrive in BREs. The next section contains an extensive discussion of the procedures used to process BREs at Nashua, Mystic and Seattle.

With respect to returning the finished photo product to customers, which does not involve BRM, and thus is not at issue here, most packages of prints weigh less than one pound. All three companies use an expedited dropship service to send those packages to destinating SCFs, at which point the individual customer envelopes are entered as Standard A (formerly third-class regular) mail, for final delivery.

I. PROCESSING OF BUSINESS REPLY MAIL BY NASHUA, MYSTIC AND SEATTLE

Nashua, Mystic and Seattle are substantial Postal Service customers using the BRM service, with each firm maintaining an advance deposit BRM account. From this account the Postal Service withdraws funds to cover First-Class postage on all incoming pieces, as well as the BRM fees. The Postal Service has ruled that the type of BRM used by NMS — which is assessed at the current rate of 10 cents per piece — is ineligible for the lower, prebarcoded BRMAS rate of 2 cents per piece because it is not automatable.[4] At the same time, as will be shown here, the counting, weighing, rating and billing functions, which constitute the unique special services feature associated with the business reply aspects of their incoming non-automatable First-Class Mail, are perhaps **less costly than** those associated with BRMAS-qualifying mail. Although BRM addressed to Nashua, Mystic and Seattle is not handled identically at each location, in each instance the operation requires comparatively little effort by the Postal Service.

The following explanation of how BRM is processed at Nashua, Mystic and Seattle is fundamental to an understanding of the two alternative BRM reclassification proposals submitted herein for the Commission's consideration in this docket. I have personally visited the Nashua plant in Parkersburg, West Virginia, and have visited

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[4] See Library Ref. LR-NMS-1.

both the Mystic and Seattle FilmWorks plants and the New London, Connecticut and Seattle, Washington Post Offices that process this mail.

Nashua Photo Inc.

Nashua has one central processing facility, located in Parkersburg, West Virginia. Customers send their film to one of several Nashua post office boxes located throughout the country. Customer envelopes received at Nashua's post office boxes are forwarded (via Priority Mail Reship) to Nashua's West Virginia plant.

Prior to 1990, all of Nashua's customers paid the required First-Class postage. In 1990 Nashua began limited experiments with BREs in selected parts of the country. During this experimental phase, when the number of BREs was fairly limited, the Postal Service manually counted, weighed, rated and billed Nashua for each such envelope individually.

Nashua began distributing a substantial number of BREs to existing customers, as well as to potential new customers, in the summer of 1994. From then until October, 1994, when Nashua implemented the incoming manifest system[5] described below, BREs were manually counted, weighed and rated individually and the Postal Service assigned additional employees to do the work. **From October 1994 onward, the Postal Service has not segregated, counted, weighed and rated, or otherwise accounted for, Nashua's BREs at either the location of its post office boxes or in**

[5] This system has also been referred to by the Postal Service as a "reverse" manifest system. See response to NM/USPS-34.

West Virginia (other than some inexpensive monitoring of the accuracy of the Nashua-generated manifest).[6] All incoming mail is merely delivered to Nashua's West Virginia plant. As described below, all necessary counting, rating and billing functions are performed at the Nashua plant by Nashua employees who, when opening each envelope, enter data used by Nashua to prepare an incoming manifest.

BREs continue to represent an increasing percentage of exposed film received by Nashua, and have grown to the point where for the last 12 months they now represent almost 70 percent of Nashua's incoming mail.

Nashua's incoming manifest system. The incoming manifest system developed by Nashua works as follows. Nashua's BREs are combination envelopes/order forms containing price schedules and employing uniquely coded "track" numbers. These track numbers indicate whether the envelope was business reply mail or a mailpiece which required customer-applied stamps. In addition to the tracking code, Nashua employees enter (i) product codes (*e.g.*, 35mm, 110mm, 126mm disc; and 12, 24 or 36 exposures), (ii) the quantity of each product received,

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[6] The Postal Service Motion for Leave to File Brief Response to the Nashua/Mystic Opposition to the USPS Motion to Reconsider PRC Order No. 1129 (filed September 5, 1996) states that "The Postal Service and Nashua have been working closely to test a 'reverse manifest' BRM accounting system since the fall of 1995." This statement is not correct. The "test" referred to there has been running since October 1994, or for almost 24 months (**not** 12 months), it encompasses **all** BREs received by Nashua, and has become standard operating practice. The local post office has reassigned to other work all postal employees who sorted, counted, weighed and rated Nashua's mail immediately prior to October, 1994. The so-called "test" was in place and ongoing for (i) almost 21 months before Postal Service headquarters convened the first meeting of the working group, and (ii) well over one year before the BRM task force was established.

(iii) whether rolls of film were enclosed in the plastic film canister that comes with the film, and (iv) other enclosures, such as a check, coupons, or credits. All of the preceding factors combined, when entered, are used by Nashua's sophisticated computer system to calculate the weight and associated appropriate amount of First-Class postage applicable to each piece, including the non-standard surcharge (if applicable) plus the BRM fee.[7] The incoming manifest system has been in continuous use since implementation in October, 1994.

Revenue protection. The incoming manifest on each piece enables the Postal Service to conduct daily audits in which individual pieces are weighed and the postage due is compared with the postage calculated on the incoming manifest. The audit capability helps assure accountability and revenue protection. The Postal Service uses basically the same sampling procedures and standards on Nashua's incoming manifest as it applies to Nashua's outgoing manifest.[8]

On a daily basis, Nashua transmits the incoming manifest information to the Postal Service so that the amount due for First-Class postage and fees can be deducted from its Business Reply Advance Deposit Account. The Postal Service's only involvement in the processing of Nashua's BREs is sampling, which consists of

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[7] A package with a roll of film is over 1/4 inch thick. If it weighs less than one ounce, Nashua pays First-Class postage of 32 cents plus the 11-cent, non-standard surcharge, for total postage of 43 cents. The current BRM fee of 10 cents brings total postage and fees to 53 cents for an under-one-ounce package.

[8] For more information on the procedures followed by the Postal Service, see *LR-SSR-148, Guide to the Manifest Mailing System*, USPS Publication 401 (July, 1993), pp. 86-87, section on Procedures for Verifying and Adjusting Batched Mailings.

pulling, recording data from, and weighing approximately 50 mailpieces from the daily incoming shipments.[9] Data from the daily sample are compared, for purposes of verification, to the data submitted to the Postal Service by Nashua. Each day the total postage paid by Nashua is subject to adjustment if the sample shows overpayment or underpayment.

The error rate in the sampling procedure can be assessed in two ways:

i) the number of pieces for which the estimated postage was not 100 percent accurate; and

ii) the extent to which estimated postage differs from actual postage.

A. Number of pieces for which postage is mis-estimated. The Postal Service response to NM/USPS-34 indicates that in October, 1995, the postage was estimated incorrectly for some 20.2 percent of the pieces sampled. In June, 1996, the error rate declined to 16.3 percent of pieces sampled, and in July, 1996, the error rate was down to 5.7 percent. The decline in the error rate reflects refinements implemented by Nashua to make the system more accurate.

B. Variation in total postage due. The Postal Service response to NM/USPS-34 notes that errors sometimes favor Nashua, and sometimes favor the Postal Service. This indicates that the system, although subject to error, has no

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[9] Since all of Nashua's outgoing mail is plant-loaded, when the incoming manifest system was implemented the Postal Service already had available an on-site employee who has been able to accomplish the daily sampling as a collateral duty. The sampling associated with the incoming manifest system thus caused the Postal Service to incur no additional costs.

consistent bias one way or the other. The net result is that the errors are largely offsetting. For each of the three months covered in the response to NM/USPS-34, as well as last August, the estimated postage on the manifest as a percentage of the postage for the pieces in the sample was as follows:

October, 1995	93.05%
June, 1996	97.80%
July, 1996	97.75%
August, 1996	98.00%

The system itself has become increasingly accurate. Moreover, since the total postage paid by Nashua is adjusted daily on the basis of the sample, Postal Service revenues are fully protected.

C. Nashua's costs to develop and operate its incoming manifest system. To develop the software program for its incoming manifest system, Nashua has to date incurred a one-time cost of approximately $10,000. In addition to this non-recurring cost, Nashua incurs annual operating costs of about $45,000 for the daily verification requirement and the additional keying that operators must do when they process each incoming order. Should BREs expand to the point where they constitute 100 percent of Nashua's volume, the additional cost of keying would increase to between $55,000 and $60,000 per year. Any further refinements and improvements to the system will add to the non-recurring cost and, perhaps, to the recurring costs as well. In all respects, Nashua's incoming manifest system is a form of worksharing,

wherein mailer effort and expense supplant and replace Postal Service labor and expense.

Summary. To sum up, Nashua has developed and operates, at its own expense, an extremely effective system for handling BRM, under which Nashua does essentially all work required to process its BRM, and collects all necessary data to compute First-Class postage and all fees due. The Postal Service has almost no involvement, aside from on-site sampling inspections and accepting payments. Nashua's incoming manifest system constitutes an innovative and reliable means by which the Postal Service is able to collect all First-Class postage and fees due for Nashua's BRM while incurring only negligible cost.

Mystic Color Lab

Mystic Color Lab has one central processing facility, located in Mystic, Connecticut. Since its founding in 1970, Mystic has provided its customers with BREs, which Mystic's customers use to mail their exposed film. All mail for Mystic is routed to the post office at New London, Connecticut, where it is picked up by Mystic once daily, around 4:30 a.m., every day except Sunday. As described below, the New London Post Office and Mystic have developed a highly efficient, low-cost and mutually beneficial method of handling Mystic's BRM.

The daily procedure, in effect for over ten years, is as follows.[10] Upon arrival at New London, incoming BREs for Mystic are consolidated by the post office into large sacks,[11] which are then weighed.[12] No individual business reply envelopes have been counted or weighed, either manually or in any other fashion, since 1985, when the New London Post Office started using the current weight-averaging system. After subtracting the tare weight of the sack from the gross weight of the sack, the net weight is multiplied by a pre-determined **price per pound** to compute the total First-Class postage, including the non-standard surcharge (if applicable) and BRM fees due. This simplified handling and billing procedure involves some time each night from a single Postal Service clerk.

After weighing, the sacks are simply held for pickup by Mystic. Importantly, no other handling cost is incurred because none of the BREs are reinserted into the mailstream for delivery with regular First-Class Mail (as must be done for some

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[10] Use of the weight-averaging system by the New London Post Office and Mystic predates formation of the Postal Service's internal BRM task force by more than nine years. The system has worked successfully and essentially without problems at New London for over ten years (and for over 15 years at Seattle FilmWorks; see the discussion, *infra*). These facts stand in contrast to the Postal Service's statement that "The task force. . .will explore potential opportunities for. . .***new*** products and services, including alternative methods of BRM processing and billing such as 'reverse manifesting' and '***weighing/piece conversion***.'" (Emphasis added.) Response of the United States Postal Service to PRC Order No. 1131, p. 2 (August 23, 1996).

[11] Some of Mystic's mail may already have been sorted into separate sacks prior to arriving in New London.

[12] The only capital cost involved in the weight-averaging system is a large capacity scale, which may be used for other purposes as well. By comparison, a far higher capital outlay is required for the automation equipment that is used to process mail that receives the BRMAS rate.

customers that receive small quantities of pre-barcoded BRMAS-qualified mail),[13] nor does the Postal Service incur any cost to deliver the mail.

