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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

PSA-RT-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

REBUTTAL TESTIMONY
SANDER A. GLICK
ON BEHALF OF
PARCEL SHIPPERS ASSOCIATION

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1 **Autobiographical Sketch**

2 My name is Sander A. Glick. I co-manage the Economic Systems practice at
3 Project Performance Corporation (PPC), a consulting firm based in McLean,
4 Virginia. PPC provides economic and technology consulting services to private
5 and public sector clients. I joined PPC in 1994 as an Analyst and am now a
6 Program Manager. At PPC, I have worked on a number of economic and cost
7 issues for mailer associations, the Department of Defense, and the Department
8 of Energy.

9
10 In Docket No. R97-1, I testified on behalf of the Magazine Publishers of America
11 (MPA) regarding the special service fee for Qualified Business Reply Mail
12 (QBRM) and the appropriate method for distributing rural carrier costs to mail
13 classes and subclasses. In this case, I have provided direct testimony on behalf
14 of the Association for Postal Commerce (PostCom) and Recording Industry
15 Association of America (RIAA) regarding Standard (A) rate design and on behalf
16 of the Magazine Publishers of America (MPA) regarding the appropriate methods
17 for distributing mail processing and rural carrier cost to mail subclasses and the
18 Test Year cost savings that will result from reduced bundle breakage and
19 improved bundle recovery.

20
21 I attended the Maxwell School of Citizenship and Public Affairs at Syracuse
22 University, where I received a Masters of Public Administration in 1994, and
23 Carleton College, where I received a Bachelors Degree, magna cum laude, in
24 Physics in 1993. I am a member of the American Economic Association and the
25 System Dynamics Society.

1 **Purpose and Scope**

2 In this case, UPS witnesses Luciani (UPS-T-5) and Sellick (UPS-T-4) presented
3 direct testimony arguing that the Postal Service overstated Parcel Post revenue
4 and understated Parcel Post costs. Furthermore, they argued that discounts for
5 destination-entry Parcel Post should be smaller because the Postal Service's
6 estimated cost avoidances and proposed passthroughs are too high. In this
7 testimony, I show that their arguments are wrong. Specifically, I make eight
8 points:

- 9
- 10 1. The joint Bulk Revenue, Pieces and Weight/Domestic Revenue, Pieces
11 and Weight (BRPW/DRPW) system that the Postal Service used to
12 estimate Parcel Post revenue, pieces, and weight is more accurate than
13 DRPW, the system that the Postal Service used in past cases.
14
 - 15 2. In the absence of a new study of the effect of parcel weight on elemental
16 load costs, elemental load costs for parcels should continue to be
17 distributed based on parcel pieces.
18
 - 19 3. The costs for "Exclusive Parcel Post Routes" should not be distributed
20 entirely to the Parcel Post subclass because, despite the unfortunate
21 choice of name, Parcel Post volume makes up only a small portion of the
22 mail delivered on these routes.
23
 - 24 4. While Mr. Luciani's Destination Bulk Mail Center (DBMC) cost avoidance
25 model is flawed, so is the Postal Service's model. Therefore, neither
26 should be used to estimate the DBMC cost avoidance. I propose a middle
27 ground alternative.
28
 - 29 5. The Destination Delivery Unit (DDU) cost avoidance is larger than
30 estimated by the Postal Service, not smaller.

- 1 6. Contrary to Mr. Luciani's suggestion, the Postal Service's method for
2 distributing Alaska air costs to rate category is appropriate.
3
- 4 7. Just as it did in Docket No. R97-1, the Commission should pass through
5 nearly 100 percent of the DDU cost avoidance. UPS has provided no
6 justification for passing through less.
7
- 8 8. Mr. Luciani's bottom-up model of DDU costs is incorrect. Therefore, his
9 related criticism of the Postal Service's rate design approach is irrelevant.
10

11 In the remainder of this testimony, I provide detail on each of these points.

12 **1. The joint Bulk Revenue, Pieces and Weight/Domestic Revenue, Pieces**
13 **and Weight (BRPW/DRPW) system that the Postal Service used to estimate**
14 **Parcel Post revenue, pieces, and weight is more accurate than DRPW, the**
15 **system that the Postal Service used in past cases.**

16 Mr. Sellick believes that the new BRPW/DRPW method¹ for deriving Parcel
17 Postal RPW estimates is unreliable and that the Commission "should instead use
18 the FY 1998 DRPW-only estimates." Tr. 31/15037 and 15039 (Sellick).
19 However, Mr. Sellick does not provide a persuasive argument to substantiate his
20 belief. Instead, he describes three possible problems with the new method, none
21 of which is likely to cause a significant impact on the Parcel Post RPW estimates.
22 Furthermore, the potential problems described by Mr. Sellick do not explain the
23 19 percent difference between the Parcel Post estimates derived by the new
24 BRPW/DRPW method and those produced by the former DRPW-only method.
25 Tr. 31/15034 (Sellick). On the other hand, the Postal Service's explanation is
26 reasonable, can explain the entire discrepancy, and shows that the new method
27 corrects a serious data collection problem with the DRPW-only method.

28

¹ The new BRPW/DRPW method estimates RPW for permit imprint Parcel Post from the BRPW system and RPW for all other Parcel Post from the DRPW system. The old DRPW-only method estimated RPW for the entire Parcel Post subclass using the DRPW system.

