MPA-T-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001



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| POSTAL RATE AND FEE CHANGES, 2000 | ) | Docket No. R2000-1 |

# DIRECT TESTIMONY
# OF
# RITA D. COHEN
# ON BEHALF OF
# MAGAZINE PUBLISHERS OF AMERICA, INC.
# ALLIANCE OF NONPROFIT MAILERS
# AMERICAN BUSINESS MEDIA
# COALITION OF RELIGIOUS PRESS ASSOCIATIONS
# DOW JONES & CO., INC.
# THE McGRAW-HILL COMPANIES, INC.
# NATIONAL NEWSPAPER ASSOCIATION
# TIME WARNER INC.

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## AUTOBIOGRAPHICAL SKETCH

My name is Rita Dershowitz Cohen. I am Senior Vice President for Legislative and Regulatory Policy at the Magazine Publishers of America (MPA). I am responsible for postal, tax, environmental, state, and consumer protection issues. As part of my postal responsibilities, I am MPA's association executive for the Mailers' Technical Advisory Committee (MTAC) and participate in several MTAC work groups, a member of the Postal Service's Periodicals Advisory Group, a postal advisor to MPA's Smaller Magazine Advisory Council, and a frequent speaker on postal topics. I was also the Industry Co-Chair of the Periodicals Operations Review Team (Team).

I attended the University of Pennsylvania, receiving a bachelor's degree in statistics and a master's degree in business and applied economics. I received the J. Parker Burst prize for outstanding achievement in statistics.

I have worked on postal rate issues for almost 27 years. Following my graduation, I was employed by the Postal Rate Commission (PRC or Commission) as a statistician for two years, testifying in Docket No. R74-1 on the issue of second-class costing methodology. In 1975, I joined the United States Postal Service (Postal Service or USPS) as a cost analyst in the Revenue and Cost Analysis Division. I was employed by the Postal Service for ten years, including four years as an operations research analyst in the Mail Classification Research Division and four years as a principal operations research analyst in the Office of Rates. I conducted analyses of postal costs in various cost segments and worked on classification and rate issues in various postal rate and classification cases during that period. I testified on the roll-forward model used to project costs in Docket No. R77-1.

In 1985, I left the Postal Service to join Buc & Associates, Inc., which, in 1986, merged with ICF, Incorporated, a consulting firm based in Fairfax, Virginia. I worked at ICF until 1995, becoming a Vice President in 1993. I directed and performed economic and policy analyses for both private and public sector clients, including MPA, The McGraw-Hill Companies, Inc. (MH), and the National

Newspaper Association (NNA). In Docket No. R87-1, I testified on city carrier street time for MPA and second-class presort discounts for NNA. Continuing my representation of MPA, I proposed a rate design for second-class regular rate and nonprofit in Docket No. R90-1 and testified on cost savings likely from introduction of the barcode discount for flats in Docket No. MC91-1. In Docket No. R94-1, I testified on the In-Office Cost System and the Postal Service's distribution of mail processing costs to classes and subclasses.

In 1995, I joined MPA, and was promoted to my current position in January 1999. I continue to analyze postal issues and prepare testimony, as I have done for my entire professional career. On behalf of MPA, I presented both direct and rebuttal testimony in the reclassification case, Docket No. MC95-1, presenting alternative structures and rate designs for the proposed publications service subclass. In Docket No. R97-1, I proposed alternative methodologies for distributing mail processing costs to classes and subclasses of mail.

## I. PURPOSE AND SCOPE OF TESTIMONY

This testimony is cosponsored by Magazine Publishers of America, Alliance of Nonprofit Mailers, American Business Media (formerly American Business Press), Coalition of Religious Press Associations, Dow Jones & Co., Inc., The McGraw Hill Companies, Inc., National Newspaper Association, and Time Warner Inc., whom I will refer to collectively as "Periodicals mailers."

In this testimony, I update and correct costs presented by the Postal Service for Periodicals. These updates are based in large part on information that has become available since the Postal Service filed its case in January. This new information relates to the results of joint Postal Service/industry initiatives undertaken over the past several years to improve efficiency and reduce costs for Periodicals. The concerted efforts of all involved are now bearing fruit and will lead to substantially lower Periodicals costs in the Test Year than originally forecast by the Postal Service. A roadmap of my testimony follows.

In Section II of this testimony, I describe the history of Periodicals' cost increases and discuss the Periodicals Operations Review Team (Team), a joint

effort of industry and the Postal Service to identify and ameliorate the causes of cost increases for Periodicals. I summarize the findings of the Team and its recommendations. I firmly believe that implementation of the Team's recommendations will result in more than $150 million in costs savings for the Postal Service. Based on the record in this case to this point and the steps the Postal Service has already undertaken, I am able to identify $111 million in savings for Periodicals that will result from the efforts of the Team. More than $75 million in savings are acknowledged in various USPS documents filed subsequent to the filing of its direct case on January 12, 2000. These savings are referred to in Table 1 below as "USPS TY Cost Reductions." All cost reductions that I describe will be in place by the Test Year and are in addition to those previously presented by the Postal Service in its direct case. These savings are referred to as "Periodicals TY Cost Reductions." In this section, I also prescribe some other cost savings opportunities in transportation.

**Table 1.**

**Cost Reductions**

**(millions of dollars, TY)**

| | USPS TY Cost Reductions | Periodicals TY Cost Reductions |
|---|---|---|
| Carrier Route Sacks, L001, and Combining Automation and Nonautomation Flats in Sacks and on 5-Digit Pallets | $15 | $15 |
| Line of Travel | $23 | $23 |
| Bundle Breakage | $15 | $21 |
| Air Transportation | $11 | $11 |
| Memorandum of Understanding of Vertical Flats Casing | $ 7 | $ 7 |
| Equipment and Productivity Enhancements | $ 6 | $ 6 |
| Correction to Projected Cost Savings from the AFSM 100 | $ 0 | $28 |
| Total | $77 | $111 |

In Section III, I address cost attribution and distribution issues. While the Team spent its time in the field, our observations suggested the need to revisit the theories of cost causation underlying USPS's cost attribution and distribution

methodologies. This review continued in a cooperative manner after the field effort was completed. In this section, I review a number of methodological changes proposed by the Postal Service in its direct case that were encouraged by this cooperative effort. I also explain the need for further improvements in mail processing cost attribution and distribution methodologies based on operational considerations and propose appropriate interim solutions pending further data collection. My testimony supports and incorporates the distribution of mail processing costs to classes and subclasses presented by Time Warner witness Stralberg (TW-T-1) and discussed by witness Glick (MPA-T-2). Further, in this section I discuss the Postal Service's proposed city carrier street time attribution methodology and witnesses Crowder's (ADVO-T-1) and Hay's (MPA-T-4) analysis of the new method. As witnesses Crowder and Hay will describe in their testimonies, witness Raymond's carrier street time study is defective, and the Commission should not accept it. Finally, I discuss several methodological improvements MPA witness Nelson (MPA-T-3) makes to transportation costing methodology and adjustments to rural carrier costs presented by witness Glick. In total, the costing methodology changes I propose and advocate reduce Base Year Periodicals costs (without piggybacks) by $275 million.

**Table 2.**
**Periodicals Cost Attribution**
**and Distribution Improvements**
**Without Piggybacks**
**(in millions of dollars, BY)**

| | |
|---|---|
| Mail Processing | $127 |
| City Carriers | $57 |
| Rural Carriers | $13 |
| Purchased Transportation | $78 |
| Total | $275 |

In Section IV, I estimate Test Year After Rates (TYAR) costs based upon the aforementioned cost reduction programs, the more accurate variability

estimates, and the improved distribution methods. Finally, in Section V, I discuss considerations that the Postal Rate Commission should take into account when designing rates for Periodicals. Specifically, I explain that, given the cost savings and improved costing methodology I identify and quantify, the rate increase for the Periodicals subclasses should not exceed the systemwide average. Further, the Commission should take into account the additional $10 million of projected Periodicals revenue from Ride Along pieces as approved by the Commission in the recently completed Docket MC00-1. The Postal Service's filing neglected to incorporate this additional revenue. I also discuss several rate design issues, including an improved method for measuring cost avoidance, as well as recommendations regarding discounts for automation, dropshipping, and for 5-digit pallets.

