UNITED STATES OF AMERICA
Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

RECEIVED
JUN 29 3 15 PM '00
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Postal Rate and Fee Changes, 2000) Docket No. R2000-1

TRIAL BRIEF
OF
THE OFFICE OF THE CONSUMER ADVOCATE

TED P. GERARDEN
DIRECTOR

EMMETT RAND COSTICH
SHELLEY S. DREIFUSS
KENNETH E. RICHARDSON
ATTORNEYS

June 29, 2000

UNITED STATES OF AMERICA
Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes, 2000	)	Docket No. R2000-1

TRIAL BRIEF OF THE
OFFICE OF THE CONSUMER ADVOCATE

The Office of the Consumer Advocate ("OCA"), pursuant to Presiding Officer's Ruling R2000-1/4, issued February 25, 2000; Presiding Officer's Ruling R2000-1/71, issued May 26, 2000; and Rule 30(e)(1) of the Rules of Practice and Procedure of the Postal Rate Commission ("Commission"), 39 C.F.R. §3001.30(e)(1), hereby submits its Trial Brief in this proceeding.

EXECUTIVE SUMMARY

To lessen the burden of new postal rates on members of the general public, the OCA urges the Commission to recommend several changes in the rates and fees proposed by the Postal Service in this case. The Commission should recommend a one percent contingency provision as reasonable under all of the circumstances confronting the Postal Service. The 2.5 percent contingency requested by the Postal Service is unnecessary, unsupported, and harmful to all mailers. The Commission should resist efforts by the Postal Service and other parties to reduce attributable costs. To the contrary, and particularly with respect to mail processing and city carrier load time, the Commission should attribute costs to services in the manner that most accurately reflects the costs of providing the services.

The First-Class first-ounce rate should remain at 33 cents. First-Class Mail has been carrying an ever-increasing portion of the Postal Service's institutional costs, and restraint is needed now to prevent the situation from becoming even more unfair. Investment in automated letter-mail processing equipment has kept the cost of First-Class Mail down, and the public should receive the benefit of the Postal Service's success in this area. The Commission should again recommend a discount for Courtesy Envelope Mail ("CEM") to permit the public to share in the lower cost of handling automation-compatible mailpieces.

The Commission should recommend that the Board of Governors adopt a rate stability plan under which single-piece First-Class rates change only every other rate case. This would permit greater rate stability and convenience for consumers while accommodating large mailers' preference for smaller, more frequent and predictable rate increases. The nonstandard surcharge should be eliminated for square and near-square letter mail. The Commission should recommend that the Postal Service improve convenience for consumers when the First-Class rate does change by providing courtesy "make-up" stamps at the time of the rate change. The Commission should recommend a reduction in the fees for domestic and military money orders and should carefully review the support for the per increment fee for insurance.

ARGUMENT

I. THE POSTAL SERVICE CONTINGENCY REQUEST IS UNREASONABLE

As part of its requested revenue requirement, the Postal Service is permitted to include a "reasonable provision for contingencies." Postal Service management must articulate a reasoned explanation for the amount of the contingency requested. Among the considerations that shape management's judgment should be an assessment of national economic conditions and the Postal Service's microeconomic position. The reasonableness of the Postal Service's request can be tested by reference to a variance analysis, which measures the Postal Service's historic ability to forecast costs and revenues accurately.

OCA witnesses Robert Burns and Edwin Rosenberg find that the justification presented by the Postal Service for a 150 percent increase in the contingency is inadequate and that the Commission should retain the current one percent contingency. OCA-T-2 at 12; OCA-T-3 at 3, 7. Both OCA witnesses point out that the Postal Service has fared well financially with rates that reflect a lower contingency, enjoying robust fiscal health for the period FY 1995-1999. Even in FY 2000, the second year in which the current one percent contingency will have been in effect, and prior to any rate increases, the Postal Service projects positive net income. OCA-T-3 at 5; OCA-T-2 at 9.

A. The Postal Service Has Failed To Support a 2.5 Percent Contingency Provision

1. The Postal Service has failed to "articulate[ ] to a reasonable degree" its reasons for the dramatic increase in the contingency—from 1.0 to 2.5 percent

The Postal Service's explanation for its 2.5-percent contingency proposal is insubstantial. Postal Service witness Tayman presents a frankly subjective, short list of reasons for increasing the contingency from one to 2.5 percent. Witness Tayman has not based his proposal on the specific evaluation of individual factors, OCA-T-2 at 8, and disavows the results of a variance analysis that he reluctantly furnishes in conformance with past Commission directives. *Id.*

As support for a contingency proposal, the Commission requires that management's perception of risks in the test year must be "articulated to a reasonable degree" so that the substantial evidence test is satisfied. PRC Op. R87-1, ¶2073. OCA witnesses Burns and Rosenberg conclude that witness Tayman has not satisfactorily articulated the Postal Service's reasons for increasing the contingency so dramatically. *See generally* OCA-T-2 at 8-12; OCA-T-3 at 16, 18.