The pre-determined price-per-pound is calculated through a periodic sampling, conducted jointly by the New London Post Office and Mystic. The sample consists of 1,000 pieces, selected at random, which are weighed and rated individually by employees of both the Postal Service and Mystic; *i.e.*, duplicate weighing and rating of each piece is performed. As the work can be somewhat tedious, this redundancy helps ensure accuracy.[14] Each party prepares its own spreadsheets, the results are compared, and any discrepancies between the two are checked and reconciled. The First-Class postage, including non-standard surcharge (if applicable) and BRM fees for the 1,000 sample pieces are summed and divided by their total weight, which becomes the price per pound until the next sample is taken.[15]

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[13] Additional information on how carriers handle small volumes of BRMAS-qualified mail is provided in response to NM/USPS-20. After BRM has been segregated so that it can be counted, rated and billed, under certain circumstances it may require some additional in-office handling. In this regard, the Commission stated that:

> If the BRMAS piece requires street delivery, the piece is consolidated with other mail for walk sequencing and then delivered. If the BRMAS piece is addressed to a post office box it may require further sequencing to box section number and to the numerical order of the post office box. [Docket No. R94-1, *Op. & Rec. Dec*, p. V-147, ¶5456.]

[14] The periodic sampling process requires about 1 to 2 days of effort by the Mystic employee and by the Postal Service employee.

[15] The predetermined price per pound reflects all applicable postage and fees. For example, a package with a roll of film that weighs less than one ounce pays First-Class postage of 32 cents plus the 11 cent non-standard surcharge, for total postage of 43 cents. The BRM fee of 10 cents brings total postage and fees to 53 cents for a one-ounce package.

The New London Post Office and Mystic Color Lab use a weight-averaging system to handle non-automatable bulk BRM. When 100 percent of the arriving mail consists of BREs, the weight-averaging system is simple, effective and has been time-proven for more than 10 years at the New London Post Office.

Seattle FilmWorks, Inc.

Seattle FilmWorks, Inc. also has one central processing facility, located in Seattle, Washington. Seattle FilmWorks opened its doors for business in 1977. For most if not all of the 19 years since it was founded, Seattle has provided its customers with BREs exclusively, which they use to mail their exposed film. All mail for Seattle is routed to the Seattle, Washington Post Office Annex. After processing, it is picked up at the terminal station by Seattle FilmWorks twice daily, Monday through Friday, around 5:00 a.m. and again at 8:00 a.m., and once on Saturday, around 9:00 a.m. As described below, the Seattle Post Office and Seattle FilmWorks have independently developed a weight-averaging system that is substantially identical to the one used at Mystic and which has worked successfully and without problems for over 15 years.[16]

For marketing reasons, Seattle FilmWorks distributes BREs with one of three different P.O. box numbers on them. Consequently, when mail arrives at the Seattle

[16] Use of the weight-averaging system by the Seattle Post Office and Seattle FilmWorks predates formation of (i) the Postal Service's BRM task force by at least 13 to 14 years, and (ii) the Postal Service's working group by some 15 years or more.

Post Office, it is sorted into different sacks according to the P.O. box number on the envelope. Following the incoming sortation, the post office simply weighs each incoming sack.[17] After subtracting the tare weight of the sack from the gross weight of the sack, the net weight is multiplied by a pre-determined distribution of pieces over all possible rate categories (including the BRM fee of 10 cents per piece). The resulting distribution of pieces is then multiplied by the applicable rate to compute the total postage and fees due.[18]

As with Mystic, the simplified handling and billing procedure used by the Seattle Post Office involves, on average, about 1½ to 2¼ labor hours each night by a single Postal Service employee.[19] Importantly, no other handling cost is incurred because none of the BREs are reinserted into the mailstream for delivery with regular First-Class Mail (as must be done for customers that receive small quantities of pre-barcoded BRMAS-qualified mail), nor does the Postal Service incur any cost to deliver the mail.

The pre-determined distribution is arrived at through a sampling conducted solely by the Seattle Post Office. Unlike Mystic, Seattle FilmWorks has no

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[17] At Seattle, as at Mystic, the only Postal Service capital cost involved in the weight-averaging system is a large capacity scale which can be used for other purposes. Automation equipment used for mail that receives the BRMAS rate has required substantial capital outlays by the Postal Service, as well as recurring costs for updating software programs.

[18] The procedure developed by the Seattle Post Office involves more arithmetic computation than the procedure at the New London Post Office, but the end result is essentially the same.

[19] This is an average throughout the year. Volumes are subject to significant variation, both seasonally and daily.

involvement in the sampling. Periodically, the Postal Service takes a sample over a period of one week. The distribution of the sample then becomes the pre-determined distribution until the next sample is taken. This method of handling non-automatable bulk BRM, which is essentially equivalent to that used by the New London Post Office and Mystic, is also a weight-averaging system.

When sacks contain all BREs, as they do for both Mystic and Seattle, the weight-averaging system is simple and effective. In the case of Seattle FilmWorks, it has been time-proven (over 15 years). As the preceding description indicates, the weight-averaging system is not a worksharing system.[20] Rather, it is somewhat analogous to automation, where the Postal Service on its own initiative has implemented a more efficient method for processing mail.[21]

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[20] Mystic and Seattle could, and would be willing to, weigh the incoming sacks of BRM, thereby relieving the Postal Service of even that small expense and, by doing so, combine worksharing with the weight-averaging system. This consideration would appear to be somewhat inconsequential, however, in view of the comparatively small amount of time and expense which the weighing operation requires.

[21] As is discussed *infra*, the Commission has approved and the Postal Service has implemented lower rates for BRM that is automatable and *potentially* has lower unit cost, regardless of whether such mail *actually* achieves lower unit cost by virtue of being processed on automation equipment.

Volume of BRM Received by Nashua, Mystic and Seattle

As strong competitors in a competitive industry, Nashua, Mystic and Seattle naturally consider data on their incoming volume of BRM to be proprietary and confidential, both in terms of public disclosure and disclosure to one another. It is no secret, though, that the film-developing business is somewhat seasonal, with summer volume substantially exceeding winter volume. Volume in the peak summer months can exceed volume in a typical mid-winter month by a factor ranging from 1.5 to as high as 2.5. Even on a slow winter day, however, Nashua, Mystic and Seattle each receive thousands of customer-mailed business reply envelopes, aggregating hundreds of pounds and many sacks of mail. Of course, on busy summer days the volumes received by Nashua, Mystic and Seattle are significantly greater. These volumes were sufficiently large to have led each respective local post office to help develop and implement alternative means of ascertaining postage and fees on non-automatable bulk BRM. The large daily volumes and weight of BRM received by Nashua, Mystic and Seattle distinguish them among BRM advance deposit account holders, including the vast majority of those who receive the BRMAS rate.

The Postal Service Incurs a Low Unit Cost to Account for Non-Automatable Bulk BRM

The Postal Service incurs certain accounting costs when it prepares a statement of postage and fees due and then debits a customer's advance deposit account. Whatever this particular cost is, it is not unique to non-automatable BRM; rather, it is

common to all advance deposit business reply accounts, including BRMAS accounts. The key cost issue with respect to non-automatable bulk BRM is the amount of work required by the Postal Service before it can generate a billing statement; *i.e.*, counting, weighing and rating.

Nashua. As explained above, the incoming manifest system developed by Nashua has not caused the Postal Service to incur any additional costs whatsoever, inasmuch as a full-time Postal Service employee was already on-site for the outgoing mail operation. Within the approach embodied by the In-Office Cost System ("IOCS"), however, employees' time is apportioned on the basis of the work they actually perform. Consequently, a portion of the time of the clerk assigned to Nashua to supervise the plant load operation would become attributable to the BRM operation on account of the daily sampling.[22] I estimate that such attribution should at most represent no more than one hour per day.[23]

Mystic. With respect to Mystic and the weight-averaging system developed jointly with the Postal Service, all of Mystic's BRM is handled by only one clerk on the night shift, even during the peak months of the summer season. Over the course of a year, I estimate that the time spent by this one clerk handling Mystic's BRM

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[22] The IOCS is, of course, unlikely to capture a fraction of only one person's time.

[23] The Postal Service has no information on either the recurring or non-recurring costs which it incurs to process Nashua's incoming BRM; see response to NM/USPS-32.

would range between 1.4 to 2.0 hours per day.[24] Capital costs, consisting only of depreciation on the Postal Service's large scale, are negligible.

Seattle. As noted previously, I estimate that a Postal Service clerk spends between 1½ and 2¼ hours per night weighing and rating Seattle's BRM.

Combining Nashua, Mystic and Seattle, the annual cost to the Postal Service for handling and billing their BRM, including all fringe benefits and piggybacks, ranges between $54,000 and $72,000. The high end of this range barely exceeds the cost of one full-time clerk (including piggybacks).[25] Since Nashua, Mystic and Seattle will each receive millions of BREs during test year 1997, the fully-loaded unit cost for the three firms combined will average well under 1.0 cent per piece. At 10 cents per piece, the BRM fee represents a **markup** over average cost substantially in excess of 1,000 percent. A BRM fee of just 2 cents per piece would represent a **markup** well in excess of 100 percent over attributable cost; *i.e.*, a **coverage** of well over 200 percent.[26]

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[24] This estimate is based on 365 days a year. The Postal Service has no information on either the recurring or non-recurring costs which it incurs to process Mystic's incoming BRM; see response to NM/USPS-33.

[25] $43,297.62 per year for one full-time clerk, plus piggyback factors estimated at 1.533220 to 1.717276 of direct labor cost.

[26] Confidential and proprietary data on volumes (as well as a more exact estimate of unit cost) were developed in a set of confidential workpapers.

Mutual Benefits Derived from the Incoming Manifest and Weight-Averaging Systems

As indicated previously, through-the-mail film processors compete with a multitude of local and regional film processors. In many metropolitan areas, some local developers offer turn-around times as low as one hour, and overnight service is extremely common.

Through-the-mail film processors obviously cannot compete with local developers on turn-around time, and mail-order customers understand that they cannot have prints returned in one or two days.[27] Nevertheless, total turn-around time from initial mailing by the customer to receipt of prints is an extremely important consideration. When total turn-around time exceeds six or seven days, repeat orders tend to fall off sharply. Since time spent within the Postal Service network greatly exceeds the time required for development and prints,[28] it is critically important that mail move through the Postal Service network as quickly as possible. If the Postal Service actually were to spend many hours, perhaps even days, manually counting, weighing, rating and billing each individual BRE commensurate with the level of

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[27] A substantial portion of people who use through-the-mail film processors reside in rural areas, small towns, and other areas where access to same-day or overnight developing service may be limited. Lack of competition may cause prices to be higher.