## II. COST REDUCTION PROGRAMS

In this section, I first discuss the history of Periodicals cost increases. Troubled by these cost increases, the Postal Service and the Periodicals mailing community formed the Periodicals Operations Review Team to identify and resolve the issues that have led to a trend of rapidly escalating Periodicals costs. I next describe the Team effort and summarize its findings and recommendations. I discuss a number of factors uncovered by the Team that it concluded contributed to the cost increases and explain why measures recommended by the Team and already underway lead me to be confident that the trend will abate. Then, I describe several cost reduction programs developed in a cooperative effort between industry and the Postal Service that were not identified by witness Tayman (USPS-T-9) and present the cost savings that will result from these programs. I developed these cost savings from data provided by the Postal Service in its testimony, written cross-examination responses, and library references.

## A. Measured Costs for Periodicals Have Been Increasing Rapidly

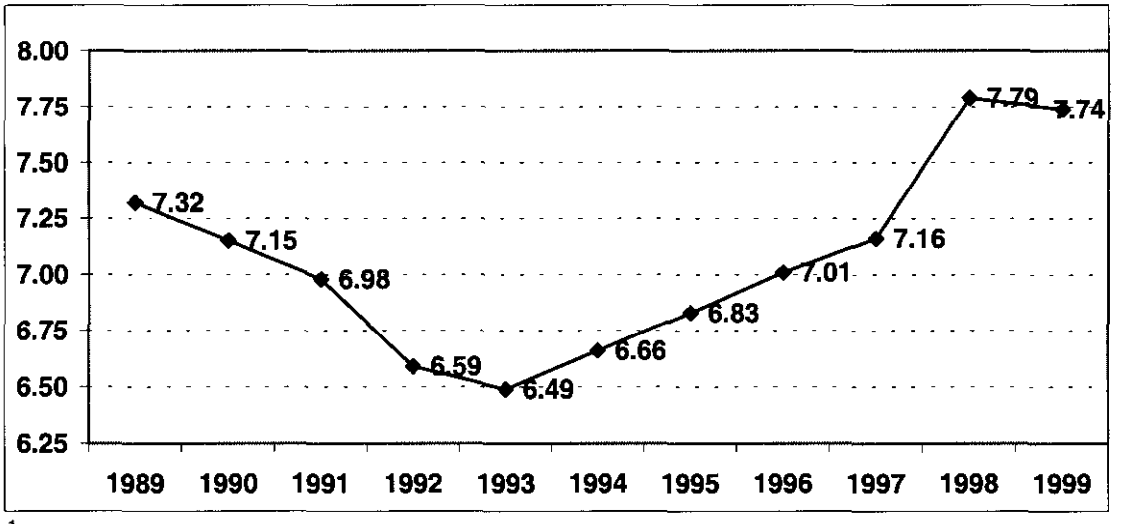
Since 1990, Periodicals mailers have noted with alarm both the rapid increase in Postal Service costs for processing Periodicals and the fact that since 1987 the costs attributed to Periodicals have been increasing much faster than costs in other mail classes. Periodicals mailers have expressed concern about these large increases to senior management at the Postal Service and to the Postal Rate Commission during the past four rate cases. For example, in Docket No. R97-1 witness Little pointed out "from fiscal year 1986 through fiscal year 1996, Periodicals mail processing unit costs have increased 71 percent." Docket No. R97-1, Tr. 15/14545.

The PRC is concerned about the issue as well. It expressed this concern in an order on March 28, which "requests that Postal Service present detailed evidence explaining the causes of the trend in the costs of processing Periodicals from a witness qualified to respond to participants' questions on the topic. . . . A witness with high-level managerial responsibility over flat handling operation would appear to be best suited to this need." PRC Order No. 1289 (March 28, 2000) at 1. The Order provides several graphs, one of which shows trends for mail processing plus city carrier in-office unit costs for various classes of mail. Figure 1, below, reproduced from the Order, shows this rapid increase in Periodicals costs since 1993.

**Figure 1.**

**Periodical Regular Mail Processing Plus City Carrier In-Office Unit Costs**

**Cents per Piece, Wage Level Adjusted to FY 1989[1]**




[1]Source: PRC Order No. 1289 (March 26, 2000).

Adding to Periodicals mailers' concern over these cost increases is the fact that they have occurred even as mailers have increased their worksharing activities. The Commission recognized this phenomenon in its Docket No. R97-1 opinion: "the Commission finds the argument that additional worksharing should have reduced costs has some plausibility." PRC OP. R97-1, para. 3191.

Further, the Postal Service acknowledges that the mailers are performing *more worksharing than they did a decade ago. In his response to an* MPA interrogatory, witness Taufique confirms that mailers performed more worksharing in 1999 than in 1992 or 1989, noting, "three major changes that stand out in the comparison of these three years are the increases in barcoded, Carrier Route and dropshipped volumes." Tr. 17/6986.

I examined major changes in mail characteristics to explore the extent of Periodicals mailers worksharing. Table 3 below presents my findings. The results show, unambiguously, that mailers are saving the Postal Service enormous amounts of work, which should translate into major savings in costs. As the Table shows, in 1999, 65 percent of Periodicals Regular mail was barcoded, while in 1989 none of it was. In 1999, 64 percent was on pallets, while

ten years earlier only 37 percent was. In 1999, 40 percent of Periodicals mail was presorted to carrier route, while 10 years earlier only 26 percent was. And in 1999, 40 percent of our mail was drop shipped, while 10 years earlier only 20 percent was. Based on these trends, costs should be decreasing rather than increasing.

**Table 3. Periodicals Regular Subclass Worksharing Over Time[1]**

| Worksharing Characteristic/Level | 1989 | 1992 | 1999 |
|---|---|---|---|
| ***Presort Level*** | | | |
| Basic | 10.3% | 8.5% | 9.1% |
| 3-Digit | 26.4% | 21.5% | 19.6% |
| 5-Digit | 37.1% | 31.5% | 31.5% |
| Carrier Route | 26.2% | 38.5% | 39.8% |
| ***Automation Level of Non-Carrier Route Mail*** | | | |
| Nonautomation | 100.0% | 99.3% | 34.7% |
| Automation | 0.0% | 0.7% | 65.3% |
| ***Drop ship Level*** | | | |
| DDU | 0.0% | 2.2% | 0.9% |
| DSCF | 21.4% | 25.2% | 39.2% |
| Not Drop shipped | 78.6% | 72.6% | 59.9% |
| ***Containerization*** | | | |
| Sacks | 52.4% | | 35.6% |
| Pallets | 37.3% | | 64.4% |
| Other | 10.3% | | |

[1] USPS-LR-I-272, worksheets "1989", "BD_All_Yrs" and "1990 Mail Chrct Stdy" and USPS-LR-I-90, worksheet "Vols-Per Reg"

On April 17, the Postal Service responded to PRC Order No. 1289 by filing supplemental testimony from two operations witnesses: Walter F. O'Tormey, Manager of Processing Operations, Operations Planning and Processing (USPS-ST-42), and Dennis R. Unger, Manager Operations Support for the Southeast Area (USPS-ST-43). Although both witnesses purported to address the topic of why processing costs for Periodicals flats may be higher than the costs for other flats, neither provided any plausible explanation for the trend of increasing costs. In fact, witness O'Tormey unconditionally accepted the proposition that automation "has lowered per unit cost for mail processing". Tr. 21/8391. Witness Unger also agreed with this proposition. Tr. 21/8240. Unger also agreed that drop shipping, barcoding, palletization, and presorting also all reduce

costs. Tr. 21/8238-39, 8246-47. Based on their testimony, I would have expected mail-processing costs for Periodicals to decrease rather than increase.

**B. Periodicals Operations Review Team**

Several years ago, after much prodding from industry and the Commission, the Postal Service finally admitted the need to examine Periodicals operations to stem the continuing escalation in cost. In 1997, the Postal Service and Periodicals mailers agreed to form the Team in order to identify and address the causes of the rapid increase in Periodicals costs over the past decade and to suggest solutions. I served as co-chair of the Team and worked with representatives from both the Postal Service and Industry. The effort began in 1998.

Field visits began in September and lasted through December 1998, the now infamous Fall 1998 mailing season. USPS-ST-43 at 11-13. The Team visited more than a dozen Postal Service facilities, which collectively process and deliver approximately 14 percent of all flat mail processed in the U.S. USPS-LR-I-193, Report of the Periodicals Operations Review Team (Team Report) at 3. We also visited two mailer plants. The focus of our effort was to "identify the causes of the rapid rise in Periodicals costs over the past decade, identify opportunities to drive costs from the postal system, and make recommendations for industry and the Postal Service to capture these opportunities." Team Report at 2.