Witness Rosenberg contrasts the meager explanation furnished by witness Tayman with the careful, thorough analyses that are often performed in the course of contingency planning. Utilities perform hundreds or thousands of simulations of unexpected conditions and random unplanned events in order to estimate the size of needed generating capacity reserves. OCA-T-3 at 21. This type of analysis should (and could) have been made by the Postal Service in presenting its case before the

Commission. But the Postal Service eschews such analysis in favor of relying on its prerogative to select a number to its liking.

2. The few reasons advanced by the Postal Service for increasing the contingency are not convincing

Largely, the conditions that witness Tayman does cite as uncertainties are actually matters that the Postal Service can influence or control. These include volume growth, which the Postal Service can influence by improving service to particular subclasses or by advertising targeted services more aggressively. Witness Tayman's vague reference to "significant new pressures on salary," loses sight of the fact that management has important input into wage and salary levels. OCA –T-2 at 10. With respect to wages that will be paid in the test year, witness Burns stresses that some labor contracts are already in place for FY 2001. Those that are yet to be negotiated are fully accounted for in the roll-forward to the test year by means of a respected government index—the Employment Cost Index.[1] Furthermore, management has material input into the new contracts that will result in test year wages. OCA –T-2 at 10.

Likewise, health benefit costs—another "uncertainty" cited by witness Tayman—are, to a large extent, both foreseeable and controllable by postal management. Indices and forecasts exist for such costs; *id.* at 11, and management can keep health insurance premiums down by increasing employee overtime, rather than adding new employees to the payroll.

1 *Id.* The Bureau of Labor Statistics maintains the Employment Cost Index.

B. The Commission Should Recommend Continuation of the Existing One Percent Contingency Provision

1. Stable economic conditions point toward a one percent contingency

Relatively favorable and stable economic conditions strengthen the Postal Service's ability to forecast reliably. OCA-T-3 at 7. In turn, reliable forecasts tend to allow for smaller contingency provisions; indeed, the Postal Service reduced its own contingency request in Docket No. R94-1 and again in Docket No. R97-1. It is clear, therefore, that a disciplined analysis of the optimum size of the contingency provision would place great weight on the state of the economy. *Id.* at 6.

The United States is currently enjoying low inflation and stable conditions. Macroeconomic forecasts of highly respected organizations, both private and public, predict continued moderate inflation through 2001. *Id.* at 8-10. This stable economic environment calls for continuation of a low contingency provision.

The early years of postal reorganization were characterized by volatility in economic conditions, especially in the rate of inflation. *Id.* at 12. Annual rates of change in the Consumer Price Index ("CPI") are presented in the testimony of witness Rosenberg. *Id.* at 13. They show an overall decline in the rate of change in the CPI in recent years. When these changes are averaged for time periods corresponding to postal rate changes, it is evident that epochs for which high contingency levels were approved (*e.g.*, 1970-1990), were characterized by great volatility in the CPI, while the recent periods of relatively lower contingencies (*i.e.*, 1991-1999), correspond to low levels of change in the CPI. *Id.* at 14.

2. Developments in Postal Service forecasting point to a low contingency

There is a sharp contrast between the Postal Service's incipient ability to forecast accurately its costs and revenues at the outset of postal reorganization and its current ability to do so. The Postal Service now has thirty years of experience in the exercise of honest, efficient, and economical management under postal reorganization. *Id.* at 12. Moreover, the Postal Service recently created a sixteen-person forecasting organization whose mission is to improve forecasts of changed conditions. *Id.*

Postal Service witness Tayman presents a variance analysis in his exhibits, but expressly disavows any reliance on it. His attempt to avoid variance analysis is understandable when one considers that the 2.5 percent contingency that he proposes lies outside the range of the variance analysis results. *Id.* at 18. The mid-point of the range of the four results is nearly zero, with ominous implications for a 2.5 percent contingency proposal. *Id.*

The Postal Service has indicated that it may be moving in the direction of shorter rate cycles. Docket No. R97-1 rates were put in place in January 1999. Rates from the instant case are likely to be implemented in January 2001, thus concluding a two-year rate cycle. There are indications that the Postal Service is already planning for a rate increase in 2003. Witness Rosenberg observes that shortened rate cycles reduce the amount of error and uncertainty in forecasting. *Id.* at 24-25. This allows for a smaller contingency provision.