[28] All through-the-mail film processors attempt to have finished prints in the outgoing mail within 24 working hours after incoming mail is received from the Postal Service.

effort for which they are charging these mailers, repeat orders would decline, a lose-lose situation for both the Postal Service and film processors.[29]

As indicated in the preceding discussion, the weight-averaging system used for incoming BRM at Mystic and Seattle eliminates all individual manual handling of BREs by the Postal Service. The procedure greatly enhances efficiency, since sacks need only to be weighed before being delivered to Mystic and Seattle. At Nashua, as a result of the worksharing inherent in the incoming manifest system, the Postal Service does not even have to weigh the sacks. These systems constitute extremely efficient ways to process non-automatable bulk BRM, and they provide the Postal Service with enormous savings in comparison to the cost of manually counting, weighing and rating individual BREs. Elimination of the long-established weight-averaging system in favor of individually assessing each incoming piece would drive up Postal Service costs and serve no useful purpose. Elimination of the weight-averaging system in favor of some so-called "optimum" system (as the Postal Service has occasionally stated) could do little more than force these mailers to spend large amounts of time and money on developing new systems without achieving any real savings to the Postal Service, while prolonging the time that the Postal Service could collect these extraordinarily-high BRM fees.

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[29] To be sure, film processing constitutes the entire business of Nashua Photo Inc., Mystic and Seattle, but only a minuscule percent of the Postal Service's total delivery business. Film processors thus have a great deal more at stake than does the Postal Service. Further, all BRM, automatable as well as non-automatable, represents only a small portion of Postal Service total revenues, which may help explain why BRM has not been given greater priority by the Postal Service.

II. BRIEF HISTORY OF THE BRM/BRMAS FEE STRUCTURE

Business Reply Mail predates the **Postal Reorganization Act** (the "Act"), and has always been limited to incoming First-Class Mail. Prior to the Act, the BRM fee was 2 cents for mail weighing two ounces or less, and 5 cents for mail over two ounces. (*See* former Title 39, U.S.C., sections 4253(d) and 4303(c).) The only criterion for application of the BRM fee, therefore, was weight.

In the first omnibus rate case heard by the Postal Rate Commission under the Act, **Docket No. R71-1**, the Postal Service did not request an increase in BRM fees. In the second rate case, however, **Docket No. MC73-1**, the Commission recommended, and the Governors approved, a rate schedule distinguishing between regular BRM and the BRM advance deposit system. That new classification schedule became effective September 12, 1976, and resulted in the following fee change: 3.5 cents for mailers maintaining an advance deposit account, and 12 cents for those without such accounts.

In **Docket No. R80-1**, BRM fees were increased to 5 cents (with advance deposit account) and 18 cents (without advance deposit account), respectively, and the annual permit fee was raised to $40, as requested by the Postal Service. Although no party objected to these increases, there was some debate about the Postal Service's

rationale for one of the increases. *See Op. & Rec. Dec.*, Docket No. R80-1, pp. 302-303.

In **Docket No. R84-1**, the Postal Service proposed raising the advance deposit per-piece fee to 7 cents (from 5 cents) and the non-advance deposit, per-piece fee to 25 cents (from 18 cents). It also proposed an increase in the annual permit fee to $50 (from $40), as well as an increase in the annual accounting fee to $160 (from $75). The Commission recommended all of the proposed increases, except that the non-advance deposit, per-piece charge was raised only to 23 cents. It was at this time that BRM was changed, from a subdivision of First-Class Mail, to a Special Service set forth in Schedule SS-2 of the Domestic Mail Classification Schedule (DMCS).

In **Docket No. R87-1**, the concept of the **Business Reply Mail Accounting System** (BRMAS) was born. The Postal Service had again proposed higher rates, and the Commission recommended increases to 40 cents and 8 cents, respectively, for regular and advance deposit mailers. In addition, however, the Commission also recommended a 3-cent discount for advance deposit, automatable, pre-barcoded BRM mail (known as BRMAS), making the BRMAS rate 5 cents. In so doing, the Commission created two subcategories within advance deposit business reply mail.

As explained by the Commission in Docket No. R90-1, the rationale for recommending the lower per-piece fee for BRMAS mail in Docket No. R87-1 was as follows:

> The 5-cent per-piece BRMAS rate reflects the lower costs associated with the Service's counting, weighing, rating and billing operations for advance deposit BRM pieces since, in the case of a BRMAS piece, a

> computer can perform these functions. In the case of nonadvance and advance deposit BRM these functions are performed through manual or mechanical means. [*Op. & Rec. Dec.*, Docket No. R90-1, p. V-411.]

It is important to note that the special BRMAS fee was created as a discount, to reward the Postal Service's BRM customers whose BRM enabled the Postal Service to reduce its costs; *i.e.*, the Commission sought to create subgroupings of BRM that were more homogeneous in terms of cost characteristics.[30]

In **Docket No. R90-1**, the Commission once again recommended most of the Postal Service's proposals, which were 40 cents for regular BRM (no increase), 9 cents for advance deposit accounts (a 1-cent increase), and an increase in the permit fee to $75; but it reduced the BRMAS fee from 5 to 2 cents (rather than to the 3 cent per-piece level proposed by the Postal Service). The Commission, noting the substantial fee difference between regular and advance deposit BRM, observed that:

> the higher per-piece fee represents the higher cost to the Postal Service to collect the First-Class postage and BRM per-piece fee amount due from the permit holder subsequent to the processing [of] the mail piece.... [*Op. & Rec. Dec.*, Docket No. R90-1, p. V-410.]

Finally, in **Docket No. R94-1**, most of the Postal Service's proposed fee increases were again recommended by the Commission, resulting in increases in the permit fee (to $85), the accounting fee (to $205), and the per-piece charges for regular (to 44 cents) and advance deposit (to 10 cents) BRM. The one exception was

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[30] As noted in the previous section, the weight-averaging system, which enabled an even greater reduction in average unit costs, had already become the standard operating procedure at both Mystic and Seattle before 1987.

BRMAS, which the Postal Service asked be increased to 4 cents, but which the Commission left at 2 cents after it struck the Postal Service's testimony in support of the increase due to problems with the underlying cost evidence.

III. THE BRMAS PROGRAM: INCLUSION, EXCLUSION AND DISCRIMINATION

The features of the special service Business Reply Mail, as distinguished from the features of regular First-Class Mail, to which this special service relates, involve the counting, rating and billing of BRM pieces.[31] One way or another, these functions are performed on all pieces of BRM.

Prior to Docket No. R87-1, BRM permit holders with an advance deposit account paid a uniform per-piece fee; *i.e.*, rate averaging existed for *all* BRM. As discussed previously, however, after Docket No. R87-1 the rates for BRM were *de-averaged*. The BRMAS rate then was created solely for business reply envelopes meeting established criteria for automation compatibility, including barcoding. Since then, permit holders that receive automation-compatible BRM have been able to qualify for and receive the reduced BRMAS rate regardless of how the Postal Service actually counts, rates and bills for such mail; *i.e.*, the BRMAS rate applies to all qualified BRM letters or cards received by a customer who has been approved for the BRMAS program, regardless of whether automation equipment is in fact used to process such mail at the post office where it destinates.[32] At the same time, BRM

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[31] However, see the response to NM/USPS-22, where the Postal Service expresses certain reservations concerning this view.

[32] See response to NM/USPS-18.

permit holders who receive non-automatable bulk BRM are summarily denied access to the BRMAS rate regardless of procedures used or the unit cost incurred by the Postal Service to accomplish the counting, weighing, rating and billing functions.[33]

For First-Class prepaid reply mail, the distinguishing eligibility criterion between BRMAS and non-BRMAS mail has been *automation compatibility*. At the same time, the *cost differential* has been the fundamental product-defining criterion in the Commission's rationale for having different BRM fees - plus, perhaps, some abstract commitment to automation. The substantial difference between the current prebarcoded (BRMAS) fee of 2 cents and the much higher regular BRM fee of 10 cents is based entirely on estimated Postal Service costs incurred in the counting, rating and billing functions necessitated by each BRM service. However, paradoxically, an identifiable subset of **2-cent automatable BRMAS** mail is counted, rated and billed manually at **high unit cost,** while an identifiable subset of **10-cent non-automatable BRM** is counted, rated and billed at **very low unit cost.**

It should be noted that the foundation for the BRMAS rate is the billions of dollars spent by the Postal Service to develop and deploy automation equipment, including BRMAS software and the local programming efforts necessary to implement that software effectively. The principal involvement by BRM permit holders relates to their pre-printing a designated barcode on the envelope. Since BRM envelopes must be printed in any event, including a pre-printed barcode on the envelope requires no additional outlay by the mailer. In no way is BRMAS equivalent to worksharing

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[33] See, for example, LR-NMS-1.

programs where mailers undertake significant efforts and incur significant costs (*e.g.*, presorting or dropshipping) that otherwise would have to be incurred by the Postal Service.[34]

With BRMAS, the Postal Service has simply implemented a more efficient way of handling a subset of Business Reply Mail. In this respect, BRMAS and the weight-averaging system used for non-automatable BRM at the New London and Seattle Post Offices are similar. Two critical differences exist, however. First, under BRMAS the Postal Service extends a discount to automation-compatible mail, but it offers no discount for non-automatable bulk BRM that is counted, rated and billed under the weight-averaging system. Second, the Postal Service has incurred substantial expense to implement the automation program generally, and the BRMAS program specifically, whereas development of the weight-averaging system required virtually no capital investment whatsoever. In my opinion, *automation compatibility* should be regarded as a means to an end, not as an end in itself. Without further justification, the Postal Service's establishing a dividing line based exclusively on *automation compatibility* and wholly ignoring all real world operational and cost considerations is capricious and unduly discriminatory.[35]

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[34] Nashua's incoming manifest system involves far more worksharing effort by the BRM permit holder than does BRMAS.

[35] The Postal Reorganization Act bars both undue and unreasonable discrimination as follows:

> In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized

(continued...)

Discrimination Against Non-Automatable Bulk BRM

Since the BRMAS rate became available following Docket No. R87-1, the Postal Service (i) has extended the reduced rate to all approved customers using qualifying automation-compatible BREs, regardless of whether such envelopes are in fact processed on automation equipment, and (ii) has not required any minimum volume (either per day, per week, per month or per year), despite the obvious high unit cost associated with low-volume accounts. The absence of such eligibility requirements is significant, particularly when compared with the Postal Service's treatment of non-automatable bulk BRM. A minimum volume requirement, for example, regardless of whether automation equipment is available, would have excluded from BRMAS eligibility much automation-compatible mail that the Postal Service knows will be manually processed at a high unit cost, averaging up to 10 cents per piece. Further, the Postal Service could have indicated the post offices at which the BRMAS rate would not apply, owing to lack of automation equipment. For reasons never articulated, it has elected not to do either.[36]

The average cost of counting, weighing, rating and billing the non-automatable bulk BRM of Nashua, Mystic and Seattle is quite low in absolute amount, less than

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[35](...continued)
in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user. [39 U.S.C. § 403(c).]

[36] See response to NM/USPS-36. It is interesting to note that in Docket No. MC95-1 the Postal Service had no reservations about recommending carrier route presort discounts that were restricted to facilities not served by presortation on DBCS equipment.

1.0 cent per piece. That fact alone is sufficient reason to recommend one of the proposals advanced in the next section of this testimony. Furthermore, as discussed in Appendix I, the unit cost of counting, weighing, rating and billing non-automation compatible bulk BRM is low even in relation to the average cost of BRMAS-qualified mail. Astonishingly, even if all BRMAS-qualified mail were to be processed on automation equipment (where available), the average unit cost for the NMS BRM would be lower than the BRMAS unit cost.[37] The unit cost data for BRMAS-processed mail, presented in Appendix I, admittedly are not precise. Nevertheless, they are adequate to help demonstrate the discrimination that exists in the current postal product offerings against low-cost, non-automation compatible bulk BRM.