With respect to its first focal point, which is also the question posed by the PRC in Order No. 1289, the Team did not find a "smoking gun." But while we did not find one root cause for the large increases in costs, we did learn more than perhaps we could ever have hoped. Each facility visited was different, but over the course of the study, we began to see patterns and uncover clues about what was going on with Periodicals. Trying to convey the complexity of the situation, the Report states, "[t]he Team concluded that it had observed system inefficiencies in both postal and mailer processes along with other inherent characteristics that likely have contributed to, but do not explain fully, the large

increases in Periodicals costs." Team Report at 3. Although I cannot unequivocally explain the large increases for flats, I can identify a major contributing factor. Because flats automation trailed letter automation for both technological and economic reasons, Postal Service management focused on letters. The resulting inattention on flats created inefficiencies. We saw:

- Too much manual processing of machinable flats, while flat sorting machines sat idle. This was especially true for Periodicals. This manual processing was occurring at decreased productivity rates, which declined after 1994 even though the flats volumes processed manually grew in 1995. MPA/USPS-ST42-3(d) (filed May 9, 2000). Extensive preparation work to separate periodicals into machinable categories was frequently wasted effort, as periodicals did not often get automated handling. Team Report at 32-34.
- A lack of effective supervision, particularly crucial during a period of rapid change in flats processing procedures and emerging technology. Team Report at 27-29. This deficiency may have been due to the effects of reorganization described by witness O'Tormey. USPS-ST-42 at. 17.
- Wide fluctuations in flats processing procedures among facilities. This stood in marked contrast to the standardized processing procedures used for letter mail. Team Report at 19-20.
- Poor coordination between upstream and downstream facilities. Downstream facilities would sometimes undo processing steps taken upstream, for example, separating mail classes that had been combined in previous operations. Team Report at 19-20.
- Little, if any, attention by facility management to processing costs by type of operation and no attention to costs by class. Facility management was judged on and cognizant of overall budget, complement, and service levels. Team Report at 11.
- A relative lack of communication between mailers and Postal Service personnel about matching mail preparation to postal processing needs.

Team Report at 13-16. During this period of rapid change, additional facilities, and new mail separation processes, we saw instances of apparent mailer confusion about, or disregard for, correct mail makeup. Team Report at 18.

**C. Cost Reductions**

In spite of the trends of the past, I am sanguine about Periodicals cost prospects for the future. The Team's field visits were an eye-opener both for the mailing community and the Postal Service. I firmly believe that at senior levels of Postal management there is a fundamental recognition and understanding of the flaws in the system that caused costs to increase. In fact, Postal Service management recently has taken steps to solve major elements of the problem and regain their focus. Witness O'Tormey briefly touched on a number of these steps in his testimony, and provided additional information in written answers to interrogatories and oral cross-examination.

- As stated by witness O'Tormey, "There are scheduled teleconferences with the Area Managers of Operations every two weeks to monitor overall flats processing performance." USPS-ST-42 at 20. The Postal Service has developed a "scorecard" to use in the teleconferences, which includes ten major indicators by which area managers are compared. The scorecard measures utilization of both 881 and 1000 flat sorting machines and productivity improvement in manual operations. TW/USPS-9 (filed on May 10, 2000). The Postal Service is committed to a "use it or lose it" policy and has pulled machines out of low-utilization facilities. Tr. 21/8257.

- To provide a game plan to the field, Headquarters revised the Strategic Improvement Guide for Flats Processing (USPS-LR-I-193) and has issued management instructions on many facets of bundle and flats processing, including proper staffing and how to maximize use of automation.

- The Postal Service's direct case included some cost savings related to these initiatives. Witness Tayman quantified cost reductions for increasing utilization of equipment as well as the procurement of additional automation. USPS-LR-I-126. And witness O'Tormey assures us that they have already begun to plan to capture the labor savings from this new equipment. Tr. 21/8374-75.

However, there are additional cost savings in these areas and others that will also reduce Periodicals costs in the Test Year. Following the Team's field visits and based on its observations and conclusions, it recommended a number of initiatives that will reduce Periodicals costs. These initiatives "identify mail preparation and processing issues that could be rapidly addressed to achieve the maximum initial benefit, and lay the groundwork for longer-term improvements." Team Report at 2. Although they are not included in its direct case, the Postal Service has subsequently followed up on a number of these recommendations.

Below, I describe and quantify seven cost reduction programs that the Postal Service already has implemented or will implement by the Test Year, but for which the Postal Service did not quantify cost savings in its direct case.

***Reducing Costs Through Improved Mail Preparation***

Currently, the Periodicals Industry is working closely with the Postal Service to better align mailer preparation with USPS processing. Based upon these efforts, the Postal Service has recently issued a Federal Register notice regarding the use of L001 lists and "Carrier Routes" sacks and will shortly issue a notice to establish line-of-travel (LOT) sequencing for Periodicals Carrier Route mail. I briefly describe the benefits of these changes in mail preparation standards and then quantify their impact on TYAR costs.

*Carrier Route Sacks, L001, and Combining Automation and Nonautomation Flats in Sacks and on 5-Digit Pallets*

On February 29, the Postal Service issued a Federal Register notice that will require changes in the makeup of containers at the 5-digit level to maximize

efficiency and to direct the mail to the point at which it will actually be processed. These changes will decrease the number of containers, particularly sacks. There are three components that lead to the reduction in containers: (1) mailers will combine mail for 5-digit zip codes that is processed together in an L001 sort scheme; (2) mailers will combine mail for carriers that deliver out of the same carrier delivery unit; and (3) mailers will combine barcoded and non-barcoded packages when this mail is processed together in incoming secondary operations. 65 Fed. Reg. 10735-59 (February 29, 2000).

MPA has been a strong supporter of allowing mailers to combine mail and reduce the number of containers when doing so is consistent with Postal Service processes. This is reflected in two Team recommendations: (1) to match mail preparation to postal processing; and (2) to optimize use of containers I understand that the Postal Service is planning to require the use of the L001 scheme and the combining of CRRT "skin sacks" into "carrier routes" sacks, as suggested by MPA. The Postal Service has estimated that these improved mail preparation standards will reduce TYAR costs for Periodicals by $15 million. MPA/USPS-ST42-4-5 (filed on May 9, 2000); USPS-LR-I-332.

*Line of Travel (LOT)*

Since 1997, the Postal Service has required Standard A Carrier Route flats to be prepared in LOT sequence. This same sequencing has not been required for Periodicals. As part of our cooperative effort to identify mail preparation changes that could drive costs from the postal system, the Postal Service asked industry to consider a LOT requirement for Periodicals. Industry discussions revealed widespread willingness to prepare Periodicals in this manner if it would reduce postal costs. As a result, the Postal Service undertook to quantify the potential savings from a LOT requirement for Periodicals. Finding substantial savings, the Postal Service plans to move forward quickly.

As the Postal Service stated in its response to MPA/USPS-47, it plans to propose "imposing a line-of-travel (LOT) requirement for Periodicals Carrier Route Basic mail through a Federal Register notice within the next several

months." Tr. 21/8947. Just as it did for Standard (A) Carrier Route Basic flats, the LOT requirement will improve casing efficiency and reduce carrier costs. The Postal Service estimates that implementing the LOT requirement will reduce Periodicals costs by $23 million in the Test Year. USPS-LR-I-307 at 8.

Given industry's already stated agreement with a LOT requirement for Periodicals and the ready availability of comparable programming logic from Standard (A), I believe implementation for Periodicals will be accomplished quickly. I agree with the Postal Service that its calculated $23 million cost savings will be achieved in the Test Year.

***Reducing Costs Through Improved USPS Operations***

*Bundle Breakage*

In its report, the Team noted that bundle breakage is a significant problem, but one that can be solved:

> Flats bundles are at risk of breaking during bundle sorting, especially when dumped on the automated feed systems of SPBS machines. Bundles that travel in sacks also incur substantial breakage during sack handling operations, although the sack preserves the presort level of the sack itself. There are a number of possible remedies that together could lead to substantial cost reductions, including better bundle strapping, use of pallets rather than sacks, improved bundle sorting methods, alternatives to today's SPBS feed systems, and better efforts at salvaging partially broken bundles.

Team Report at 24.

Since the issuance of the Team Report, MPA has worked actively with the Postal Service to study the causes of bundle breakage and reduce it. As discussed in more detail by witness Glick, who is a member of the MTAC Package Integrity Work Group, through improved mailer preparation and USPS operations, I believe we can reduce the magnitude of this problem significantly. The Postal Service agrees. Based upon the cost model presented by witness Yacobucci (USPS-T-25), it estimates a $15 million dollar reduction in Periodicals

costs due to a 25 percent reduction in broken bundles. MPA/USPS-ST42-10 (filed on May 9, 2000).