3. A high contingency is counterproductive

Unnecessarily high contingencies create "perverse managerial incentive[s]." Managers may be cushioned from the consequences of failing to control costs. This leads to laxity. OCA-T-2 at 6. Witness Rosenberg cites measures taken in other industries to avoid the "moral hazard" of an overly comfortable cushion against cost increases. OCA-T-3 at 22. If postal managers feel the pressure of a properly moderate contingency, they also will act aggressively to keep costs down.

Witness Tayman cites increasing competition as a justification for increasing the contingency to 2.5 percent. OCA's witness Rosenberg, however, warns that a large contingency provision can be counterproductive. A vicious cycle may be created that creates more headroom for Postal Service competitors. *Id.* at 28-29. This, in turn, can lead to lower revenues and accelerate calls for further rate increases. Increased competition calls for restraint in rates, not for rate increases.

II. THE COMMISSION SHOULD REJECT THE POSTAL SERVICE'S PROPOSED CHANGE IN THE VOLUME VARIABILITY OF MAIL PROCESSING COSTS

A. Witness Bozzo's Analyses of Mail Processing Volume Variability Are Flawed

OCA witness J. Edward Smith responds to the testimony of Postal Service witness Bozzo (USPS-T-15). Dr. Smith concludes that Dr. Bozzo's study is significantly flawed and that his proposed model is incomplete and should be rejected by the Commission.

Dr. Bozzo's work is a continuation of Dr. Michael D. Bradley's work on segment 3 mail processing cost variability presented in Docket No. R97-1. The work attempts to measure the volume variability of each of several pools of costs (MODS pools) comprised of activities associated with mail processing. Volume variability is an important issue. Segment 3 mail processing costs are in excess of $17 billion, and the variabilities applied to the various cost pools associated with a mail processing activity are used to measure mail processing costs attributable to the various classes and subclasses.

Volume variability measures the percentage change in cost with respect to the percentage change in volume. OCA-T-4 at 5. Dr. Bozzo measures the variability of cost, measured in hours worked, with respect to changes in the volume of mail, as measured by total pieces handled (TPH), or total pieces fed (TPF), for ten mail processing activities. *Id.* Traditionally, the Commission has found that mail processing volume variability is 100 percent. *Id.* at 6. Dr. Bozzo found estimated variabilities ranging from 52 percent to 95 percent. *Id.* at 8, Table 1.

Dr. Smith analyzes Dr. Bozzo's study on the basis of the evaluation criteria set out by the Commission in Docket No. R97-1. *Id.* at 8-9, 22.

1. A study should include the development and use of an adequate database, appropriately verified and complete.

2. Models should be derived from the appropriate economic theory and should fit correctly within any system that applies them.

3. The study should include a discussion of the modeling approach and how it is consistent with the underlying data.

4. A correct estimation (regression) procedure which is suitable to the estimation needs at hand should be used.

5. Results of econometric equations and alternative econometric analyses should include a discussion of the values, signs and other relevant information for the variables.

Dr. Smith first reviews the work of Dr. Bradley in Docket No. R97-1 and the Commission's criticisms of Dr. Bradley's study in that case. *Id.* at 10-17. Dr. Smith testifies that, in general, these criticisms apply as well to Dr. Bozzo's work. Dr. Smith also concludes that Dr. Bozzo's study suffers from significant flaws in each of the above evaluation criteria. *Id.* at 18-19. The major problems of the study as determined by Dr. Smith are:

1. the questionable accuracy of the data base, *id.* at 23-25, 30-36, as well as a discontinuity in the investment data series that may not reflect current operations, *id.* at 26-29;

2. the short-run nature of the study, which failed to focus on longer-run expansion paths as they affect costs, *id.* at 12-13, 40-43;

3. the continued use of the fixed effects model, *id.* at 69;

4. conceptual problems associated with variables such as the manual ratio, *id.* at 29-30, the network variable, *id.* at 44-45, and the capital (QICAP) variable which ostensibly models capital, *id.* at 52-54;

5. the omission of important variables, *id.* at 43-44, such as capacity utilization, *id.* at 36;

6. the need to consider additional factors such as the interdependence of mail processing activities, *id.* at 45-46; Dr. Bozzo's inappropriate assumption that the ratio of capital to labor does not change (homotheticity), *id.* at 47; and new issues concerning Postal Service cost minimization of its factor inputs and the impact on the volume variability analysis, *id.* at 47-51;

7. a lack of a clear presentation and derivation of the model being estimated from microeconomic theory, *id.* at 37-40; and

8. the failure to consider the possibly endogenous nature of capital investment, *id.* at 54, 60.