A substantially-reduced BRMAS fee of 2 cents per piece is extended to all automation-compatible mail. As discussed previously, the Postal Service makes no effort to exclude any BRMAS-qualified mail that it knows will be processed manually (at an average cost of over 10 cents per piece) from receiving the 2-cent BRMAS rate. Whether it makes sense to extend such a low rate to automation-compatible BRM that is nevertheless known to have predictably high cost characteristics is perhaps a matter of business judgment within the Postal Service's discretion. At the same time, however, the Postal Service discriminates without any cost justification by excluding from the reduced BRMAS rate all non-automation-compatible bulk mail, even though the average unit cost of counting, weighing, rating and billing such bulk mail is lower than the average cost of mail that pays the BRMAS rate.

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[37] More detail is provided in Appendix I and confidential workpapers.

The only reasonable conclusion is that low-cost non-automation-compatible bulk mail is the object of undue discrimination. Monopolistic exploitation is the most apt term to describe the profit margins gained by overcharging users of this special service.[38] The decision as to whether the Postal Service should be permitted to exploit highly inelastic demand for First-Class Mail subject to its monopoly is properly a matter to be decided by the Commission; under no circumstances should it be left to the unfettered discretion or business judgment of the Postal Service.

To sum up, if rates for Business Reply Mail are to be de-averaged on the basis of cost, the lower rate should be extended to all low-cost BRM. It stands to reason that **any** system for processing BRM mail that substantially reduces the unit cost of the counting, weighing, rating and billing functions, and that has an average unit cost similar to (or even lower than) that achieved by automatable mail, should be entitled logically and equitably to fees similar to those available for pre-barcoded (BRMAS) mail.

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[38] BRM is a special service applicable only to First-Class Mail, all of which is subject to the Postal Service's statutory monopoly. With respect to pricing of other special services under consideration in this docket, the Postal Service has advocated the principle of "demand pricing" - or, in other terms, charge what the traffic will bear. That principle must be tempered for classes of mail and special services subject to the statutory monopoly. Special services tied to monopoly products like BRM are especially susceptible to abuse, and special care should be taken to avoid discriminatory pricing by the Postal Service.

The Prepaid Courtesy Reply Mail Test[39]

Since June, 1995, the Postal Service has been engaged in an exclusive test, with Brooklyn Union Gas Company ("BUGC"), of a product known as Prepaid Courtesy Reply Mail ("PCRM").[40] Under the PCRM test, Brooklyn Union Gas Company mails to its customers monthly invoices and PCRM envelopes to be returned through the mail, without cost to the customers. PCRM envelopes typically contain only a statement of account and a remittance.[41] For each piece of PCRM actually received,[42] Brooklyn Union Gas Company pays only 32 cents per envelope,

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[39] The Postal Service's responses to Nashua/Mystic interrogatories 37-65 relating to Prepaid Courtesy Reply Mail were filed on August 13, 1996, but were not responded to until September 23, 1996. Even then, the responses were such as to require follow-up interrogatories which are due to be responded to by Friday, October 12, after this testimony is due. If the responses to those interrogatories necessitate changes to this testimony, which is based on the Postal Service responses as of this date, supplemental or amended testimony will be prepared.

[40] See responses to NM/USPS-37 and 38.

[41] Response to NM/USPS-63.

[42] The name Prepaid Courtesy Reply Mail could give the impression that the mailer pays the full postage on each reply envelope that is mailed out, irrespective of the number of such envelopes actually returned, analogous to a mailer who sends out return envelopes with postage stamps. Nonetheless, this is not the way that PCRM works. With PCRM, the mailer "deposits[s] with USPS, in an advance deposit account sums equal to the return postage for prepaid COURTESY ENVELOPES, determined at the first ounce rate of postage for First-Class Mail for each, which sum USPS shall deduct from the BUGC advance deposit account on each day OUTGOING BILLS are mailed." (LR-SSR-149, at para. 2.) After an initial period of weeks, the amount of this advance deposit is adjusted to represent the "historic percent of COURTESY ENVELOPES actually used by BUGC customers for returns." (Id.) And throughout the test, a reconciliation takes place once each month. BUGC submits documentation for an adjustment of prepaid COURTESY ENVELOPE postage which is "in excess of the amount it should have prepaid for postage for the prepaid COURTESY ENVELOPES mailed by its customers in said month." (Id., at (continued...)

the rate for the first ounce of a First-Class letter.[43] No additional per-piece fee is charged for PCRM, BRM or BRMAS, nor are any additional annual fees paid for PCRM permits or PCRM advance deposit accounts.[44] The PCRM test, originally scheduled for six months, is now expected to continue at least through November 30 of this year; *i.e.*, for at least 18 months.[45]

A critical consideration for participation in the PCRM test was said to be "machinability and automation-compatibility of mail pieces."[46] In other words, in order to participate in a test of reply mail that has no per-piece fee, the mail first had to meet all qualifications for the pre-barcoded BRMAS rate. In addition, "[i]t was also vital to limit the test to mail pieces which could be expected to be uniform and not in excess of an ounce in weight, so that issues related to additional-ounce mail could be avoided."[47] Further, the Postal Service says that it "preferred to work with a

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[42](...continued)
para. 6.) The prepayment account is thereafter adjusted for any overpayment of postage. In other words, under this test, the mailer is charged only for incoming pieces, as with BRM, but BUGC provides to the Postal Service certain advance payments which presumably can be used to earn interest so that for approximately one month the Postal Service benefits from the "float" on those funds, thereby creating a source of funding to offset the expenses incurred by the Postal Service in monitoring BUGC's data collection system and other related expenses.

[43] Response to NM/USPS-56.

[44] Response to NM/USPS-57.

[45] Response to NM/USPS-47.

[46] Response to NM/USPS-43.

[47] Id.

mailer with a uniform and fairly predictable monthly volume."[48] The monthly volume of remittance mail generated by a major public utility company is of course substantial. Because the PCRM test is designed only for *automation-compatible* "bulk" mail, it obviates the problems that are associated with low-volume BRMAS accounts.

It is interesting to note that while PCRM is fully automatable and, presumably, all sortation is done on automation equipment, such equipment is not used exclusively to count the mail. The necessary reply mail function of counting, rating and billing is verified by means of what must be perceived to be a very accurate sampling and weight-averaging system. According to LR-SSR-149, Attachment 1:

> [a]t Brooklyn Union's Mail Processing Facility Prepaid Return Mail (PRM) will be counted each day by the following steps:
>
> (a) place 10 pieces of BRM [sic] on postal scale for count;
>
> (b) place full tray on scale; and
>
> (c) deduct tray weight from total count." [Footnotes omitted.]

The weight-averaging system used for PCRM is analogous to that used by the New London and Seattle Post Offices for Mystic and Seattle FilmWorks, respectively. In the case of PCRM, however, each tray of mail is sampled every day for the first two weeks, and thereafter bi-weekly (or perhaps monthly - the test procedures are ambiguous on this point). The sampling procedure is thus more extensive, and costly, than the said-to-be quarterly sampling of BRM at Mystic and Seattle FilmWorks.

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[48] Id.

Moreover, at Brooklyn Union Gas Company each tray is weighed, as opposed to each sack at the New London and Seattle Post Offices. Since sacks contain, on average, far more mail than a tray, the weighing operation at Brooklyn Union Gas Company is more extensive — and costly — than the weighing operation at the New London and Seattle Post Offices. Interestingly, the Memorandum of Test Procedures seems to indicate that the Postal Service will continue to rely primarily on "the bin holdout counts from the Bar Code Sorter" for its daily count. (LR-SSR-149, Attachment 2.) The sampling and weighing appear to be for verification purposes only (termed the BUG weight verification"). (*Id.*) As such, rather than PCRM resulting in less work for the Postal Service due to additional work performed by BUGC, it appears from the documents submitted thus far that the Postal Service is doing more work than it ordinarily does with BRMAS. It certainly is doing less work for Nashua, Mystic or Seattle than it does for BUGC, while the price charged to these users of non-automatable bulk BRM is, literally, infinitely greater than that charged to BUGC.

The essence of the justification for the discount (to the extent that a complete waiver of fees can be properly described as a discount) appears to be (i) the benefit of the "float and (ii) that "[t]he mailer would perform accounting functions based on its records to establish the amount of postage."[49] This is not fully explained in the documents thus far submitted, but even if true, and BUGC keeps its own records of incoming pieces of PCRM, this is, of course, the same work being performed by Nashua with its incoming manifesting system. In its response to NM/USPS-49, the

[49] Response to NM/USPS-49.

Postal Service appears to recognize quite properly, at least for purposes of the PCRM test at Brooklyn Union Gas Company, that it should not charge for work being performed by a mailer of automatable mail where the mailer does virtually all the work. On the other hand, the Postal Service has thus far expressed no comparable concern for a virtually identically-situated mailer of non-automatable mail, Nashua. Whereas the Postal Service is willing to reduce the BRMAS rate from 2 cents to 0 cents for Brooklyn Union Gas Company, it continues to collect the BRM rate of 10 cents from Nashua, Mystic and Seattle. This is true despite the fact that the Postal Service certainly does much more work for Brooklyn Union Gas Company than it does for Nashua, and may do more work in the weight-averaging system for Brooklyn Union Gas Company than it does for Mystic or Seattle. Based on the Postal Service's treatment of Brooklyn Union Gas Company in this test, the Commission ought to consider whether mailers should pay no BRM/BRMAS fees at all.

If the PCRM test is made permanent or continued, it should be expanded to include low-cost, non-automatable bulk BRM. The Postal Service should not be allowed to continue charging Nashua/Mystic/Seattle more than it charges in cases where it appears to incur higher costs, such as PCRM for Brooklyn Union Gas Company. Such an approach could operate for Nashua/Mystic/Seattle in the same way that it does for BUGC, in that these mailers could engage in prepayment of postage so that the interest earned on those funds would offset any costs that are incurred by the Postal Service in administering the program.

The only stated objective of the PCRM test is "to conduct a trial of the administration and operations involved in applying *the prepayment concept*."[50] (Emphasis added.) As discussed above, how the "prepayment concept" of PCRM actually differs from that involved in BRM is not altogether clear from the information provided thus far.

What is clear is that the Postal Service has undertaken a test of a high-volume, low-cost subset of mail that would otherwise have paid the BRMAS fee. It is also clear that the Postal Service has totally overlooked any test of or other equivalent concern for the prepayment concept for low-cost non-automation compatible bulk mail. The discrimination in this respect is self-evident. Less clear is why the Postal Service favors certain customers, or at least certain types of mail, over others.

The Postal Service indicates that PCRM is in a "test" status.[51] Beyond that, both the present status and the future status of PCRM are somewhat ambiguous. On the one hand, it is not considered to be a classification.[52] On the other hand, the amount due for First-Class postage is deducted from the BRM advance deposit account of Brooklyn Union Gas, and no annual fees for PCRM are required beyond the BRM permit and accounting fees. In other words, the annual BRM fees for a permit and advance deposit account would appear to include PCRM. Moreover,

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[50] Response to NM/USPS-42.

[51] Response to NM/USPS-37. It is implied that a study of PCRM is currently underway (response to NM/USPS-54 and 55), but "No specific criteria have been formulated to evaluate the test." (Response to NM/USPS-47.)