I believe the estimated 25 percent significantly understates the reduction in bundle breakage that will be achieved in the Test Year. As described by witness Glick, efforts to reduce bundle breakage are proceeding on many fronts simultaneously and with a not surprising sense of urgency. I am aware of changes in bundle preparation already being considered by publishers and their printers based on reports emerging from the MTAC Work Group that bundles enclosed in polywrap have lower breakage rates. Publishers have a very strong interest in retaining bundle integrity, not only to keep costs down, but also because bundle breakage tends to damage the magazines in the bundle. Damaged subscriber copies are something the magazine industry tries to avoid assiduously.

With all the effort being put forth by industry, USPS, MTAC, and printers, I believe a 50 percent reduction in bundle breakage is easily achievable. Correcting for witness Yacobucci's use of an average bundle breakage rate for both sacks and pallets, witness Glick shows that industry and Postal Service efforts to reduce bundle breakage and improve bundle recovery methods will reduce Periodicals costs by $21 million in the Test Year.

*Air Transportation*

While the Periodicals Operations Review Team was tasked with looking at mail processing operations, it also learned quite a bit about transportation operations. In particular, it learned of situations in which the Postal Service undertook to provide extraordinary transportation measures to meet perceived Periodicals' service needs. The Team concluded that obtaining extraordinary transportation was inappropriate, as mailers understand critical entry times and are already willing to live with the consequences of missing critical entry.

In following up on transportation issues, the Postal Service discovered that Periodicals mail was sometimes transported by air rather than surface transportation. Except in areas where this is the only means of transportation,

the Postal Service agreed with the Team that this use of extraordinary air transportation should be discontinued. As evidenced by the 65 percent ($12 million) decrease in Periodicals "passenger air" costs between FY 1998 and 1999, the Postal Service is making a concerted effort to keep "surface mail off of air transport." TW/USPS-6 (filed on May 9, 2000). Due to these efforts, FY 1999 purchased transportation costs for Periodicals are $11 million less than witness Kashani (USPS-T-14) projected. USPS-LR-I-276; USPS-T-14, Exhibit USPS-14B. While the Postal Service does not believe that it can reduce Periodicals air transportation costs further, it is committed to "sustaining these reductions." TW/USPS-6a (filed on May 9, 2000). This will result in Test Year Periodicals transportation costs being $11 million less than projected by the Postal Service.

*Memorandum of Understanding on Vertical Flats Casing*

In the "Current Improvement Efforts" section of his testimony, witness O'Tormey describes a memorandum of understanding between the Postal Service and the National Association of Letter Carriers (NALC), which "gives management the authority to implement the vertical flats casing method for those routes not currently using it. Under this method, flats are sequenced in the order of delivery in one handling by the carrier rather than in two handlings" USPS-ST-42 at 24. The Postal Service estimates that this processing change will result in Test Year savings of $7 million for Periodicals. TW/USPS-7 (filed on May 9, 2000).

*Equipment and Productivity Enhancements*

The Team Report noted that the Postal Service should "look for low-cost opportunities to increase automated FSM capacity, e.g., more Barcoding and OCR capabilities on FSM machines." Team Report at 32. I am pleased that the Postal Service is following through on this recommendation by modifying FSM 1000s with OCRs and automatic feeders. Response to MPA/USPS-ST42-9 (filed on 5/9/00). The Postal Service is also improving its capability to process flats in an automated fashion through the deployment of AFSM 100s. While it's too early to tell whether AFSM 100s will do for flats what barcode sorters have done for

letters, early indications are extremely encouraging. Based upon pre-production improvements, the Postal Service has recently revealed that it now believes that the performance of the AFSM 100s will be even better than expected. MPA/USPS-ST42-2 (filed on May 9, 2000).

The FSM 1000 modifications and the better-than expected performance of the AFSM 100s will reduce Test Year costs for Periodicals by $4.3 million more than was projected by witness Tayman. USPS-T-9. MPA/USPS-ST42-8-9 (filed on May 9, 2000). Aggressive productivity targets for manual flat sorting will reduce TYAR Periodicals costs by another $2 million. TW/USPS-9 (filed on May 9, 2000).

*Correction to Projected Cost Savings From the AFSM 100*

As discussed by witness Buc, witness Tayman has understated the cost savings that will be achieved from procurement of the AFSM 100 machines. DMA, et al.-T-1. Using information provided by the Postal Service in its direct case and written discovery responses on the number of AFSM 100 machines being purchased, their deployment schedule, and known productivity levels for the machine, witness Buc recalculates the cost savings estimate. Buc's correction reduces Periodicals costs by an additional $28 million in the Test Year.

***Ongoing Efforts to Reduce Costs***

While the efforts I have detailed above will allow us to capture $111 million in cost savings in the Test Year, there are additional efforts underway, not presently quantified, that I am confident will also bear fruit in the near term. Time Warner Inc. Witness O'Brien (TW-T-2) describes in substantial detail each of the 15 recommendations of the Team, and explains why their implementation will result in substantial cost savings. Industry and the Postal Service continue to meet regularly to assess our progress in implementing each of the Team's recommendations. There are a number of recommendations for which measured cost savings are not yet available but which are the subject of initiatives underway. These include improvements in address quality, increased compliance by mailers with mail preparation regulations, optimizing use of

containers, and opportunities to gain processing efficiencies by combining mail of different classes when appropriate. I believe that implementation of the Team's 15 recommendations would result in Test Year savings of more than $150 million. I understand the Postmaster General agrees.[1]

***Other Cost Savings Opportunities in Transportation***

Witness Nelson identifies several opportunities for cost savings within transportation. Some of these he is able to quantify based on information on the record in this case, as well as on his extensive expertise in transportation. Others are currently unquantifiable.

One of the significant cost savings opportunities he identifies relates to Amtrak rail service. Witness Nelson shows that USPS currently pays Amtrak a

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[1]The following exchange occurred between Postmaster General William J. Henderson and the Honorable Jim Kolbe on April 4, 2000:

Chairman Kolbe: I think all of us have heard from the magazine industry. There is a lot of concern, obviously about the periodicals, and I think a legitimate concern. And I think you have expressed your concerns about this, that you do not want to see this class of mail simply disappear from the Postal Service, and clearly that seems to be the direction we are heading with a 15 percent increase. I know you have been looking for ways to make sufficient savings and efficiencies in delivering this particular class of mail, since each of your classes of mail have to stand alone. What progress have you made in this regard that might enable you to get down below a 10 percent increase?

PMG Henderson: We've made substantial progress. We have a task force that is actually made up of industry representatives and postal operating management and they have made substantial progress. I think all the parties are pleased with the progress that's been made in reducing the hit of this rate increase.

Chairman Kolbe: And I understand that you have actually identified, along with the Magazine Publishers Association, you have identified some costs that might total as much as 150 million dollars. If those are able to be implemented and saved would you then be able to then project less than 10 percent? Or 10 percent or less?

PMG Henderson: That final determination would be up to the Postal Rate Commission, but we believe that $150 million in savings would bring it to single digits, yes.

Chairman Kolbe: Is that a realistic number? $150 million that you can – you think you can squeeze that kind of savings out?

PMG Henderson: Yes. I think it's going to be greater than that actually.

Hearings on Postal Appropriations, 2000: House Subcommittee on Treasury, Postal Service and General Government, Committee on Appropriations, U.S. House of Representatives, (April 4, 2000) (transcribed from videotape; proceedings not yet printed).

substantial premium over the cost it would pay to obtain equivalent transportation services from other sources. While the Postal Service describes Amtrak as a "less-than-truckload" network, witness Nelson shows that more than 94 percent of Amtrak costs occur on segments where USPS procures capacity that equals or exceeds a truckload, and that 94 percent of those costs are on segments where USPS pays Amtrak an amount greater than the cost of equivalent highway transportation. Eliminating this premium in the Test Year would reduce Periodicals costs by $15 million.

Several of witness Nelson's quantified cost savings relate to purchased highway transportation. In particular, he describes cost savings that could be achieved by tightening administrative requirements to ensure competitive terms on renewed highway contracts. He demonstrates that there is currently a "premium" on renewed contracts that costs Periodicals over $19 million, $4 million of which he estimates could be eliminated by the Test Year. Similarly, cost savings could be obtained by renegotiating highway contracts that are no longer needed prior to the expiration of such contracts. He calculates that a program to identify and renegotiate unneeded contracts prior to their expiration could save $2 million for Periodicals in the Test Year.

With regard to freight rail transportation, witness Nelson shows that recent changes in the freight rail industry, leading to increased competition, should allow USPS to achieve lower intermodal rates than currently in effect. This could save $1 million in Periodicals freight rail costs.