Dr. Smith reviews Postal Service witness Degen's testimony on the physical and operational nature of mail processing. Utilizing witness Degen's information, Dr. Smith presents a theoretical analysis of the underlying economic basis for the longer-term expansion path by which volume variability should be measured that demonstrates a fundamental shortcoming of the Bozzo methodology, *id.* at 55-65; see particularly Figures 4 and 5 at 61-62.

Dr. Smith also provides graphs simply plotting all data for six cost pools that provide a visually compelling indication of 100 percent volume variability for those cost pools, *id.* at 65-6, Appendix at 1-6.

B. The Commission Should Retain 100 Percent Volume Variability for the Cost Pools Analyzed by Witness Bozzo.

Dr. Smith has considered the alternatives to the continued use of the 100 percent volume variability. He recognizes that the Commission may wish to attribute mail processing costs for the ten cost pools on the basis of a variability analysis other than its traditional approach. Dr. Smith reviewed the mail processing information and data supplied by the Postal Service and applied the appropriate economic theories. Dr. Smith concludes that based upon the information now available, the cross sectional "between" model is the "least bad" of the models presented. He points out that the Commission has previously outlined the deficiencies of the alternative fixed effects model, and that the other alternative, the pooled model, lacks sufficient measures of variables and so is subject to specification error. On the other hand, the "between" model permits analysis on the basis of the size of the facilities. Nevertheless, Dr. Smith does not advocate adoption of the "between" model. Although the "between" model results in costs that are 95 percent attributable, the application of the model, which is *known* to be subject to error, is hardly worth the effort. *Id.* at 69-70, 74.

Dr. Smith recommends that the Commission continue with the 100 percent volume variability for the ten mail processing cost pools that witness Bozzo studied. He provided this information to OCA witness Thompson (OCA-T-9), who presents a cost analysis incorporating this recommendation. *Id.* at 74. Dr. Smith also sponsors OCA-LR-I-2, a Category 2 Library Reference.

C. The Commission Should Recommend the Establishment of a Technical Working Group to Consider Mail Processing Volume Variability

Dr. Smith further advises that inasmuch as Dr. Bozzo's study needs substantial work for completion, the Commission should recommend that the Postal Service establish a working group to discuss mail processing volume variability issues. *Id.* at 19-21, 75-76. The four-month period available to the parties for examination of Dr. Bozzo's work is not sufficient to explore all aspects of this complex problem. It is the necessary consequence of the time constraints of a rate case, but is not adequate from a scientific analysis point of view. A working group is necessary to discuss, evaluate, and comment on theoretical, data, and modeling approaches in an effort to bring these issues to a conclusion. Obviously, such a group would require the honest and effective participation of all of the parties involved. Accordingly, Dr. Smith urges the Commission to recommend the establishment of a working group to consider in detail the volume variability of mail processing. *Id.* at 75-76.

III. THE COMMISSION SHOULD AGAIN REJECT THE POSTAL SERVICE'S PROPOSED TREATMENT OF CITY CARRIER LOAD TIME COSTS

Postal Service witness Baron (USPS-T-12) has proposed that a portion of load time be treated as "fixed time at a stop." This portion of load time (amounting to $260 million) would then be reallocated to the access component of carrier street time. Witness Baron would split the remaining load time into two parts. Only "elemental" load time costs would be attributed to categories of mail. The Commission rejected this proposal in Docket No. R97-1, and OCA witness Mark Ewen (OCA-T-5) urges it to do so again.

After estimating the direct volume variability of the remaining load-time accrued cost pool, witness Baron treats the residual component, or coverage-related load-time, as an unattributable institutional cost. This treatment differs from the Commission's established approach of attributing coverage-related load-time based on the proportion of mail delivered to single subclass stops.

In its Opinion and Recommended Decision, Docket No. R97-1, the Commission specifically rejected this approach, concluding that the stops effect concept is theoretically flawed. Based upon review of the relevant testimony and supporting data, Mr. Ewen concurs that the proposed stops effect approach is not justified. It is a fictional construct founded upon an incorrect interpretation of prior Commission opinions. Additional justification offered for the approach is based on a strained and unnecessary extension of the activity-based functional approach for allocating total street-time among the major carrier activities into the assessment of load-time volume variability. No data exist that directly measure the effect, nor do the results of the load-time regression equations provide a hint that carriers might spend some fixed amount of time at each stop. Furthermore, even if such an effect exists, it cannot be accurately imputed using available data. As a result, the Postal Service's analysis of the stops effect is neither theoretically nor empirically supported. For these reasons, Mr. Ewen recommends that the Commission maintain its established treatment of load-time costs.