[52] Response to NM/USPS-53.

customers of Brooklyn Union Gas Company who mail their remittances in a PCRM envelope could otherwise have been expected to use a BRM envelope; *i.e.*, under the circumstances PCRM acts as a substitute for BRMAS envelopes. It would thus appear that the PCRM test is being conducted as some kind of "subset" or "subcategory" that falls within the aegis of BRM — a sort of "rate category" of reply mail, except that no rate is charged for PCRM.[53]

BRMAS Eligibility Criteria Are Imposed By the DMM, Not the DMCS

The DMCS establishes and classifies BRM as a special service, but it does not spell out the requirements to qualify for the BRMAS rate. The only description of BRMAS in the DMCS is one word appearing in Rate Schedule SS-2, the word "pre-barcoded." The DMCS does not expressly identify automation compatibility as an essential component of BRMAS.[54] That requirement was established by the Postal Service in the DMM, along with other details that are appropriately left to the DMM. The Postal Service has authority to amend the DMM so long as the change does not conflict with the DMCS. Due to the way in which the applicable DMCS provision is written, it would appear that the Postal Service on its own initiative could unilaterally

[53] The Postal Service cites no provision in the DMCS or DMM authorizing it to conduct "experiments" where it waives postage or fees for selected mailers. See NM/USPS-45.

[54] The BRMAS acronym stands for "business reply mail **accounting** system," **not** "business reply mail **automation** system," even though BRMAS has been uniquely identified with automation capability.

amend the DMM, and extend the BRMAS rates to users of non-automatable bulk BRM, where the Postal Service's costs are comparable to BRMAS costs.[55] The requirement of prebarcoding is actually met by both Mystic and Seattle (which do not use post office boxes around the country like Nashua), and which in fact print a barcode on their envelopes. This requirement could be waived for mailers (such as Nashua) which have multiple destination addresses on their order envelopes. The Postal Service has declined, however, to take any such initiative.

I propose the extension of current BRMAS rates to users of bulk, non-automatable Business Reply Mail (including Nashua, Mystic and Seattle and other similarly-situated mailers), based upon the important criteria on which BRMAS was really founded - namely, significant cost savings to the Postal Service. The current automation standards in BRMAS, as addressed by the DMM, are simply one means of achieving those savings. The DMM logically should not restrict BRMAS rates to automatable mail and, to the extent that the Postal Service is right in its view that DMCS does, it should not be so restricted either.

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[55] According to official correspondence from the Postal Service (LR-NMS-1), the Postal Service uses failure of Nashua, Mystic, Seattle, and other similarly situated mailers to meet standards set forth in the DMM (not the DMCS) to deny BRMAS rates.

IV. NASHUA/MYSTIC/SEATTLE CLASSIFICATION PROPOSAL

Classification Objectives

This Docket is the third in a series of recent dockets aimed at major reclassification of Postal Service products and services. The first in this series was Docket No. MC95-1. In that docket the Postal Service's policy witness, Charles C. McBride, when establishing a foundation for undertaking major reclassification, reviewed problems that arise when a grouping of mail includes "categories that vary greatly with respect to both cost and market factors; *i.e.*, they are heterogeneous."[56]

Subsequently, when elaborating on objectives guiding the reclassification effort, witness McBride stated that "Defining [more] homogeneous mail subclasses with respect to cost and market factors would allow the various pricing factors of the Act to be applied in an effective manner."[57] In Docket No. MC95-1, witness McBride was concerned not with BRM, but with improving mail classification by redefining subclasses within First-, second- and third-class mail. Nevertheless, witness McBride's general principle - that it is desirable to have more homogeneous groupings of mail with respect to cost factors - clearly applies to BRM. In fact, the Commission's recognition of BRMAS rates in Docket No. R87-1 can be viewed as an

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[56] Docket No. MC95-1, USPS-T-1, p. 13.

[57] Id., p. 25.

effort (i) to create subgroupings of BRM that were more homogeneous with respect to their cost characteristics and (ii) to set rates that were more reflective of those cost characteristics.

After screening eight different criteria which he deemed appropriate for defining homogeneity, witness McBride narrowed the final list to two criteria: "bulk bypass of postal operations and use of advanced technology."[58] Elaborating on the appropriateness of his final bulk bypass criterion, witness McBride stated that:

> It comes as a surprise to no one that the cost characteristics of bulk-entered bypass mail are distinct from those of nonbulk, or single-piece entered mail.[59]

This assessment applies equally to BRM — it should come as a surprise to no one that cost characteristics of BRM received in bulk are quite distinct from those of BRM received as single pieces or in small quantities that are far below any reasonable threshold of "bulk."[60]

The changes to the DMCS proposed here are in accord with the spirit of classification reform objectives articulated by witness McBride. Those changes focus on business reply mail (i) that is received in bulk and (ii) that bypasses all manual counting, weighing and rating operations. The weight-averaging system used by the New London and Seattle Post Offices satisfies both of these conditions. In addition,

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[58] Id., p. 26.

[59] Id., p. 27

[60] For more discussion concerning incoming *bulk* mail, see the subsection, "Definition of 'bulk' mail as it pertains to BRM," *infra*.

the incoming manifest system developed by Nashua. also relies on advanced technology; *i.e.*, innovative use of Nashua's sophisticated computer system.

In this docket, the Postal Service policy witness, W. Ashley Lyons, has enunciated objectives that are specifically tailored to special services. For example, "[s]pecific pricing reform objectives include . . . the realignment and streamlining of certain special service offerings to *make them more commercially attractive.*" [61] (Emphasis added.) Also, "three major pricing and classification policy objectives that Postal Service management is seeking to accomplish in its Request. . .include: (1) to better reflect market conditions; (2) **to realign fees to reflect costs**; and (3) to streamline product offerings when appropriate." (Emphasis added.)[62] The changes in the DMCS proposed here will make non-automation-compatible bulk BRM more commercially attractive, and will also comport with Postal Service management's objective to realign fees to reflect costs.

Two Proposals for Amending the DMCS

In this docket, I advance two alternative proposals designed to achieve the same general result. The first proposal, A, is as follows: for those mailers who maintain an advance deposit BRM account, add a third category to Rate Schedule SS-2 of the DMCS, to be known as "non-automatable bulk" BRM as defined by the

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[61] USPS-T-1, p. 2.

[62] Id., p. 12.

Postal Service (in the DMM), with the lower BRMAS rate of 2 cents per piece extended to the new category. (See Appendix II, Proposal A.)

The Commission may not perceive the need to add a third category to Rate Schedule SS-2. Under that circumstance, I offer an alternative proposal, B, as follows: for advance deposit account BRM, amend Rate Schedule SS-2 of the DMCS to change only one word now describing the existing rate category, from "pre-barcoded" to "BRMAS-qualified," as defined by the Postal Service (in the DMM), with the explicit understanding that the lower, 2-cent rate shown under the Business Reply Mail Accounting System would be extended to non-automatable bulk BRM (i) that the Postal Service does not handle and account for manually on an individual piece-by-piece basis, but instead can handle under an acceptable alternative system, such as the weight-averaging system or the incoming manifest system,[63] and (ii) that meets a minimum quantity requirement for arriving non-automatable bulk Business Reply Mail, as described *infra*. (See Appendix II, Proposal B.)

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[63] The response to NM/USPS-27 states that "[s]ome plants have entered into local agreements with customers and have established 'reverse manifest' procedures; however **there is no national policy which requires uniformity in the precise terms of these agreements.**" (Emphasis added.) Of course, the Postal Service has no national policy on what constitutes "minimal" volumes for automated sorting under the BRMAS program; see responses to NM/USPS-18 and 19. Similarly, the Postal Service has no national policies regarding when it will perform manual counts of BRM for BRMAS accounts; see response to NM/USPS-15. Under the circumstances, the determination that incoming manifest systems must have a "national policy which requires uniformity in the precise terms of these agreements" seems not only discriminatory, but also arbitrary and capricious.

Under proposal A, the rate for non-automatable bulk mail would initially be identical to the BRMAS rate.[64] It would be separately stated, however. Then, should future cost studies show disparate average costs for automatable BRMAS and non-automatable bulk BRM, separate rates could be established for each category.[65] Proposal A would result in more homogeneous groupings of BRM than proposal B, and would thereby allow the rate for each category to be aligned better with costs. In this regard, proposal A is superior to proposal B.

Under proposal B, the rate for non-automatable bulk BRM would be under a general BRMAS category, and accounting costs for mailers that use weight-averaging and incoming manifest systems would be averaged with automatable BRMAS users. Proposal B furthers simplicity of classification structure, but that simplicity also results in a grouping that may be less homogeneous.[66]

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[64] In Docket No. R94-1, the Postal Service initially thought that it could justify a fee of 6 cents per piece for BRMAS, which was far higher than the requested across-the-board rate increase averaging 10.1 percent. What this forebodes for future rate requests is uncertain.

[65] The Postal Service has stated that such a cost study is underway. If extensive problems still exist with BRMAS, the unit cost may be higher than the unit cost estimated in Docket No. R94-1.

[66] The BRMAS category for automation-compatible mail is homogeneous insofar as physical characteristics of the mail are concerned. However, it is far from homogeneous with respect to the way mail is actually handled. A significant portion, perhaps exceeding 20 or even 30 percent, although automation-compatible, in fact is processed manually at an average cost exceeding 10 cents per piece. See Appendix I.

Definition of Non-Automatable "Bulk" Mail as It Pertains to BRM

Either of the preceding proposals would effect only a minimal change in the DMCS, and would leave details of implementation in the DMM to the Postal Service. However, some discussion is in order concerning the way in which "non-automatable bulk BRM" should be defined. At the present time, bulk eligibility requirements are imposed at various places in the DMM, but only for originating mail, not for arriving mail. Either of the two proposals advanced here thus requires that a new standard be developed.

By way of illustration, for a First-Class originating mailing to qualify for bulk rates, a minimum of 500 pieces is necessary. In Standard A-Class (formerly third-class), the minimum is 200 pieces. These minimums apply to each mailing. If a mailer presents mail to the Postal Service no more than once per day, they in effect constitute a daily minimum.

Common sense indicates that any minimum for arriving non-automatable bulk BRM mail should represent a threshold above which the Postal Service can and should utilize a system to avoid manual counting, weighing, rating and billing of individual pieces. For non-automatable bulk BRM, instead of basing the definition on pieces, the standard might be set more readily in terms of pounds, because that datum is readily available from either the weight-averaging system or the incoming manifest system. In terms of time frame, there is no necessity for a daily minimum. It could be stated as a minimum number of pounds per week or per month. Based on what I consider to be an appropriate volume level to permit taking advantage of the

economies in handling such mail, I would propose that the definition of bulk be stated as 100 pounds per day,[67] or 500 pounds per week, or 2,000 pounds per month. The task of defining and establishing a standard for bulk BRM does not appear to be unmanageable.

It should be pointed out that under either of the two alternative proposals advanced here, non-automatable bulk mail would receive a reduced rate *only* when BRM is in fact received in bulk, and *a cost-reduction system is actually used* to process incoming BREs. In other words, the only non-automatable bulk BRM that will be eligible to receive a lower rate will have a low unit cost for counting, weighing, rating and billing (unlike BRMAS, which includes a significant portion of high-cost, manually handled mail). Non-automatable bulk BRM will be far more homogeneous, in terms of cost characteristics, than pre-barcoded automatable mail that qualifies for the BRMAS rate.

