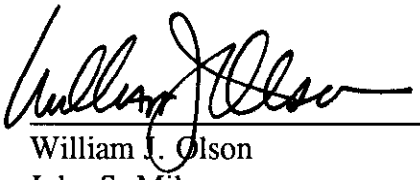
BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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

ERRATA TO DIRECT TESTIMONY OF DR. JOHN HALDI (VP/CW-T-1)
ON BEHALF OF VAL-PAK DIRECT MARKETING SYSTEMS, INC.,
VAL-PAK DEALERS' ASSOCIATION, INC., AND
CAROL WRIGHT PROMOTIONS, INC. (ERRATUM)
(July 17, 2000)

The attached errata provide corrections on several pages of VP/CW-T-1. A list of the corrections is attached, along with copies of the relevant pages with the highlighted corrections.

Respectfully submitted,



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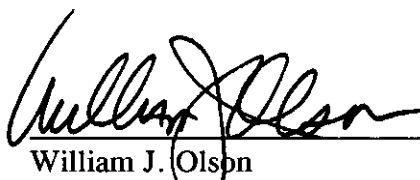
Carol Wright Promotions, Inc.

CERTIFICATE OF SERVICE

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



William J. Olson

July 17, 2000

Corrections to Direct Testimony
of VP/CW Witness John Haldi (VP/CW-T-1)

Page	Line(s)	Change
51	8	"-0.162" to "-0.570"
51	9	"0.162" to "0.570"
51	10	"much" to "somewhat"
51	10	"five" to "1.4"
51	12	"five" to "1.4"
51	14	"five" to "1.4"
51	fn. 35	"p. 138" to "p. 111"
A-3	17-19	After "letters", delete "ostensibly corresponds to the volume of heavy-weight ECR letters in the Test Year Before Rates, and"
A-4	2	After "Mail", insert "The difference reflects (i) a change in mail mix assumed by witness Moeller; and (ii) a difference in letters as defined by the DMM and RPW systems."
A-4	2	After "constitute", delete "such"
A-9	4	"1.0" to "1"
B-6	11	"randomly mixes" to "fails to isolate and analyze separately"
B-6	12	After "most presorted mail", insert "randomly mixes weight-cost relationships and"
B-14	8	"mixed" to "non-single piece"

2. Rates influence demand for mail products. Prices send signals to mailers; specifically, higher prices of a given product of mail will reduce the volume of that product, and *vice versa*. As between different mail products, the effect varies and can be quantified by the economists' elasticity measure, computed and presented by witness Tolley.

The elasticity of ECR Mail as reported by witness Tolley is -0.808; that is, the volume of ECR falls by 0.808 percent whenever the ECR rate is increased by 1 percent.[34] The elasticity of Regular Mail is -0.570.[35] Thus, a 1 percent rise in the rate of Regular Mail reduces the volume by only 0.570 percent, somewhat less than in the case of ECR. The demand for ECR is over 1.4 times more price-sensitive than that for Regular Mail. This means that the same percentage rate increase will reduce ECR volume over 1.4 times more than it would reduce Regular Mail volume. Conversely, the same percentage rate reduction would expand ECR volume by over 1.4 times more than it would expand Regular Mail volume.

The high elasticity of demand for Standard A ECR probably reflects a number of factors, but above all, the ready availability of alternatives (criterion 5). Such alternatives include advertising in local newspapers, shopping guides (which may be given out in stores or delivered by alternate

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[34] USPS-T-6, p. 129.

[35] *Id.*, p. 111.

percent of the tallies between 3.0 to 3.5 ounces in weight, to estimate 73 tallies in the 3.3 to 3.5 ounce range.

The total tallies of letter-shaped pieces that are overweight (3.3 to 16 ounce) are obtained by adding the tallies in Row 5 to the tallies in the 3.5-16 ounce range, shown in Row 6, yielding a sum of 384 tallies (row 6). This represents 2.589 percent of the total tallies of Standard A letter-shaped pieces. This percentage can be applied to the total cost of Standard A ECR letters by assuming that (i) the ECR subclass has the same proportion of heavy-weight letters as all Standard A Mail, and (ii) the dollar weighted costs of heavy-weight letters are in proportion to the raw tallies.

The above 2.589 percent adjustment appears rather conservative when judged by other available data which are drawn from the ECR Subclass alone. Witness Daniel (USPS-T-28) estimates that Standard A ECR Mail will contain 13,127.962 million letters of all weights in Test Year Before Rates, while witness Moeller estimates the volume of letters below the 3.3 ounce breakpoint to be 10,799.400 million.[37] The difference between witnesses Daniel and Moeller, 2,328.562 million letters, [redacted] represents 17.7 percent of all ECR letters, which is almost

[37] *See* response to VP-CW/USPS-1 (Response filed May 4, 2000) and witness Daniel response to ADVO/USPS-T28-1 (Tr. 4/1202).