We have held preliminary discussions with the Postal Service on the costs of Amtrak service and USPS has indicated that it is currently conducting a review of its Amtrak costs and is hopeful that this review will lead to cost savings in the coming year. USPS has also indicated a willingness to consider our other suggestions for costs savings.

## III. COST ATTRIBUTION AND DISTRIBUTION

My testimony in Docket No. R97-1 focused extensively on the distribution of costs for mail processing. As discussed in that testimony and in preceding

cases, many questions have been raised about the costs attributed to classes by the Postal Service and the relative proportion of costs distributed to Periodicals by the Postal Service methodology. In its decision in Docket No. R97-1, the Commission agreed that there were many uncertainties regarding both cost causation and distribution. The Commission, for example, noted the need to collect more information on the contents of items and containers and stated, "[i]t is also clear that better models of cost responsibility for allied operations are urgently needed." PRC Op. R97-1, para. 3179.

The uncertainty about cost attributions and distributions was one of the factors motivating the formation of the Team. Unfortunately, the Team's study was not able to address complex costing issues but was limited to potential changes in mailer and postal operations to drive costs from the system. The Team's conclusions noted that the inefficiencies it observed in postal and mailer processes "likely have contributed to, but do not explain fully, the large increases in Periodicals costs." Team Report at 3. The Team concluded that "[f]urther study of postal operations and analysis of cost attribution - which was not part of this study - must still be undertaken if the cost behavior of Periodicals is to be fully understood and maximum cost containment is to be achieved." Ibid. The Team included a recommendation (number 14) on cost attribution and distribution, noting the need for further study of volume variability models and examination of alternative procedures for distributing costs, particularly allied labor costs, to classes.

In this case, the Postal Service has proposed several changes in cost attribution and distribution, two of which I believe provide a more accurate representation of cost behavior and cost causation. Below I describe the nature of improvements in the Postal Service's methodology for mail processing attribution and suggest further enhancements. In terms of distribution, as described by witnesses Stralberg and Glick, the Postal Service in this case has taken one step forward and one step back. While expounding correctly on the interplay between the hours in allied operations and the workload in both allied and distribution operations and taking this relationship into account in the

distribution of allied not-handling costs, the Postal Service failed to take this relationship into account in its distribution of allied mixed-mail costs. This was especially disappointing to publishers in light of the Commission's decision in the last case. In its decision, the Commission both noted the validity of our arguments about the effect of allied and distribution workloads on allied work hours, and it distributed allied mixed-mail costs on tallies from both allied and distribution operations. PRC Op. R97-1, para. 3172, 3178.

After my experience on the Team, I am more convinced than ever that allied workload is dependent to a large degree on, and supportive of, the needs of the distribution operations. I concur with witness Stralberg's observations in this regard based on our joint field experience. My Test Year costs incorporate the analyses of witnesses Stralberg and Glick, which refine the distribution of mail processing costs.

MPA has also undertaken detailed reviews of the Postal Service methodology for city carrier costs, rural carrier costs, and transportation. In these areas, my calculations of Test Year costs incorporate analysis and results from the testimonies of witnesses Crowder, Hay, Glick, and Nelson.

## A. Mail Processing Costs

### *The Commission Should Accept Witness Bozzo's Estimates Of Volume Variability*

USPS witness Bozzo, USPS-T-15, presents a state-of-the-art analysis of the volume variability of 10 MODS cost pools. This analysis represents a clear advance over the approach used by the Commission in Docket No. R97-1, which primitively assumes that the volume variability of each mail processing activity is either 100 or zero percent. Witness Bozzo explains how the traditional approach originated with Docket No. R71-1 as an attempt to provide the best possible estimates of volume-variability factors, given the econometric techniques available in the late-1960s and the manual mail processing environment of that time. Because of the difficulties of carrying out sophisticated regression analyses 30 years ago, the traditional approach relied purely on operational judgments to

identify mail-processing activities as either fixed or variable with respect to volume changes. With witness Bozzo's testimony in the current case, the Postal Service has taken advantage of advances in cost analysis over the past 30 years to provide considered econometric estimates of volume-variability factors for a set of mail processing cost pools.

In rejecting Dr. Bradley's analysis in Docket No. R97-1, the Commission described a number of defects that it said prevented acceptance of the econometric approach at that time. Witness Bozzo has squarely addressed these defects in his analysis and testimony and has incorporated important changes.

- His regressions include lag terms that reflect cost responses over a full year, in contrast to the single lagged accounting period used by Bradley.

- He performs a more modest scrubbing of the data, removing an average of 9.6 percent of the data as opposed to Bradley's removal of 22.4 percent. Tr. 15/6383 Table 3; PRC OP. R97-1, Appendix F, Table F-1.

- He adds wage, capital and network variables, including both standard cost function variables and controls for network effects important to mail processing.

- He worked with witness Degen to make sure his quantification was firmly grounded in operational realities.

These changes argue strongly for Commission acceptance of a cost analysis for mail processing in this docket that marries operational considerations and sophisticated quantification techniques.

USPS witness Degen, USPS-T-16, provides an extensive operational analysis supporting the concept that mail processing volume variability is less than 100 percent. He analyzes the Postal Service network as well as individual operations and demonstrates that the structure of the operations themselves lead to the conclusion that volume variability differs by operation and is less than 100 percent for the numerous operations he studies. Further validating his conclusions, he also analyzes the differences in variability among operations and

explains these differences in operational terms. For example, in discussing manual sortation he says,

> The estimated volume-variabilities for all the manual cost pools are substantially less than one, as expected. The lowest estimate is for Priority Mail and parcels where the low volumes mean that set-up and takedown times are substantial portions of the total workhours. Manual letter and flat sortation have higher volume-variabilites reflecting their substantially higher volumes.
>
> Manual flat sortation has slightly higher volume-variability than manual letter sortation. Manual flat sortation involves proportionately more production sorting as opposed to functioning as a backstop. This can be seen from the fact that the proportion of flats sorted manually is more than twice the share of letters sorted manually. Relatively less of a backstop role for manual flat sortation means more time at full capacity and greater volume variability.

USPS-T-16 at 52.

My own extensive field observations corroborate witness Degen's analysis. For example, I have observed numerous set ups and pull downs of sort schemes on all postal sorting equipment, including SPBSs, FSM 881s, and FSM 1000s. In my experience, the time required to set up and tear down a scheme, which can be a considerable proportion of the total time on that scheme, is generally independent of the volume run through it. I have also observed substantial variations in speed of both manual and mechanized processing, depending on volume. Higher volumes lead clerks to process mail more quickly, but at a rate that appears sustainable, leading to marginal cost being less than average cost.

***Witness Bozzo's Econometric Volume-Variability Estimates Should Be Extended To Other Cost Pools Based On Analogies And Operational Comparability***

In leaving many of the mail processing volume-variability factors arbitrarily set at 100 percent, Witness Bozzo has failed to provide the best estimates for those cost pools. The testimonies of witnesses Bozzo and Degen describe

operational information that can be used to improve the estimated volume-variability factors of many of these mail processing cost pools. First, witness Bozzo has identified a number of analogies between cost pools where he estimated econometric variabilities and cost pools where he did not. Tr. 15/6263-64, 6278-80. To identify these analogous cost pools, he relied on the testimony of witnesses Degen and Kingsley. USPS-T-10. Witness Bozzo supports the use of these analogies to derive more accurate estimates of volume-variability factors:

> I believe the use of econometric results for analogous operations is potentially superior to the IOCS-based method in that it makes use of the qualitative operational information used to derive the analogies as well as the quantitative evidence for the analogous operations.

Tr. 15/6278-79.

Witness Bozzo's suggested analogies involve mail-processing activities that are closely related. For example, it is intuitively obvious that the characteristics of the Non-MODS manual letters cost pool are likely to be similar to the characteristics of the Function 1 MODS manual letters cost pool.

In Table 4, I present revised volume-variability factors for seven cost pools that use the analogies that witness Bozzo has described. These revised volume-variability factors are the best current estimates based on available operational and econometric information. Tr. 15/6381-86.

**Table 4. Volume-Variability Factors for Analogous Cost Pools[1]**

| Cost Pool | Analogous Function 1 Cost Pool | Volume Variability |
|---|---|---|
| LD41—Unit Distribution—Automated | BCS | 0.897 |
| LD42—Unit Distribution—Mechanized | FSM | 0.820 |
| Automated/ Mechanical Operations (Non-MODS) | BCS | 0.897 |
| Manual Letters (Non-MODS) | Manual Letters | 0.737 |
| Manual Flats (Non-MODS) | Manual Flats | 0.773 |
| Manual Parcels (Non-MODS) | Manual Parcels | 0.522 |
| SPBS & IPP (BMC) | SPBS | 0.645 |

[1]Tr. 15/6264, 6280, 6283 (Bozzo).