Conclusion

The change to the DMCS proposed by NMS is in accord with classification objectives recently articulated by Postal Service policy witnesses. Specifically, it will result in more homogeneous groupings of mail, thereby helping to permit fees to reflect costs and make non-automatable bulk BRM more commercially attractive. If

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[67] In terms of sacks, a 100-lb daily minimum would be two relatively heavy 50-lb sacks, or four relatively light 25-lb sacks per day; *i.e.*, between two and four sacks of mail. Translated in terms of pieces, a 100-lb minimum would be equal to 800 pieces averaging exactly two ounces.

recommended favorably by the Commission, it will confer the Commission's approval to charge a lower, cost-based rate for BRM when the counting, weighing, rating and billing procedures for such mail result in a dramatically lower unit cost for the Postal Service, regardless of whether that lower unit cost is achieved through Postal Service automation or by some other means. In other words, in this case the Commission will apply the principle that it is the end result (efficiency in operation and consequent low unit cost) that is important, not the means by which that result is obtained. This result is consistent with the Commission's repeatedly stated desire to set rates that are more cost-based. It will be up to the Postal Service to establish a definition of bulk BRM which, when combined with efficient procedures used to account for non-automatable bulk BRM, the unit cost will be as low as the average unit cost of bar-coded pieces that qualify for the lower BRMAS fee, currently 2 cents per piece.

Assuming that the Commission recommends my proposal for non-automatable bulk BRM in this docket, the Postal Service can no longer use the terms of the DMCS as an excuse for exploitative monopolistic behavior by refusing to offer a lower BRMAS fee when the Postal Service incurs so little cost to handle such mail.

V. WHY THE NASHUA/MYSTIC/SEATTLE PROPOSAL SHOULD BE RECOMMENDED

As discussed in the preceding section, the two alternative proposals advanced here comport with the objectives of reclassification reform. In addition, they also comply with the applicable provisions of the Postal Reorganization Act.

The Proposals Are In Accord With the Statutory Classification Criteria

Section 3623(c) of Title 39, United States Code, requires that classification changes be made in accordance with the following factors:

1. the establishment and maintenance of a fair and equitable classification system for all mail;

2. 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 services of mail;

3. the importance of providing classifications with extremely high degrees of reliability and speed of delivery;

4. the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;

5. the desirability of special classifications from the point of view of both the user and of the Postal Service; and

6. such other factors as the Commission may deem appropriate.

When large quantities of non-automatable BRM are subject to the weight-averaging system (processed by the Postal Service) or the incoming manifest system (processed by the recipient), the Postal Service's cost of computing postage and fees due is quite low, less than a penny per piece. However, recipients are charged a fee of 10 cents per piece because the BRMAS rate applies only to automatable mail. The existing Postal Service practice unduly discriminates against non-automatable bulk BRM and prevents the fee for such mail from being cost-based. The proposed classification change would eliminate the discrimination, and permit non-automatable bulk BRM to benefit from a lower, cost-based rate which would be more fair and equitable (Criterion 1).

All BRM has significant convenience value to the mailing public. This is especially true when payment of the correct postage requires the public to weigh the mail piece, be cognizant of the surcharge for pieces that weigh less than one ounce and exceed one-quarter inch thickness, and then have the right denomination stamps available (or else apply more postage than is necessary). The classification change proposed here is desirable because it will facilitate cost-based rates, encourage wider use of BRM for non-automatable pieces, and enhance the relative value to all people who use business reply envelopes to enter mail into the postal system (Criterion 2).

When members of the public opt to send their exposed film through the mail, it goes via First-Class Mail, which is the Postal Service's foundational and most profitable product. And when members of the public mail exposed film, which is non-automatable, they want the envelope to reach the addressee with a high degree of

speed and reliability (Criterion 3). Such a result is furthered by the weight-averaging and the incoming manifest systems used by NMS, both of which avoid unnecessary and time-consuming counting, rating and billing procedures. The classification change proposed here should promote the adoption and use of these more efficient procedures by the Postal Service, whereby mail is delivered more quickly, in furtherance of Criterion 3.

When people opt to use through-the-mail film processors, instead of local drop-off and pick-up, the Postal Service gains business as do its mail processing customers. Likewise, an efficient and cost-competitive universal delivery service promotes competition in the film development business, and gives the general public more options. The proposed classification change is thus desirable from the point of view of both users and the Postal Service (Criterion 5).

To sum up, the classification change proposed here accords fully with all applicable criteria of the Act and should be recommended.

The Proposals Are In Accord With the Statutory Pricing Criteria

Section 3622(b) of Title 39, United States Code, requires that postal rates and fees be set in accordance with the following factors:

1. the establishment and maintenance of a fair and equitable schedule;

2. the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not

limited to, the collection, mode of transportation, and priority of delivery;

3. 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;

4. the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

5. the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

6. the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

7. simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

8. the educational, cultural, scientific, and informational value to the recipient of mail matter; and

9. such other factors as the Commission deems appropriate.

Criterion 1 requires fees to be fair and equitable. The existing situation is patently inequitable and akin to monopolistic exploitation, which the Commission should take the lead to prevent. Either of the two BRM proposals advanced here by NMS would result in rates that are more cost-based. According to USPS witness Lyons, realignment of fees to reflect costs is among the major pricing and classification policy changes that Postal Service management seeks to accomplish.[68]

[68] USPS-T-1, p. 12.

Cost-based rates have long been regarded as a benchmark in the establishment and maintenance of a fair and equitable schedule (Criterion 1).

Prepaid Business Reply Mail is a special service available only to First-Class and Priority Mail, and the value of mail service actually provided is already reflected in those rates (criterion 2). It stands to reason that when the fee for business reply service is far higher than the associated costs of providing the service (including a contribution to overhead that is in line with the systemwide average), then the total amount paid (postage plus fee) becomes distorted and fails to reflect the value of mail service actually provided.

The Postal Service incurs low unit costs for the business reply feature (*i.e.*, counting, weighing, rating and billing) when it uses the weight-averaging system, and virtually no such cost when the recipient prepares an incoming manifest. At the BRMAS rate of 2 cents per piece, non-automatable bulk BRM processed by either system will cover by a substantial margin the attributable costs associated with the business reply feature (Criterion 3).

The Postal Service has no direct competition for collecting and delivering BRM from the general public. Indirectly, the Postal Service does compete with regional courier companies that pick up film and return it to drop-off locations such as drug stores, supermarkets, etc. Criterion 4 is satisfied because establishing a cost-based fee structure with a cost coverage in excess of 200 percent for the business reply features will not disadvantage any company engaged in the delivery of mail matter other than letters, while benefitting the general public and business mail users.

Business reply is widely used to facilitate and encourage mailing by the general public. In some instances, a number of alternatives may be available. For instance, some business reply users can provide the option of toll-free telephone services. However, that is not an option for items such as film, union ballots, or other physical objects that need to be mailed. Or, when users expect a high percentage return of the reply envelopes which they distribute (*e.g.*, utility bills), they can distribute stamped courtesy reply pieces. But that alternative is totally impractical when the expected return of reply envelopes is low, and/or when the weight is likely to vary and the 11-cent surcharge for non-standard First-Class Mail under one ounce may be applicable. For many business reply users, the only alternative is to require respondents to pay the postage. For through-the-mail film processors and other similarly-situated users, the Postal Service is in a position to exploit its monopoly, even though the cost of handling non-automation compatible bulk BRM is quite low. Criterion 5 requires that the coverage on such mail be tempered so as to be in line with systemwide coverage, and not set at an implicit level of over 1000 percent.

BRM represents incoming mail from individual mailers, so at first blush Criterion 6, which deals with the degree of preparation performed by the mailer, may not appear to be directly applicable. In fact, however, it is quite on point with respect to the weight-averaging and incoming manifest systems at issue here. By eliminating all counting, weighing, rating and billing of individual pieces, these systems facilitate the Postal Service's preparation of mail for delivery and reduce costs to the Postal Service, which satisfies Criterion 6.

NMS classification Proposal A would add a single line to Rate Schedule SS-2, while NMS classification Proposal B would change one word in Rate Schedule SS-2. Neither proposal would change the DMCS narrative text. Either proposal adopts the principle, with respect to BRM, that a low unit cost, however achieved, entitles the recipient to a cost-based fee. In that respect, the reclassification proposals advanced here promote simple, identifiable relationships between fees charged for BRM service (Criterion 7).

The ESCI provision (Criterion 8) is usually interpreted to apply to magazines, newspapers, newsletters and other matter mailed at the rate for periodicals (formerly second-class). As such, this criterion is not applicable to BRM, which is a special service provided for First-Class and Priority Mail only.

Finally, the elimination of undue discrimination and monopolistic exploitation prohibited by 39 U.S.C. § 403(c) is an important factor that also supports the proposed classification proposal and should be considered by the Commission (Criterion 9).

To sum up, the two alternative proposals advanced by NMS in this Docket comport with all relevant pricing criteria of the Act, and one of the two should be recommended by the Commission.

Operational and Administrative Simplicity

Under either of the two alternative proposals recommended in this Docket, the Postal Service would not change by one iota its existing operations at Nashua's

Parkersburg plant, or at the New London Post Office, or at the Seattle Post Office. The Postal Service already has in place fully adequate procedures for sampling and revenue protection. Existing procedures, some of which have been in place for as long as 15 years, would continue unaltered. No new procedures need by drawn up and promulgated, nor is any employee training or re-training required. From an operational standpoint, the proposals here amount to nothing more than "business as usual." The Postal Service would simply need to promulgate some changes to the DMM that would conform it to the modified DMCS as well as to existing practice.

No Reason Exists to Wait for Completion of a "Comprehensive Re-engineering Plan" said to be Under Study by the Postal Service Task Force

Existing treatment of non-automatable bulk BRM is unduly discriminatory. That discrimination should be eliminated without further delay. The two alternative classification proposals advanced here are designed to do exactly that, and nothing more. Furthermore, a fundamental principle underlying any "re-engineering" of BRM should be to eliminate all vestiges of undue discrimination among BRM users. Implementing that principle within the context of this docket should not in any way prejudice the Postal Service's ongoing study of BRM. Nothing proposed here prevents the Postal Service from subsequently offering its own classification and rate proposals for BRM (including BRMAS and, perhaps, PCRM), on such schedule and at such time as it so elects.

It is undisputed that BRMAS has many problems which need careful and comprehensive study. Even before rebuttal testimony was submitted in Docket No. R94-1, the Postal Service knew that its study of BRMAS was fundamentally and fatally flawed. As indicated above, BRMAS is not a subset of reply mail with homogeneous cost characteristics. Some pre-barcoded BRMAS mail is handled manually at a unit cost that is up to 16 times the unit cost of mail processed solely on automation. Extensive manual handling of pre-barcoded reply mail, which results from factors that are both *internal* and *external* to the Postal Service, drives up the average cost. The problems with BRMAS-qualified mail clearly need to be addressed in a careful, thoughtful manner. However, consideration of such matters is not pertinent to the two alternative proposals that are the subject of this testimony. Problems associated with BRMAS mail can be analyzed and discussed without reference to non-automatable bulk BRM. Likewise, the problem of undue discrimination against bulk BRM can be solved without consideration of any BRMAS-related problem.