IV. OCA COSTING PROPOSALS INCREASE TEST YEAR VOLUME VARIABLE COSTS BY $2.3 BILLION

OCA witness Thompson calculates the effect on volume variable costs of witness Smith's and witness Ewen's costing proposals. Witness Thompson uses a modified version of the Commission's cost model to perform these calculations. Descriptions of the cost model functions as well as electronic copies of her files may be found in OCA-LR-I-1. Witness Thompson has verified the accuracy and reliability of the cost model by replicating the Postal Service's base year, interim years, and test year after rates cost estimates to a high degree of precision. OCA-T-9, Exh. 1D, col. C.

After using the cost model to replicate Postal Service results, witness Thompson incorporates Postal Service corrections,[2] as well as OCA witnesses Ewen's and Smith's proposals. As shown in OCA witness Thompson's supplemental testimony, Exhibit 3C, OCA witnesses Ewen's and Smith's proposals increase test year cost attribution approximately \$2.3 billion (\$42.77 — \$40.44 billion). Of the \$2.3 billion increase, First-Class single piece letter cost attribution increases \$1.0 billion or 7.9 percent. Test year total costs increase \$74.6 million (0.1 percent) as a result of the Postal Service corrections and the OCA's proposals.

V. THE FIRST-CLASS, FIRST OUNCE RATE SHOULD REMAIN AT 33 CENTS

The OCA proposes that the current 33 cent rate for single-piece First-Class Mail be maintained in order to mitigate the growing institutional cost burden on the First-Class Letter Mail subclass. The testimony of OCA witness James F. Callow (OCA-T-6, Part I) shows that First-Class Letter Mail has been carrying an increasing burden of the institutional costs of the Postal Service.

---

2 Due to time constraints, witness Thompson was unable to incorporate the following three corrections: (1) Rehabilitation program costs (Tr. 2/660-662); (2) Labor cost changes (P.O. Information Request No. 7 (April 6, 2000), POIR-7-1; and (3) Mail volume changes due to reclassifying from Priority to First-Class those pieces weighing more than 11 ounces but not more than 13 ounces (Tr. 9/3578). Nor has witness Thompson incorporated the Commission's single-subclass-stop methodology, although OCA witness Ewen recommends that the Commission continue using that methodology. OCA-T-5 at 19.

A. First-Class Letter Mail Is Bearing An Increasing Institutional Cost Burden of the Postal Service

Witness Callow shows that the First-Class Letter Mail cost coverage, while traditionally higher than the "systemwide" average cost coverage for all mail, has risen significantly in recent years compared to the systemwide average. During the 12 year period FY 1988 through FY 1999, the First-Class Letter cost coverage has risen from 162 percent to 197 percent, compared to an advance in the systemwide average from 149 percent to 168 percent. To put this rapid advance in the cost coverage into perspective, from FY 1988 to FY 1996 the First-Class Letter Mail cost coverage rose gradually from 162 percent to 175 percent. In the test year, the Postal Service proposes to preserve the high First-Class Letter Mail cost coverage at 197 percent—the same cost coverage actually provided by First-Class Letter Mail in FY 1999. OCA-T-6 at 7-8.

Measuring the institutional cost burden via a markup index or a cost coverage index also reveals a rising burden on First-Class Letter Mail. The markup index for First-Class Letters rose from 1.256 to 1.439 during the 12 year period FY 1988 through FY 1999. In the test year, the markup index of 1.422 is higher than the markup index for all but two of the preceding 12 years. A review of the First-Class Letter cost coverage index reveals a similar change. *Id.* at 8-10.

First-Class Letter Mail has long contributed more in absolute terms to the institutional costs of the Postal Service than the next largest class of mail, Standard (A) Regular mail. Over time, the relative share of institutional costs contributed by First-Class Letter Mail has grown as compared to the share contributed by Standard (A)

Regular mail, and the "gap" has widened in recent years. For the five year period beginning in FY 1995, the First-Class Letter markup index rose steadily from 1.169 to 1.439, while the Standard (A) Regular markup index declined from 1.080 to 0.828. Moreover, during FY 2000 and 2001, the Standard (A) Regular markup index is expected to decline further, ending at 0.777. By contrast, the First-Class Letter markup index is expected to rise still higher to 1.469 in FY 2000, and then decline in the test year to 1.422. A similar relative change is evidenced using the cost coverage index. *Id.* at 14-16.