***Witness Bozzo's Analysis Can Be Used To Develop A Better Estimate Of The Variability Of Allied Operations***

It is very unfortunate that witness Bozzo was unable to satisfactorily conclude econometric volume-variability analyses for the allied operations cost pools in mail processing, since it is clear that the assumption of 100 percent volume variability is even more inappropriate for the allied operations than for the distribution operations. As stated by witness Degen, [m]y analysis of the allied operations indicates that the allied operations have lower volume-variabilities than the distribution operations" USPS-T-16 at 69. This conclusion is further bolstered by witness Bozzo's preliminary econometric analyses of four MODS allied operations, which show aggregate variabilities ranging from 54.3 to 69.0 percent. USPS-T-15 at 136-39; Tr. 15/6233.

The observations of the Team certainly also support the notion that the volume variability of allied operations is substantially less than 100%. In fact, the Team in its recommendation on cost attribution, singled out allied operations as requiring extensive rethinking. Team Report at 38. Certainly, in both opening unit and platform operations, there are significant planned idle periods. For

example, on the platform, allied labor must be available to unload trucks, but at certain times of the day more time is spent waiting than unloading. Because of this, increases in mail volume would result, at least in part, in less waiting time per employee rather than proportionate increases in staffing. Further, allied operations function as backstops for bundle distribution operations on the SPBS and as such are subject to the lower volumes and excess capacity found in manual backstop operations as well. The self-paced nature of allied operations will also lead to lower volume variability as the speed with which workers process mail will vary with the amount of mail to be worked.

The Postal Service's estimates of allied volume-variability factors can be substantially improved by making use of the operational and quantitative evidence that the allied operations have a lower volume variability than the sorting operations. As an interim measure, pending a complete econometric analysis of the allied operations, I believe that the composite volume-variability factor of the sorting operations should be used as an upper bound for the volume variability factors of the allied operations. This composite volume-variability factor is 77.5 percent. Tr. 15/6276; revised according to Tr. 15/6381.

Witness Bozzo describes eight Function 1 MODS cost pools without econometrically estimated volume-variability factors that involve allied operations. Tr. 15/6276. In addition, he describes three BMC cost pools that involve allied operations (Platform, Allied Labor & All Other Mail Processing, and Sack Sorting Machine), and one Non-MODS cost pool that involves allied operations (Allied Operations). Finally, there are two Function 4 MODS cost pools that involve a mix of allied and sorting operations (LD43 and LD44). Tr. 15/6278, 6281. For these 14 cost pools, I use the composite volume-variability factor from the sorting operations as an upper bound that represents the most accurate available estimate of the volume-variability factor in allied operations.

***Witness Stralberg Provides A More Accurate Distribution of Allied Mixed Mail Costs***

In Docket No. R97-1, I provided both direct and rebuttal testimony regarding the appropriateness of distributing mixed-mail and not-handling costs in the allied cost pools to mail classes and subclasses on the basis of tallies in both the allied cost pools and the distribution cost pools. I explained that allied workload depends both on the volumes being dock-transferred at a facility as well as the volumes that need to be prepared for and moved into the facility for bundle and piece distribution. See generally Docket No. R97-1, MPA-T-1, MPA-RT-1. The Commission agreed with this finding, noting that allied workload consists of both the piece-distribution support function and the bypass processing function. PRC Op. R97-1, para. 3169-3179.

My experience with the Team leaves me more convinced than ever regarding the interplay between allied workhours and the needs of distribution operations. Clerks and mailhandlers in allied operations separate barcoded mail from nonbarcoded mail and machineable mail from nonmachineable mail to get it ready for distribution. These separate mail streams are then moved to the appropriate distribution operation. The situation is similar for the times when clerks and mailhandlers are not handling mail. In these times, clerks and mailhandlers in allied operations are either awaiting the arrival of mail to be prepared and separated or providing reserve capacity if distribution operation capacity is exceeded.

Based on my experience, I am not surprised that witness Bozzo's empirical evidence demonstrates that volumes at the piece-distribution operations are the primary drivers of allied costs. USPS-T-15 at 138.

Both witnesses Stralberg and Glick discuss this matter extensively in their testimonies. Witness Stralberg demonstrates operationally that piece-distribution support is a significant portion of allied workload. Witness Glick provides additional support for the appropriateness of distributing allied mixed-mail and not-handling costs based upon tallies in both allied operations and distribution operations. I adopt witness Stralberg's distribution methodology for allied mixed-

mail costs and allied not-handling costs in my calculation of revised Test Year costs. See MPA-LR-3. Combining this distribution with the lower variabilities described above reduces Base Year Periodicals mail processing costs by $127 million.

## B. City Carrier Street Costs

### *The Results of the Engineering Standards Study Are Unreliable and Should Not Be Used*

The Postal Service in this case has proposed a new methodology to segment the street-time costs of city delivery carriers. This new methodology, which leads to extraordinary departures from the street-time survey results used in previous cases, relies on the results of a survey of carrier street activities which, by the Postal Service's own admission, "was not designed to produce information for use in an omnibus rate proceeding." Opposition of United States Postal Service to Advo Motion to Compel Answers to Interrogatories ADVO/USPS-T13-2 and 19(c) to Witness Raymond, March 16, 2000, at 3. In addition, the survey was not designed with statistically valid sampling frames. Unfortunately, the study also failed to utilize training manuals or written instructions to data collectors on how to identify and record specific activities, leading to great uncertainty and potential bias in the assignment of time to various street activities.

As will be described by witness Crowder, the results of the Engineering Standards (ES) study presented by witness Raymond cannot be validated and, in some cases, contradict the USPS explanation for them. Further, there are several reasons to believe that the ES results are not only unreliable, but may also be biased toward an excess of load time. Overall, the proportion of load time seems incredibly high, with the results for park and loop routes, for example, showing carriers spending as much time loading mail into receptacles as they do moving between delivery points. By comparing the time measurements contained in the ES database against the accompanying videotapes of route segments, one can see that this anomaly may be caused to some extent by

inconsistent and potentially biased ES data collector coding of carrier activities. Specifically, a review of selected ES video tapes of route segments strongly suggests that (a) the ES data collectors were inconsistent in the coding of their observations which ultimately became the ES load and run time tallies, and (b) the ES load time proportion contains more than the strict rate-making standard for load time. Accordingly, the current LTV load time variability, based on the stricter rate-making standard for load time, is not correctly matched with the accrued load cost, as measured by the ES load time proportions. To the extent that the ES accrued load cost overstates true load cost, the application of the mismatched LTV load variability causes a serious overstatement of variable load cost.

Witness Hay (MPA-T-4) describes the impropriety of using the ES database for rate-making purposes. Based on his and witness Crowder's detailed analysis of this flawed study, I advocate that the Commission not use the anomaly-laden results to depart so radically from the street time proportions used in Docket No. R97-1 and preceding cases. The new results do not meet the Commission's standards for statistical studies and create a bias towards excessive levels of load time. In calculating Test Year costs for Periodicals, I use the existing Commission methodology to segment and attribute city carrier street costs. Using the existing city carrier costing methodology reduces Base Year Periodicals city carrier costs by $50 million.

***If The Commission Were to Consider Using the Engineering Standards Study, It Should Measure Load Time Variability On a Consistent Basis***

While we have been unable to determine precisely what information is contained in the Engineering Standards database in order to test and evaluate it fully, important information about the study and additional output from the ES study database has recently come to light. On May 12, 2000, the Postal Service filed a Library Reference, prepared by Foster Associates, containing a load-time variability analysis based on the Engineering Standards Database. USPS-LR-I-310.

As described in the Foster Associates Report, "[u]ntil now, only the work sampling tally data...has been used to support rate case cost analyses." USPS-LR-I-310 at 1. Foster Associates has now determined that new volume and possible delivery points data from a subset of Engineering Standards data set routes "provide an opportunity to conduct new load-time regression analyses." Apparently, while the Postal Service chose to use only part of the results of the ES study, data were also collected in that study that can be used to estimate new load-time variabilities in conjunction with witness Raymond's street time proportions

The Foster Associates Report evaluates the new model against the earlier load-time variability model. It concludes, "[h]owever, the route-level regression's use of more recent data, its much improved econometric estimation, its operationally sensible results, and its good predictive performance present perhaps even more compelling reasons to substitute it for the stops-level regressions." USPS-LR-I-310 at 23.