The Postal Service obviously has been in no hurry to address BRM. Since Docket No. R94-1, the Postal Service has considered the fee for pre-barcoded BRMAS mail to be too low.[69] Nevertheless, when preparing to file its request for classification and rate changes in this docket, the Postal Service gave higher priority to six other special services. An evaluation of PCRM is supposedly underway, but

[69] See response to NM/USPS-22.

criteria for evaluating PCRM have yet to be formulated.[70] Whether PCRM will be part of BRM re-engineering and classification reform is unknown. Under the circumstances, any BRM filing by the Postal Service could be subject to significant delay. In addition to unforeseeable events, a possible filing for classification reform of BRM (including or excluding PCRM) could be overtaken by a number of foreseeable events, such as other classification cases or an omnibus rate case. In fact, such a delay might even appear likely; reclassification has been described by Postal Service witnesses as an ongoing effort, and reclassification for parcels and Priority Mail are known to have been under active discussion long before the *ad hoc* BRM task force was formed earlier this year. Filing a reclassification case either for parcels, or Priority Mail – or both – might preclude a near-term filing for BRM.

Furthermore, the Governors have adopted a policy designed to restore the Postal Service's equity.[71] The budget for FY 1997, which has already begun, has a planned surplus of only $55 million, and that is far short of the Governors' $963 million target for equity restoration. In view of the projected fiscal deterioration between FY 1996 and 1997, the outlook for FY 1998 is presumably somewhat worse. Absent a dramatic near-term improvement in operating performance, the Postal Service may need to file an omnibus rate case sometime during the current fiscal year. Any such case could also cause re-engineering and reclassification proposals for BRM to be deferred for a significant period.

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[70] See response to NM/USPS-47.

[71] LR-SSR-112 .

Revenue Considerations

For the three intervenors combined, adoption and implementation of the pre-barcoded BRMAS rate for non-automatable bulk BRM would reduce the Postal Service's net revenues by less than one-third of one percent of the $340 million in additional revenues that the Postal Service expects to realize from its other requests in this docket.[72] By almost any standard, this impact is minimal. Moreover, the Postal Service can offset even this small negative impact by hastening its comprehensive study of BRM, which heretofore has been given such low priority. Importantly, however, the proposals made here should be recommended despite their slight revenue implications, because they are the result of undue discrimination and monopolistic exploitation that cannot be tolerated under the Postal Reorganization Act.

Conclusion

Nashua would like to continue using the BRM service, possibly for an increasing share of its orders, but it needs to be able to pay at the 2-cent, per-piece BRMAS level. This is fair and reasonable, because Nashua does not merely do ***as much work*** as those eligible for BRMAS permits, it actually does ***more work*** in processing and accounting for its own business reply mail. Nashua believes that a low fee, such as the BRMAS fee, should apply in circumstances, such as those of Nashua, where a high volume mailer has established an advance deposit account and

[72] Proprietary data supporting this estimate are contained in confidential workpapers.

does substantially all of the mail handling and data collection work via an incoming manifest system, and the Postal Service avoids all piece handling even more than it does with respect to an ordinary BRMAS account.

Mystic and Seattle believe that the current 10-cent, per-piece charge on all of their orders is grossly excessive, since their mail is weight-averaged and not subject to the usual manual counting, weighing and rating procedures used for low volumes of non-automatable BRM. In fact, the weight-averaging system is probably one of the least expensive procedures the Postal Service has ever designed for processing BRM, including BRMAS.

Mystic and Seattle also would like to continue using the BRM service, but would like their BRM fee to be adjusted to the level of the cost-based BRMAS fee. This is fair and reasonable, because their BRM is so simple and inexpensive to process and account for. Mystic and Seattle believe that a low fee, such as the BRMAS fee, should apply in circumstances such as theirs, where high-volume mailers have established an advance deposit business reply account, and the accounting system enables the Postal Service to spend less effort and actually incur less expense than would result in the case of an ordinary BRMAS account.

For all of the foregoing reasons, I would urge the Commission to recommend favorably to the Board of Governors one of the two alternative classification proposals contained in this testimony.

APPENDIX I

UNIT COST OF BRMAS MAIL

When discussing possible discrimination under 39 U.S.C. § 403(c) (as well as §§ 3622(b)(1) and 3623(c)(1)) of the Act, it is useful to have some benchmark unit cost data on BRMAS mail. The purpose of this appendix is to develop such data.

Estimation of BRMAS Costs in Docket No. R90-1

In Docket No. R90-1, USPS witness Pham estimated that 94 percent of BRMAS mail receives final processing at facilities with automated processing capability. He further estimated that 85 percent of this volume would be successfully processed under the BRMAS system. The estimate — 85 percent of the volume successfully processed by BRMAS — is referred to by witness Pham as the BRMAS "coverage factor."[1] Based on a coverage factor of 85 percent, the unit cost was estimated at 1.01 cents per-piece. And, as noted previously, the fee for BRMAS mail was set at 2 cents per piece, comfortably above the unit cost.

[1] A coverage factor of 85 percent means than only 80 percent of all BRMAS mail in fact will be processed on automation equipment, since 6 percent of all BRMAS mail will destinate at facilities without such equipment.

Estimation of BRMAS Costs in Docket No. R94-1

In Docket No. R94-1 the Postal Service at first sought to raise the BRMAS rate to 6 cents per piece, and subsequently amended that proposal to seek an increase of 4 cents per piece. The estimate of BRMAS unit costs was contested strongly. A framework for analyzing BRMAS costs was presented in rebuttal testimony by USPS witness Pham.[2] Specifically, in that testimony, witness Pham stated (p. 4) that:

> the BRMAS per-piece cost is highly sensitive to variations of the BRMAS coverage factor, as indicated in the following table:

BRMAS Coverage	56%	66%	75%	85%
BRMAS Cost/Piece	$0.0379	$0.0289	$0.0209	$0.0119

The per-piece costs in witness Pham's table above represent a weighted average of BRM pieces (i) processed on automation equipment, at a unit cost of 0.63 cents per piece, and (ii) processed manually at a much higher unit cost of 10.19 cents per piece.[3] BRMAS mail that, for one reason or another, happens to be processed manually is thus reckoned to have a unit cost about 16 times greater than the unit cost of pieces processed on automation equipment. In view of such a wide cost difference,

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[2] Docket No. R94-1, USPS-RT-7, p. 4 (submitted but not admitted into evidence).

[3] These are projected 1995 test year costs, and include both direct and indirect costs; see USPS-RT-7A, p. 1. As discussed *infra*, witness Pham also deducts from the weighted cost "the per-piece cost of a barcoded FCM incoming secondary operation." (Docket No. R94-1, USPS-RT-7, p. 5.)

witness Pham.

BRMAS-qualified mail clearly does not represent a subset of BRM with homogeneous cost characteristics.[4]

Also in Docket No. R94-1, USPS witness Donald L. Mallonee, Jr. reviewed a number of problems associated with the BRMAS program that, collectively, reduced significantly the volume of automation-compatible pieces actually processed on high speed sorters equipped with BRMAS software.[5] Several of these problems were *internal* to the Postal Service and beyond control of any BRM permit holder. In summing up his outlook for the future, Witness Mallonee stated:

> I do not foresee any substantial changes in BRMAS management, software, or customer requirements in the near term. Management efforts to improve the BRMAS program will take time. . . . . I therefore conclude that it would be unrealistic to expect that BRMAS coverage will increase to anywhere near eighty-five percent by the test year (FY 95) or even through FY 1997.

Despite witness Mallonee's less than optimistic assessment, the Postal Service may have overcome, or may be in the process of overcoming, its *internal* problems with the BRMAS program. Moreover, the Postal Service's *internal* problems are not particularly germane to the substantive issues raised in this testimony.

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[4] These comments are not intended as a criticism of BRM/BRMAS generally, but rather are relevant to the concept of evaluating the Nashua/Mystic/Seattle proposal, and assessing the presence of discrimination.

[5] USPS-RT-8, which was submitted but not admitted to the record in Docket No. R94-1. This rebuttal testimony was intended to complement the testimony of witness Pham.

Far more pertinent is the problem of insufficient volumes of automatable BRM encountered by the BRMAS program.[6] The problem of low volume experienced by a great many business reply accounts is *external* to the Postal Service. No amount of improvement in the *internal* operations will overcome the problem of low volumes. Low volume accounts represent an identifiable subset of BRMAS mail with high unit cost. Witness Mallonee reckoned that in 1993 the average volume per BRMAS account per day was only 33.18 pieces.[7] Of course, this average includes some BRMAS accounts with daily volumes substantially above the average, and many accounts that are below the average.

In addition to low average volume, many BRMAS accounts were said by witness Mallonee to be marked by seasonal fluctuations with daily volumes sometimes well below their average.[8] In off seasons, this would indicate daily volumes of less than 20 pieces per account. It should come as no surprise that expensive automation equipment designed to process up to 36,000 letters per hour is not particularly economical when sorting to such low volume accounts.[9] Witness Mallonee explained the situation as follows:

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[6] The persistent problem of low volumes varies from facility to facility; see response to NM/USPS-19.

[7] Docket No. R94-1, USPS-RT-8, p. 8, fn. 5 (not admitted into evidence).

[8] The seasonality problem also persists; see response to NM/USPS-18.

[9] All BRMAS-qualified mail is incoming First-Class Mail and, as such, is entitled to receive applicable service standards. In order to process BRMAS mail in a timely manner on automation equipment, that equipment must be diverted during critical peak periods. If BRMAS mail could be held and processed at a later time (*e.g.*, during the day), it might be more economical.

> As plants developed BRMAS sort programs they discovered that many bar code sorter stackers received minimal volumes. Consequently, the BRMAS report generation process, [FOOTNOTE: BRMAS produces a one page "bill" for each customer. This process takes considerable time (30 seconds to one minute). Therefore, a sort program with fifty customers receiving 20 pieces per customer may take over one-half an hour for report generation.] combined with the time used to process BRMAS mail pieces, actually took longer and used more resources than did the manual sorting, counting and billing system used prior to BRMAS implementation.
>
> In some cases, BRMAS volumes are so low that separate bar code sorter "hold outs" cannot be justified. [FOOTNOTE: Volume analysis is performed by local In-Plant Support operations to determine the most efficient manner in which to develop sort plans. This analysis is performed due to the limited number of stackers on bar code sorters and efforts to reduce unnecessary rehandlings.] [Docket No. R94-1, USPS-RT-8, p. 9 (not admitted into evidence).]

Because of the unsatisfactory state of the record evidence in Docket No. R94-1, the Commission used an 85 percent coverage factor, updated the unit cost from Docket No. R90-1 (1.01 cents) to 1.2 cents and recommended a BRMAS fee of 2 cents per-piece.

Development of a BRMAS Cost Benchmark To Compare With the Cost of Non-Automatable Bulk BRM

The unit cost data submitted by witness Pham in Docket No. R94-1 were not admitted into evidence and therefore were not tested. Nevertheless, table A-1 uses witness Pham's model and data to establish some benchmark parameters for the unit costs of processing BRMAS mail.[10]

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[10] As indicated previously, the approach adopted here is based on testimony of USPS witness Pham in Docket No. R94-1, USPS-RT-7. This is not an attempt to (continued...)