B. The First-Class Letter Mail Institutional Cost Burden Has Exceeded That Intended by the Commission

The institutional cost burden on First-Class Letter Mail has also grown relative to the institutional cost burden intended by the Commission, as expressed in several recent recommended decisions. Witness Callow reviews the systemwide average cost coverage and First-Class Letter Mail cost coverage and markup index recommended by the Commission in Docket Nos. R87-1, R90-1, R94-1 and R97-1. Averaging the First-Class Letter Mail markup index from all four proceedings to produce a "benchmark," witness Callow estimates the excess revenue contributed to institutional costs by First-Class Letter Mail. Based upon that benchmark, First-Class Letter Mail has contributed net additional revenues of $6.8 billion to the institutional costs of the Postal Service during the 12 year period FY 1988 to FY 1999. *Id.* at 22. Through the test year, the total net additional revenue is expected to reach $11.2 billion. *Id.* at 23.

C. Equity Requires Retaining the 33 Cent Basic Rate

The increasing institutional cost burden on First-Class Letter Mail should be reversed by maintaining the single-piece First-Class rate at 33 cents. Doing so would provide the most benefit to individual and smaller mailers. It would also restore a measure of equity to all First-Class Mailers, since the institutional cost burden has grown in absolute terms—and relative to Standard (A) Regular—and has departed further from the Commission's stated goal of maintaining cost coverages for those two subclasses roughly near the systemwide average. *Id.* at 17-28.

VI. THE COMMISSION SHOULD RECOMMEND OTHER BENEFICIAL CHANGES FOR FIRST-CLASS MAIL

A. Mailers of Automation Compatible Courtesy Reply Envelopes Are Entitled to a Three-Cent Discount

The Postal Service has proposed a three-cent discount for Qualified Business Reply Mail ("QBRM") in this proceeding. Courtesy reply mail is entitled to at least the same discount as that extended to QBRM. Postal Service witness Campbell has testified that these types of mail are processed identically.[3] Thus, as OCA witness Gail Willette has testified, the cost avoidance of CEM and QBRM is the same. OCA-T-7 at 9.

Consumers have waited for many years to reap direct benefits from the Postal Service's automation program. Not only have they watched as the discounts accorded

3 Responses to OCA/USPS-T29-1 and 5.

large mailers have increased, but their own discount has been repeatedly rejected by the Postal Service Governors. The OCA again proposes Courtesy Envelope Mail ("CEM") as a category of First-Class Mail along with a three cent discount for mailers of courtesy reply envelopes.

CEM has been a good idea for consumers for a long time. Its establishment is overdue. CEM makes sense as the Postal Service moves from the paper mail world into the electronic one with *eBillPay*. CEM can help the Postal Service retain some transactions mail which would otherwise migrate to alternatives such as electronic bill payment or account debiting. As the methods for electronic payment become more attractive to consumers, it is inevitable that some, if not all, of the transactions that are mailed today will disappear from the First-Class mailstream. The Postal Service can and should work to keep as much of this mail for as long as it can.

The Postal Service has objected to the establishment of CEM, arguing that consumers do not want to maintain two denominations of stamps, claiming that consumers will try to use CEM stamps for other correspondence, that it will be too costly to educate consumers, and that it complicates the rate schedule. Much has been made of the "two-stamp problem." The Postal Service has argued for years that consumers do not want to maintain two denominations of stamps. Yet the Postal Service has produced no credible evidence that consumers do not want the option of a discounted stamp. And consumers who prefer to keep only one denomination will still be able to use full-price stamps for all of their correspondence. The Postal Service has also argued that consumers would use CEM stamps on all correspondence and cause a huge revenue shortfall. The evidence suggests, however, that consumers overpay postage far more often than they underpay it. *See* Tr. 21/9166. There is no reason to expect the introduction of CEM to change this.

In Docket No. R97-1, the Commission earmarked $33 million to educate consumers on the use of CEM. PRC Op. R97-1 at 326. This money has not yet been spent for the purpose intended. Witness Willette estimated, based on Postal Service testimony, that $9.2 million would be needed for a nationwide mailing to inform consumers about their choices in single-piece First-Class Mail. OCA-T-7 at 15.

All of the objections of the Postal Service to establishment of CEM have been addressed and overcome. In a competitive business environment, CEM would have already been offered. Because of the postal monopoly, however, the Postal Service is not forced to recognize the low cost characteristics of courtesy reply mail and reward consumers with a discount. CEM remains a workable solution to a volume erosion problem facing the Postal Service.

B. First-Class Single-Piece Rates Should Be Held Constant Over Two Rate Cases

The OCA proposes, in the testimony of witness Callow (OCA-T-6, Part II), that the Postal Service adopt a new approach for setting the single-piece First-Class rate for letters that would benefit both household and business mailers. The Postal Service appears to have adopted plans to adjust rates every two years, in response to the concerns of business mailers for smaller, more frequent and predictable rate changes. However, more frequent rate changes can be inconvenient to household and smaller-volume mailers. The approach proposed by the OCA would accommodate the differing interests of household and business mailers.