Not surprisingly, given the apparent overestimation of load time costs by witness Raymond, the corresponding load time variability is lower than the load time variability that corresponds to the established load-time measurements. If the Commission were to consider using the street-time proportions obtained by witness Raymond, it would of necessity have to pair that cost estimate with the load time variability analysis developed as part of the same study. The details of this analysis are presented in USPS-LR-I-310.

***Correction to Variability of Loop/Dismount Costs***

As described in witness Nelson's testimony, a correction is needed to the Postal Service's calculation of the variability of driving time for park and loop routes. The method proposed by the Postal Service fails to account for the interaction between the volume variability of looping points and dismounts. As discussed by witness Nelson, the conversion of current loop delivery points to dismounts as volume increases moderates the need to add looping points. Conversely, if a volume increase on loops is accommodated by an equal

percentage increase in the number of loop parking points, none of the stops on those loops will need to be converted to dismounts, and the number of dismounts will not change.

The change proposed by witness Nelson reduces the overall variability of loop/dismount driving time to 32 percent from the 41 percent proposed by the Postal Service. This reduces Base Year Periodicals costs by $ 7 million.

**C. Rural Carrier Costs**

The Postal Service uses data from the National Mail Count (NMC) to determine rural carrier costs by cost driver and data from the Rural Carrier Cost System (RCCS) to distribute these costs to mail subclasses. Because of differences in the ways these two data systems define flat mail, the Postal Service recodes some RCCS letters as flats so that the resulting flats percentage for the RCCS data is consistent with the cost data from the NMC. In this case, the Postal Service proposes to determine the proportion of letters to recode as flats by comparing the RCCS flats percentage for the four-week period of the NMC with the NMC flats percentage.

While the Postal Service uses this approach because it compares data from the same time period, it is inappropriate because RCCS data during the four-week period of the NMC, or any other four-week period, is infected with high sampling error. MPA/USPS-49. For this reason, annual RCCS data, which contain much less sampling error, MPA/USPS-49 (filed on May 12, 2000), should be used to determine the RCCS flats percentage. Witness Glick provides more detail on this point. Use of witness Glick's methodology reduces Base Year Periodicals costs for rural carriers by $13 million.

**D. Transportation Costs**

***Witness Bradley Overstates The Variability Of Purchased Highway Transportation Costs***

As described by witness Nelson, witness Bradley's quantitative analysis of volume variability for purchased highway transportation costs is inconsistent with

the Postal Service's own description of highway transportation operating practices and, consequently, significantly overstates the true variability of these costs. Witness Nelson demonstrates that this incorrect model specification is a principal contributing factor to the rapid increase in the transportation costs attributed to periodicals in recent years.

Correcting witness Bradley's highway models leads to a significant decrease in the variability of these costs. The revised model is included in witness Nelson's testimony and leads to a decrease in Periodicals Base Year costs of $70 million.

***The Postal Service's Distribution Of Costs For Amtrak Roadrailers Is Incorrect***

There is a new type of transportation cost in this case, namely the use of "roadrailers" as part of the Amtrak rail service. Movement of mail by roadrailers is not part of the current TRACS sampling system, so the Postal Service has no data on the precise composition of mail moving by this mode of transportation.

To distribute these costs to classes and subclasses, the Postal Service uses the distribution key for the portion of Amtrak that is sampled by TRACS. However, as discussed by witness Nelson, roadrailer service is more likely to be analogous to inter-SCF highway transportation with respect to the types of movements for which it is used. Witness Nelson proposes to remove roadrailers costs from the pool of accrued Amtrak costs and distribute it to classes and subclasses using the inter-SCF distribution key. His proposal reduces Periodicals Base Year costs by $3 million.

***The Distribution of Costs for Empty Equipment Movements Via Rail Ignores the Use Of Rail To Transport Equipment Of All Types***

As discussed by witness Nelson, the Postal Service transports empty equipment for many modes of transportation, including highway transportation, via rail. The method proposed by the Postal Service incorrectly distributes the costs of empty equipment shipments solely on the basis of volumes moving on freight rail and Amtrak. Witness Nelson corrects the distribution of these costs,

using a key that combines the volume variable costs associated with purchased highway as well as freight rail and Amtrak. This refinement reduces Periodicals Base Year costs by $5 million.

## IV. TEST YEAR COSTS

To develop TYAR costs by subclass, I roll forward and piggyback the Base Year costs for mail processing, city carriers, rural carriers, and purchased transportation costs that were presented by Periodicals Mailers witnesses. To do this, I use ratios of Test Year-to-Base Year costs from the Postal Service's proposal, Exhibits USPS-11A and USPS-14K, as well as USPS Test Year piggyback factors, USPS-LR-I-77. Then, I adjust TYAR costs for Periodicals subclasses downward to reflect the cost reduction programs identified in Section II of this testimony.[2] MPA-LR-1 implements this method. Table 5 below summarizes TYAR costs by subclass.

[2] / Some of these cost reduction programs will also affect other classes. I have not calculated savings for other classes.

**Table 5. TYAR Costs by Subclass (in Thousands of Dollars)**

| Class | Subclass | USPS Attributable Cost | MPA Attributable Cost |
|---|---|---|---|
| First-Class | Letters & Parcels | $13,437,357 | $12,770,508 |
| First-Class | Presort Letters & Parcels | $5,019,464 | $4,650,865 |
| First-Class | Private Postcards | $539,919 | $525,824 |
| First-Class | Presort Private Postcards | $168,958 | $156,563 |
| Priority Mail | All | $3,064,062 | $2,747,052 |
| Express Mail | All | $480,984 | $439,726 |
| Mailgrams | All | $1,000 | $946 |
| Periodicals | Within County | $81,397 | $64,723 |
| Periodicals | Regular Rate | $1,981,587 | $1,557,112 |
| Periodicals | Nonprofit | $388,570 | $318,259 |
| Periodicals | Classroom | $14,034 | $11,509 |
| Standard (A) | Enhanced Carrier Route | $2,471,864 | $2,137,184 |
| Standard (A) | Regular | $6,823,933 | $6,044,015 |
| Standard (A) | Nonprofit ECR | $208,577 | $185,470 |
| Standard (A) | Nonprofit Regular | $1,320,611 | $1,194,857 |
| Standard (B) | Parcels Zone Rate | $1,052,158 | $798,764 |
| Standard (B) | Bound Printed Matter | $479,204 | $377,773 |
| Standard (B) | Special Standard | $301,195 | $246,373 |
| Standard (B) | Library Rate | $47,444 | $37,281 |
| Free Mail | All | $40,348 | $31,448 |
| International Mail | All | $1,429,916 | 1,387,782 |
| Special Services | All | $1,539,113 | $1,456,111 |

## V. RATE CONSIDERATIONS

### A. Overall Rate Increase

The Postal Service in this case has proposed a rate increase for periodicals that, by its own admission, is at least twice the overall average rate increase of 6.4 percent. As stated by witnesses Mayes and Taufique, the average rate increase proposed for outside county periodicals is 12.7 percent. USPS-T-32 at 32; USPS-T-38 at 6.

In fact, however, the situation faced by periodicals mailers is even worse than described in the Postal Service's direct case. The rate increase that outside county periodicals mailers are facing is, in fact, much higher than stated by the Postal Service, averaging 15 percent for Periodicals providing input to MPA and American Business Media. Attachment A contains a coded list of magazines responding to MPA's most recent postal survey and the rate increase each will

face if the Postal Service's proposed rates are approved by the Commission. As shown in the attachment, there is an unprecedented degree of consistency to the rate increases facing MPA's membership. Despite public statements by the Postal Service that smaller commercial mailers are facing more modest increases, the average increase for smaller-circulation magazines within MPA is every bit as high as for the larger-circulation magazines. The proposed increase for ABM members is similar, averaging 15 percent and with a very narrow range around the 15 percent average.

Given the magnitude of cost savings and improved cost attributions and distributions I present in this testimony and the corresponding decrease in the Test Year costs of Periodicals, there is no need for any of the Periodicals subclasses to have a rate increase that exceeds the system average.

**B. Ride-Along Revenues**

In calculating Test Year revenues for Periodicals, the Commission should include the $10 million of revenue for Periodicals "Ride-Along" enclosures that witness Taufique estimated in Docket No. MC00-1. Docket No. MC00-1, USPS-T-I, Exhibit I. As witness Taufique testified in MC00-1, these revenues should be included in the Periodicals class just as their costs are: "Currently, the revenue stream, albeit a small one, generated with these enclosures or attachments is reported with Standard (A), but additional costs, if any, are included with the Periodicals subclass". Docket No. MC00-1, USPS-T-I at 2. There has already been substantial interest in the new experimental service, and there is no reason to doubt that volume and revenue projections from MC00-1 will be met.