Column 1 of Table A-1 shows different BRMAS coverage factors. The first four coverage factors are those used by witness Pham in his Docket No. R94-1 rebuttal testimony, and the last three factors extend BRMAS coverage by 5 percent increments up to 100 percent. As discussed previously, this represents a weighted average of BRM pieces (i) processed on automation equipment, at a unit cost of 0.63 cents per-piece, and (ii) processed manually at a much higher unit cost of 10.19 cents per-piece

Column 2 shows the 1995 weighted cost per piece, including direct and indirect costs. The first four unit cost figures are from witness Pham's testimony, and last three are developed in a straightforward manner using his methodology.[11]

Column 3 shows the incoming secondary cost for an automation compatible FCM piece, which witness Pham deducts from the weighted per-piece cost shown in column 2.

Column 4 shows the result of deducting the unit cost in column 3 from the weighted unit cost in column 2. In column 3, the unit cost of 1.38 cents is seen to be twice witness Pham's estimated unit cost of BRMAS processing on automation equipment (0.63 cents). That should not be. This leads to the totally implausible

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[10](...continued)
rehabilitate that portion of his testimony which endeavored to show that the BRMAS unit cost is above some specified amount. In fact, for reasons explained below, I consider his cost estimates to be too low. Nevertheless, indicating how the unit cost of BRMAS mail varies as the coverage factor changes, in graduated steps, from 56 to 100 percent coverage is a useful exercise.

[11] For details, see Exhibit NMS-T-1.

result that, at a 100 percent coverage level, it costs less to process BRMAS mail (including the 6.22 percent that must be processed manually at non-automation sites) than it costs to process regular First-Class Mail on automation equipment.[12] Consequently, at all coverage levels, Witness Pham's estimate of the net weighted cost of BRMAS processing (column 4) is clearly too low. The available cost data obviously cannot be used to estimate the absolute cost of processing BRMAS mail. Since the unit costs are known to be uniformly on the low side, however, they can serve as a benchmark for comparison with the unit cost of processing non-automation compatible bulk BRM.

Column 5 uses the ratio of the 1996/1995 productive hourly wage rate for clerks/mailhandlers to update the units costs in column 4.[13]

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[12] Even at 100 percent coverage, 6.22 percent of all BRMAS-qualified mail would be processed manually at a unit cost in excess of 10 cents. Thus, at 100 percent coverage, the weighted cost per piece, prior to the deduction shown in column 3, amounts to 1.22 cents per piece.

[13] The updated costs are based on the ratio of the productive hourly wage rates in 1996 and 1995, $23.952 and $23.8496, respectively (see response to NM/USPS-79). The ratio is 1.0042935.

Table A-1

BRMAS Coverage Factors and Weighted Average Unit Costs
1995 and 1996

(1)	(2)	(3)	(4)	(5)
BRMAS Coverage	1995 Weighted Cost Per Piece (direct & indirect)	Incoming Secondary Cost for Automation Compatible FCM Piece	1995 Net Direct & Indirect Weighted Cost of BRMAS Processing	1996 Net Direct & Indirect Weighted Cost of BRMAS Processing
56%	$0.0517	$0.0138	$0.0379	$0.0381
66%	0.0427	0.0138	0.0289	0.0290
75%	0.0347	0.0138	0.0209	0.0210
85%	0.0257	0.0138	0.0119	0.0120
90%	0.0212	0.0138	0.0074	0.0074
95%	0.0167	0.0138	0.0029	0.0029
100%	0.0122	0.0138	-0.0016	-0.0016

DETERMINATION OF ATTRIBUTABLE COSTS OF BRMAS-QUALIFIED BRM PIECES

1. BASIC ASSUMPTIONS

Automation coverage factor	93.78%	[1]
BRMAS coverage factor (net of rejects)	90.00%	[2]
Average productive hourly wage rate for clerk/mailhandler	$24.06	[3]
Combined BCS Incoming Secondary piggyback factor	1.794304	[4]
Combined manual Incoming Secondary piggyback factor	1.533220	[5]

2. PRODUCTIVITIES	Pieces Per Hour		Direct Cost/Pce		Direct & Indirect Cost/Pce	
BRMAS processing net productivity	6880	[6]	$0.0035	[8]	$0.0063	[10]
Manual, Postage Due Unit	362	[7]	$0.0665	[9]	$0.1019	[11]

3. Weighted cost per piece (direct & indirect)	$0.0053	$0.0212 [12]
4. Inc. Sec. cost for automation compatible FCM piece		($0.0138) [13]
5. Net direct and indirect weighted cost of BRMAS processing, 1995		$0.0074 [14]
6. Total Attributable Cost of BRMAS-qualified piece, 1996		$0.0074 [15]

Footnotes

[1] 3-digit automated destinating volume coverage factor; see R90-1, USPS-T-23, Table 1.
[2] Chosen for sensitivity analysis purposes.
[3] Docket No. R94-1, response of the Postal Service to POIR 3, Item 2 (witness Patelunas)
[4] USPS-LR-G105, Page II-1
[5] USPS-LR-G105, Page I-1
[6] See R90-1, Ex. USPS-23D
[7] See R90-1, Ex. USPS-23F
[8] [3] divided by [6]
[9] [3] divided by [7]
[10] [4] * [8]
[11] [5] * [9]
[12] ([1] * [2] * {[10]) + ([11] * (1 - ([1] * [2]))
[13] See R90-1, Ex. USPS-23E, updated with 1995 hourly wage rate ([3] above) and piggyback factors (LR-G-105, pages I-1 and II-1)
[14] [12] + [13]
[15] [14] * $23.952/$23.8496; see NM/USPS-79

DETERMINATION OF ATTRIBUTABLE COSTS
OF BRMAS-QUALIFIED BRM PIECES

1. BASIC ASSUMPTIONS

Automation coverage factor	93.78%	[1]
BRMAS coverage factor (net of rejects)	95.00%	[2]
Average productive hourly wage rate for clerk/mailhandler	$24.06	[3]
Combined BCS Incoming Secondary piggyback factor	1.794304	[4]
Combined manual Incoming Secondary piggyback factor	1.533220	[5]

2. PRODUCTIVITIES	Pieces Per Hour		Direct Cost/Pce		Direct & Indirect Cost/Pce	
BRMAS processing net productivity	6880	[6]	$0.0035	[8]	$0.0063	[10]
Manual, Postage Due Unit	362	[7]	$0.0665	[9]	$0.1019	[11]

3. Weighted cost per piece (direct & indirect)	$0.0056	$0.0167 [12]
4. Inc. Sec. cost for automation compatible FCM piece		($0.0138) [13]
5. Net direct and indirect weighted cost of BRMAS processing, 1995		$0.0029 [14]
6. Total Attributable Cost of BRMAS-qualified piece, 1996		$0.0029 [15]

Footnotes

[1] 3-digit automated destinating volume coverage factor; see R90-1, USPS-T-23, Table 1
[2] Chosen for sensitivity analysis purposes.
[3] Docket No. R94-1, response of the Postal Service to POIR 3, Item 2 (witness Patelunas)
[4] USPS-LR-G105, Page II-1
[5] USPS-LR-G105, Page I-1
[6] See R90-1, Ex. USPS-23D
[7] See R90-1, Ex. USPS-23F
[8] [3] divided by [6]
[9] [3] divided by [7]
[10] [4] * [8]
[11] [5] * [9]
[12] ([1] * [2] * ([10]) + ([11] * (1 - ([1] * [2]))
[13] See R90-1, Ex. USPS-23E, updated with 1995 hourly wage rate ([3] above) and piggyback factors (LR-G-105, pages I-1 and II-1)
[14] [12] + [13]
[15] [14] * $23.952/$23.8496; see NM/USPS-79

DETERMINATION OF ATTRIBUTABLE COSTS OF BRMAS-QUALIFIED BRM PIECES

1. BASIC ASSUMPTIONS

Automation coverage factor	93.78%	[1]
BRMAS coverage factor (net of rejects)	100.00%	[2]
Average productive hourly wage rate for clerk/mailhandler	$24.06	[3]
Combined BCS Incoming Secondary piggyback factor	1.794304	[4]
Combined manual Incoming Secondary piggyback factor	1.533220	[5]

2. PRODUCTIVITIES

	Pieces Per Hour		Direct Cost/Pce		Direct & Indirect Cost/Pce	
BRMAS processing net productivity	6880	[6]	$0.0035	[8]	$0.0063	[10]
Manual, Postage Due Unit	362	[7]	$0.0665	[9]	$0.1019	[11]

3. Weighted cost per piece (direct & indirect)	$0.0059	$0.0122 [12]
4. Inc. Sec. cost for automation compatible FCM piece		($0.0138) [13]
5. Net direct and indirect weighted cost of BRMAS processing, 1995		($0.0016) [14]
6. Total Attributable Cost of BRMAS-qualified piece, 1996		($0.0016) [15]

Footnotes

[1] 3-digit automated destinating volume coverage factor; see R90-1, USPS-T-23, Table 1.
[2] Chosen for sensitivity analysis purposes.
[3] Docket No. R94-1, response of the Postal Service to POIR 3, Item 2 (witness Patelunas)
[4] USPS-LR-G105, Page II-1
[5] USPS-LR-G105, Page I-1
[6] See R90-1, Ex. USPS-23D
[7] See R90-1, Ex. USPS-23F
[8] [3] divided by [6]
[9] [3] divided by [7]
[10] [4] * [8]
[11] [5] * [9]
[12] ([1] * [2] * {[10]) + ([11] * (1 - ([1] * [2]))
[13] See R90-1, Ex. USPS-23E, updated with 1995 hourly wage rate ([3] above) and piggyback factors (LR-G-105, pages I-1 and II-1)
[14] [12] + [13]
[15] [14] * $23.952/$23.8496; see NM/USPS-79

APPENDIX II

Nashua/Mystic/Seattle
Amendment to DMCS
Proposal A

Schedule SS-2--Special Services
Business Reply Mail

Active business reply advance deposit account:
Per piece:
Pre-barcoded: $0.02
Non-automatable bulk BRM: $0.02
Other: $0.10

Payment of postage due charges if active business reply mail advance deposit account not used:
Per piece: $0.44

Annual license and accounting fees:
Accounting fee for advance deposit account: $205.00
Permit fee (with or without advance deposit account): $85.00

Nashua/Mystic/Seattle
Amendment to DMCS
Proposal B

Schedule SS-2--Special Services
Business Reply Mail

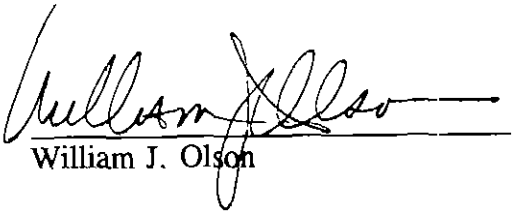
Active business reply advance deposit account:
Per piece:
~~Pre-barcoded~~ BRMAS-qualified: $0.02
Other: $0.10

Payment of postage due charges if active business reply mail advance deposit account not used:
Per piece: $0.44

Annual license and accounting fees:
Accounting fee for advance deposit account: $205.00
Permit fee (with or without advance deposit account): $85.00

CERTIFICATE OF SERVICE

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



William J. Olson

October 9, 1996