1. Adjusting the single-piece First-Class rate every other rate case would accommodate the differing interests of household and business mailers

As proposed by witness Callow, the single-piece First-Class ("SPFC") rate would be determined without regard to the "integer constraint." The rate paid by households, however, would be set at a whole cent, as in the past. The determination of First-Class rates other than single-piece would be based on the "calculated non-integer rate" in each proceeding.

In effect, the SPFC *integer* rate would be set so that sufficient revenues would accumulate in a "reserve account" to permit the single-piece rate to remain the same for a period of two rate proceedings. Revenues generated during the first rate period would be used to cover any revenue deficiency in the second rate period. In this manner, household mailers would enjoy greater rate stability, while allowing business mailers smaller, more frequent and predictable rate adjustments.

Accommodating the differing interests of household and business mailers in this manner can be achieved while preserving Postal management's prerogatives with respect to rate changes, including the timing of the filing of rate cases and the effective date of new rates. It would also preserve the right of every participant to litigate any issue in every case. The only difference is that revenues generated in the first rate case period would permit the single-piece First-Class rate to remain in effect over two rate cases.

2. The single-piece First-Class rate proposal will have modest effects on single-piece and workshare volumes

Changing the SPFC rate every other rate proceeding while rates for workshare mail change each rate case will cause volumes to shift between single-piece and workshare. By holding the SPFC integer rate constant through two rate cases as proposed, the workshare discount "cycles" up and down compared to the SPFC rate with each rate case (although the amount of the discount relative to the calculated non-integer rate is assumed not to change). In the first rate case, when the SPFC rate is greater than the calculated non-integer rate, there is a larger workshare discount. In theory, this should generate more workshare mail. The opposite effect results when the SPFC rate is less than the calculated non-integer rate after the second rate case, creating a smaller discount relative to the SPFC rate.

The shifting of volumes between single-piece and workshare mail could become larger, especially in a period of high or rising inflation. Such an outcome could create difficulties for presort and pre-barcode mailers and for the Postal Service. In order to minimize such difficulties (and to ensure that sufficient revenues are available to sustain the SPFC rate) during the second rate case period, the OCA recognizes that the SPFC rate may need to be increased in two consecutive rate cases under certain circumstances. OCA-T-6 at 45-46.

C. The Nonstandard Surcharge Should Be Eliminated for Certain Nonstandard Letters

The Postal Service proposes to retain the current nonstandard surcharge of 11 cents for First-Class Mail. However, the nonstandard surcharge is not an operational necessity for letter-shaped mailpieces that are square or nearly square. For that reason, witness Callow (OCA-T-6, Part III) proposes that the nonstandard surcharge for such "low aspect ratio" letter mail be eliminated.

The nonstandard surcharge is no longer justified for low aspect ratio letter mail. Advances in technology with respect to mail processing since implementation of the surcharge in the 1970's have made the surcharge obsolete. According to witness Callow, the Postal Service confirms that the presence of a barcode on a delivered low aspect ratio letter means that such mailpieces were processed partially or entirely on the Postal Service's automated equipment. *Id.* at 57. As a result, consumers are unfairly charged extra for low aspect ratio letter mail, such as seasonal greeting cards or invitations, that requires little (if any) special processing.

Moreover, the Postal Service's assumption that all nonstandard mail is manually processed, which assumption underlies its cost estimate for the surcharge, is unrealistic. According to witness Callow, even the Postal Service acknowledges that the assumption of 100 percent manual processing may not always be true in fact. *Id.* As a result, witness Callow proposes more realistic assumptions about the processing of low aspect ratio letter mail. *Id.* at 58. These assumptions reflect the fact that as letters move away from a square configuration toward an aspect ratio of 1:1.3—the minimum aspect ratio for standard mail—it is likely that a higher percentage of such letters will be presented for processing on automated equipment. The more realistic assumptions are used to develop several reasonable mail processing unit costs that reveal such costs are less than the surcharge. *Id.* at 63, Table 17. For these reasons, witness Callow proposes eliminating the nonstandard surcharge for low aspect ratio letter mail in order to promote fairness and equity for consumers mailing low aspect ratio letters. *Id.* at 67-68.

D. The Postal Service Should Provide Courtesy Make-Up Stamps When First-Class Rates Change

A change in postal rates places burdens on the mailing public and the Postal Service. Consumers, who almost always send single-piece mail and rely heavily on stamps, are particularly inconvenienced. Lines are long as consumers attempt to purchase "make-up" stamps and new denomination stamps in time for the rate change. The Postal Service should take the initiative to ease the burden of adjusting to new rates by providing a nation-wide informational mailing that includes ten courtesy "make-up" stamps to every delivery address.