I would note that this estimate of additional Periodicals revenue in the Test Year is conservative in that there may be publishers who continue to use Standard (A) enclosures instead of the experimental ride-along service. This would be the case, for example, for enclosures that do not meet the stringent physical characteristics required of ride-along enclosures. As described by witness Taufique, the revenues for such enclosures continue to accrue to

Standard A even though the costs are attributed to Periodicals. Correcting this inequity would yield additional revenues for Periodicals.

### C. Cost Avoidance for Rate Design

As described in detail by witness Stralberg and PostCom witness Glick (PostCom-T-1), the USPS flats cost model (USPS-LR-I-90) contains many incorrect and inconsistent assumptions, including those regarding bundle breakage, bundle and piece-sorting productivities, and optical character reader accept rates. Therefore, witnesses Stralberg and Glick have developed an improved version (MPA-LR-2) that better reflects the reality of postal operations. I recommend that the Commission use mail processing cost avoidances from this improved model when designing rates for the Outside-County subclass. This model should be used to calculate automation and presort discounts.

### D. Passthroughs For Automation Rate Categories

I recommend that the Commission maintain witness Taufique's greater-than-100 percent passthroughs of automation-related cost avoidances in this case. USPS-LR-I-167, OC1.xls, worksheet "Piece Discounts2". As discussed by PostCom witnesses Lubenow and Glick, the Postal Service's cost avoidance model (even as corrected by witnesses Stralberg and Glick) accounts for the benefits of the higher address quality of automation flats only to the extent that they affect reject rates. Therefore, the modeled automation cost avoidance understates true cost avoidance. Furthermore, in the rapidly evolving flats processing environment, it would be inappropriate to change pricing signals suddenly due to a temporary drop in cost avoidance. As stated by witness Taufique:

> And especially in the area of bar code discounts, if you are looking at those, there were three thoughts that I had. When we give a signal to the mailing community, they make substantial investments to follow through on our signals, and if you change those signals overnight, that can cause a problem for the business community.
>
> Number 2, the overall rate increase was significantly higher, as I have pointed out earlier, 12.7 percent

> compared to all the other classes, a 100 percent discount, 100 percent passthroughs would have led to increases of more than 20 percent for some rate cells, and these were rate cells that had large volumes of mail in them.
>
> And, Number 3, my thought was that at least my basic understanding of how flats processing is evolving at the Postal Service, it is not settled, things are changing, and it is possible that bar codes in the future environment of different types of machines and doing DPS (sic) at the plant level will become more valuable.

Tr. 17/7037-38.

**E. 5-Digit Pallet Discount**

In its report, the Team noted that "[m]ailers can help [reduce USPS costs] by . . . entering bundles, to the extent feasible, on pallets instead of in sacks. Sacked mail, besides incurring high sack handling costs, sustains substantial breakage during the sack sorting operations. Pallets with finer levels of presort will also reduce the probability of breakage by reducing the number of bundle sorts needed." Team Report at 25. Towards the goals of reducing bundle breakage and Postal Service container handling costs, I support witness Stralberg's proposal for a two-cent discount for pieces presented on 5-digit pallets that are drop shipped to DSCFs or DDUs. Such a discount will help overcome the high cost barriers to the creation of 5-digit pallets and provide the Postal Service with its preferred type of container.

**F. DDU Rate Design**

Witness Stralberg also identifies a mistake in the Postal Service's calculations of the DDU cost avoidance for Periodicals mail. While USPS procedures require that drivers unload mail that is drop shipped to delivery units, witness Crum's model of Periodicals dropship cost savings (USPS-LR-I-175) assumes that Postal Service employees unload the truck. As witness Stralberg shows, correcting this mistake increases the DDU cost savings for the Periodicals Regular subclass by 0.73 cents per piece. He estimates that this will lead to an increase in the per-piece and per-pound discounts for DDU entry of 0.5 cents.

## Attachment A.

## Periodicals Regular Rate Increase for MPA Members

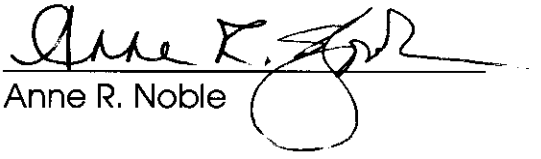
| Publication | Rate Increase (%) |
|---|---|
| 1 | 14.9% |
| 2 | 15.5% |
| 3 | 15.7% |
| 4 | 15.5% |
| 5 | 15.5% |
| 6 | 16.3% |
| 7 | 15.8% |
| 8 | 16.3% |
| 9 | 14.9% |
| 10 | 13.9% |
| 11 | 15.6% |
| 12 | 15.7% |
| 13 | 15.9% |
| 14 | 15.1% |
| 15 | 16.0% |
| 16 | 15.4% |
| 17 | 15.5% |
| 18 | 15.6% |
| 19 | 15.9% |
| 20 | 16.1% |
| 21 | 15.8% |
| 22 | 15.3% |
| 23 | 14.5% |
| 24 | 15.0% |
| 25 | 15.2% |
| 26 | 14.8% |
| 27 | 14.6% |
| 28 | 14.9% |
| 29 | 15.1% |
| 30 | 14.7% |
| 31 | 15.0% |
| 32 | 15.3% |
| 33 | 15.2% |
| 34 | 15.3% |
| 35 | 14.6% |
| 36 | 14.7% |
| 37 | 14.9% |
| 38 | 15.1% |
| 39 | 14.9% |
| 40 | 15.2% |
| 41 | 15.1% |
| 42 | 15.0% |

| | |
|---|---|
| 43 | 15.2% |
| 44 | 15.1% |
| 45 | 13.7% |
| 46 | 15.2% |
| 47 | 15.0% |
| 48 | 15.1% |
| 49 | 14.9% |
| 50 | 11.6% |
| 51 | 16.0% |
| 52 | 15.0% |
| 53 | 14.6% |
| 54 | 15.9% |
| 55 | 14.9% |
| 56 | 15.4% |
| 57 | 15.1% |
| 58 | 15.1% |
| 59 | 15.6% |
| 60 | 15.4% |
| 61 | 15.0% |
| 62 | 15.1% |
| 63 | 15.1% |
| 64 | 15.2% |
| 65 | 14.6% |
| 66 | 14.6% |
| 67 | 14.7% |
| 68 | 14.7% |
| 69 | 14.9% |
| 70 | 14.8% |
| 71 | 14.6% |
| 72 | 15.1% |
| 73 | 14.7% |
| 74 | 15.0% |
| 75 | 15.4% |
| 76 | 15.1% |
| 77 | 15.1% |
| 78 | 15.4% |
| 79 | 15.4% |
| 80 | 14.9% |
| 81 | 15.3% |
| 82 | 16.3% |
| 83 | 14.7% |
| 84 | 15.8% |
| 85 | 15.0% |
| 86 | 15.2% |
| 87 | 15.0% |
| 88 | 15.0% |
| 89 | 14.5% |
| 90 | 15.1% |

| | |
|---|---|
| 91 | 15.6% |
| 92 | 15.3% |
| 93 | 15.0% |
| 94 | 15.3% |
| 95 | 15.2% |
| 96 | 15.4% |
| 97 | 15.5% |
| 98 | 15.1% |
| 99 | 14.7% |
| 100 | 9.7% |
| 101 | 9.7% |
| 102 | 15.0% |
| 103 | 14.7% |
| 104 | 15.2% |
| 105 | 15.3% |
| 106 | 15.3% |
| 107 | 14.5% |
| 108 | 14.8% |
| 109 | 15.1% |
| 110 | 14.9% |
| 111 | 15.6% |
| 112 | 16.0% |
| 113 | 15.5% |
| 114 | 15.2% |
| 115 | 15.4% |
| 116 | 15.2% |
| 117 | 15.1% |
| 118 | 14.9% |
| 119 | 14.5% |
| 120 | 14.6% |
| 121 | 14.8% |
| 122 | 14.6% |
| 123 | 15.7% |
| 124 | 14.7% |
| 125 | 14.8% |
| 126 | 15.0% |
| 127 | 14.5% |
| MPA Total | 14.9% |

**CERTIFICATE OF SERVICE**

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with the Commission's Rules of Practice.



Anne R. Noble

Washington, D.C.
May 22, 2000