7 times greater than the estimate developed here, based on IOCS tallies for all Standard A Mail. The difference reflects (i) a change in mail mix assumed by witness Moeller, and (ii) a difference in letters as defined by the DMM and RPW systems. If heavy-weight letters do indeed constitute a large share of all ECR mail that meets the DMM definition of letters, then (i) volume data developed by the RPW System and costs developed by the IOCS (which uses DMM definitions) are substantially out of sync, and (ii) the mismatch problem discussed in this testimony should be a matter of serious concern. The Commission has repeatedly stressed its desire to establish cost-based rates. Sound cost data are a fundamental prerequisite to implement cost-based rates successfully. Its concerns about the quality of Postal Service cost data are well founded.

Cost adjustment. The procedure used here to adjust costs is shown in Table A-2, rows 1-10. The volumes of Standard A ECR letters and flats, respectively, are shown in row 1, columns 1 and 3. The volume of letters and flats, 13,127,961,721 and 20,455,078,077, respectively, correspond to the total volumes used by witness Daniel.[38] Unit costs (total costs/volume) for letters and flats, before any mismatch adjustments, are shown in Table A-2, row 2. The unit cost of letters is 6.855 cents, and the unit cost of flats is 7.396 cents. The unadjusted letter-flat difference amounts to 0.542 cents, as shown in row 3.

[38] USPS-T-28 and USPS-LR-I-92.

Adjustment for Letter-Shaped Pieces With a DAL

The adjustment for **letter-shaped** pieces entered with DALs is presented in Table A-2, rows 11-19. In the absence of any volume data on DAL mailings, I estimate that 1 percent of the total volume of Standard A ECR flats consists of letter-shaped pieces with DALs that are classified by the IOCS as letters. The number of these pieces, 204,440,781, is shown in row 12. The same number of pieces, when expressed as a percentage of total letter volume, is 1.588 percent, as shown in row 13.

Letter-shaped pieces with a DAL are not enveloped **(if they were enveloped, they could not be mailed with a DAL)**. That is, they are necessarily "loose," and may consist of an outside multipage, untabbed folded piece with an envelope and/or other loose pieces inserted into the centerfold, as in Moeller cross-exam exhibit VP/CW-CXE-1. The Postal Service does not have any cost data or cost study to ascertain whether such pieces cost more than ordinary enveloped letters.[39] In the absence of any such study or data, to be conservative I treat these pieces as if they had the same cost as all other letter-shaped mail, and adjust the cost proportionately. Accordingly, I estimate the cost of these misclassified pieces as 1.588 percent of the total cost of letters, or $14,021,103, which is the cost that has to be shifted from letters to flats. This adjustment is shown in row 14, columns 2 and 4.

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[39] Response to AAPS/USPS-T28-1 (Tr. 4/1157).

cost relationship should the study seek to estimate if only one weight-cost relationship is to be estimated for each subclass of Standard A Mail? In order to be conservative (from a ratemaking perspective), I would suggest that the study should endeavor to focus on mail with the highest weight-related cost, which is the least presorted mail within the subclass; *i.e.*, the Basic category for ECR and Regular Presort. The pound rate for the subclass should reflect all weight-related costs, and the discount structure should reflect both weight-related and piece-related cost avoidance wherever appropriate (the destination entry discounts do this; the presort discounts do not).

A second implication is that any study which fails to isolate and analyze separately tallies from the least presorted mail to the most presorted mail randomly mixes weight-cost relationships and is likely to yield a result that, at best, is useless and, at worst, is hopelessly confused and even misleading. This is one reason why any attempt to use IOCS tallies to document how weight affects mail processing costs would appear to be fatally flawed from the outset, at least until IOCS tallies can distinguish presort condition.

Witness Moeller has previously observed that a properly-designed study must control for variations "in the amount of drop shipping, presortation, average haul of non-dropshipped mail, and other factors, all of

Again, if direct piece handling tallies are used to distribute mixed mail tallies to weight increment, and if those direct piece-handling tallies show little relationship between weight and cost, their use will mask the underlying causal relationship between weight, the number of containers that must be moved manually through the facility, and the additional cost of such movement that is caused by more weight and cube. To repeat, the systematic bias is to understate the effect of weight on cost. For Standard A ECR Mail, 71.5 percent of all mail processing tallies were for non-single piece mail, and only 28.5 percent were single piece tallies.[52] Inappropriate distribution of mixed mail tallies to weight increment is yet another reason why the IOCS approach to a study of the weight-cost relationship is fundamentally flawed.[53]

The discussion of this hypothetical example is intended to demonstrate that weight affects costs in large measure via bulk operations, which include all operations that entail moving mail around and through the facility, and probably less so through individual piece handling operations.[54] The

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[52] Response to VP-CW/USPS-T28-24 (Tr. 4/1342-44). Mixed mail tallies represented 22.3 percent of city carrier in-office tallies.

[53] *See* USPS-T17, pp. 12-17, for more detail and discussion on how the Postal Service CRA methodology uses direct tallies to distribute mixed mail tallies and not handling tallies to the classes and subclasses of mail.

[54] If direct tallies of individual piece-handling are not an appropriate basis for distributing the costs of other functions to weight increment, then the number of direct tallies is of little immediate consequence to accuracy of the results. In others words, doubling or even

(continued...)