The average household sends approximately twelve pieces of single-piece First-Class Mail monthly. OCA-T-1 at 8. Providing ten courtesy "make-up" stamps would significantly enlarge the time in which consumers can purchase new stamps and reduce the surge of customers at post offices just before and after the changeover date. The hassle of the rate change would be significantly reduced. At the same time, the Postal

Service would benefit from positive public relations and would better manage the flow of customers at postal facilities. *Id.* at 9.

The cost to the Postal Service of this outreach would be modest. The Postal Service is already seriously considering a nation-wide informational mailing when First-Class rates next change. *Id.* at 10. The additional cost of a mailing that would include ten courtesy "make-up" stamps, including the revenue foregone, is estimated to be $16.0 million. *Id.* at 10-13. But provision of courtesy "make-up" stamps would reduce the number of window transactions as many consumers would be able to avoid an extra visit to their post office. If 30 percent of households and businesses avoid an extra stamp purchase transaction, the Postal Service stands to save $17.9 million and thus to offset the cost of providing the courtesy "make-up" stamps. *Id.* at 14.

VII. REDUCTION IN FEES FOR MONEY ORDERS; ELECTRONIC MONEY ORDERS; INSURED MAIL FEES; ELECTRONIC DELIVERY CONFIRMATION FOR INDIVIDUALS

OCA witness Sheryda C. Collins urges the Commission to reject the proposal of Postal Service witness Mayo (USPS-T-39) to increase the fees of domestic and military money orders. On the contrary, witness Collins proposes a reduction of 5 cents for each of these fees. OCA-T-8 at 9. Domestic money order fees should be reduced from the current 80-cent level to 75 cents; and military money order fees should be reduced from their present 30-cent level to 25 cents. *Id.* at 9-10. Money orders are essential financial instruments for low-income individuals, rural customers, and any other customer who needs a secure method of payment that is almost as easy to use as cash. Ms. Collins notes that the Commission has long held the view that money orders should be priced so that the service's cost coverage is considerably lower than the system-wide average. *Id.* at 8-9. The 123 percent cost coverage resulting from witness Collins' reduction in fees comports with the pricing criteria of the Act and with past cost coverages recommended by the Commission. *Id.* at 9.

In addition, witness Collins recommends that the Postal Service establish an electronic money order service that would be available on the Internet, possibly in partnership with private Internet companies. *Id.* at 11. The Postal Service could become a major player in the new market for money orders which is being driven by Internet sales. *Id.* at 10. Ms. Collins notes that electronic money orders can function as a convenient, secure means for purchasing goods. *Id.*

Witness Collins urges the Commission not to raise insurance fees as proposed by Postal Service witness Mayo, but to maintain these fees at their present level. *Id.* at 15. Furthermore, she advocates that the Postal Service and the Commission carefully consider the possibility of establishing different, and larger, incremental values than the $100 currently in place. For insured articles valued at over $1000, serious consideration should be given to establishment of increments of $250 or $500, with an appropriate adjustment in the per increment fee. *Id.*

Ms. Collins notes that the Postal Service is engaged in a beta test of a web-based program that will allow individuals and small volume shippers to use electronic delivery confirmation service. Several Internet companies are offering electronic delivery confirmation to individuals at no charge. *Id.* at 16. Because it would be no more costly for individuals to access that service than bulk users, witness Collins urges the Postal Service to make Priority Mail electronic delivery confirmation available to the public on its website at no charge. *Id.* at 17.

CONCLUSION

For all the reasons set forth in the OCA's Direct Testimony, the Commission should recommend rates based on a one-percent contingency allowance; increased attribution of mail processing and city carrier costs to rate classes and categories; continuation of the present 33-cent First-Class rate; a three cent discount for CEM mailpieces; rate stability for single-piece First-Class Mail; elimination of the nonstandard surcharge for letter mail; provision of courtesy "make-up" stamps at the time of a change in the First-Class rate; and lower fees for money orders and insurance.

Respectfully submitted,

OFFICE OF THE CONSUMER ADVOCATE

Emmett Rand Costich

Ted P. Gerarden
Director

Emmett Rand Costich
Shelley S. Dreifuss
Kenneth E. Richardson
Attorneys

1333 H Street, N.W.
Washington, D.C. 20268-0001
202) 789-6859; Fax (202) 789-6819

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

Emmett Rand Costich

Emmett Rand Costich

Washington, D.C. 20268-0001
June 29, 2000