1 First, Mr. Sellick argues that the BRPW portion of the new BRPW/DRPW Parcel
2 Post estimates is flawed because it does not include a trial balance revenue
3 account adjustment. This adjustment was not performed for FY 1998 because a
4 unique permit imprint Parcel Post trial balance revenue account was not
5 available, Tr. 31/15037-15039 (Sellick); only an interim adjustment based on an
6 FY 1997, PQ2 survey could be made. POIR No. 17, Question 4. However, Mr.
7 Sellick has acknowledged that a separate Parcel Post trial balance revenue
8 account did become available in FY 1999, PQ3 and PQ4. Tr. 31/15151 and
9 15162 (Sellick); POIR No. 17, Question 4. As a result, his critique applies to less
10 than half of the FY 1999 revenue estimate. Furthermore, because the trial
11 balance adjustment is larger than the interim adjustment factor that was used in
12 FY 1998 and the first two postal quarters of FY 1999, it is more likely that the lack
13 of a trial balance adjustment resulted in the new BRPW/DRPW system
14 understating revenue, not overstating it. POIR No. 17, Question 4.²

15

16 Second, Mr. Sellick argues that the BRPW portion of the new BRPW/DRPW
17 Parcel Post estimates is flawed because some BRPW data records are likely to
18 be in error. Tr. 31/15039-15045 (Sellick). As I show below, Mr. Sellick's analysis
19 did not uncover any significant flaws in the BPRW system:

20

- 21 • BRPW Error Checking Process. Mr. Sellick states that out of a total of
22 32,000 BRPW data records, about 60 records failed the Postal Service's
23 data quality checks. However, he has acknowledged that these records
24 are removed by the Postal Service's data cleaning process and that they
25 represent only \$3,048.49 in revenue and 463 pieces, or approximately
26 0.00032 percent of Parcel Post revenue and 0.00015 percent of Parcel
27 Post pieces. Tr. 31/15122-15123 (Sellick); Exhibit USPS-11C.

28

² To correct for this understatement, the Commission could replace the interim adjustment factors used for FY 1999, PQ 1 and 2 with the average of the trial balance adjustments for FY 1999, PQ3 and 4.

1 In addition, he reports that "several hundred" BRPW data records would
2 fail these tests if stricter failure criteria were used, but this still implies an
3 error rate of less than 1 percent and there is no indication that these
4 records bias the BRPW figures upward. Tr. 31/15122-15123 and 15164-
5 15169 (Sellick). Furthermore, if the 12 records in Exhibit UPS-4C (which
6 comprise only 0.007 percent of Parcel Post pieces) that fail Mr. Sellick's
7 stricter criteria are at all representative of all of the records that failed Mr.
8 Sellick's test, the piece-weighted error rate would be much less than one
9 percent. Tr. 31/15148-15150 (Sellick).

- 10
- 11 • Findings of Audit Reports. Mr. Sellick reviews a set of 48 financial audit
12 reports provided in library reference USPS-LR-I-323. He cites 14
13 passages from these reports that refer to problems in the financial and
14 accounting systems of individual postal facilities, but he provides no
15 argument that these problems bias the BRPW Parcel Post estimates, let
16 alone bias them upward. Tr. 31/15111-15116 (Sellick).

17

18 Many of the cited passages refer to inadequate verification.³ However,
19 common sense suggests that inadequate verification would be more likely
20 to cause an underestimate of BRPW Parcel Post revenue rather than an
21 overestimate. For example, one might be concerned that some Standard
22 (B) mailers would understate the number of pieces in their mailing or
23 attempt to mail at lower Standard (A) rates unless their mail were
24 adequately verified.⁴ In support of this common sense argument, my

³ Out of the 14 cited passages, only numbers 1, 3, 5, 10, and 11 do not refer directly to verification problems.

⁴ Since Standard (A) rates for parcels weighing less than one pound are uniformly lower than the lowest Parcel Post rate, there is a disincentive to mail Standard (A) parcels at Parcel Post rates. Nonetheless, I asked several parcel mailers whether they mailed any parcels weighing less than one pound at Parcel Post rates in FY 1998 or FY 1999. Most of them indicated that they hadn't done so. A couple mailers indicated that a very small portion (less than two percent) of the parcels they mailed at Parcel Post rates in FY 1998 weighed less than one pound. However, after the implementation of Docket No. R97-1 rates, these mailers discontinued this practice. This is because, with the implementation of Docket No. R97-1 rates, the Domestic Mail Manual (DMM) no longer allows Standard (A) mail to be mailed at Parcel Post rates. Specifically, the DMM only allows Standard (A) mail to be mailed at Standard (B) mail rates if the Standard (B)

1 review of the audit reports revealed a number of statements of concern
2 about possible revenue loss.⁵

3
4 Furthermore, while I agree with Mr. Sellick that the audit reports do
5 express a general concern about bulk mail acceptance and business mail
6 entry, Tr. 31/15126-15127 (Sellick), the Parcel Post subclass was only
7 mentioned by name in one of the 48 audits. USPS-LR-I-323 at 56, Postal
8 Inspection Service Audit Report: Financial Audit, Case No. [redacted]
9 (March 1998), at 3. Standard (B) was mentioned by name in only one
10 additional report. USPS-LR-I-323 at 317, Postal Inspection Service Audit
11 Report: Financial Audit, Case No. [redacted] (July 1998), at 8.

12
13 Finally, Mr. Sellick fails to mention the findings from the one study, which
14 was performed by an independent accounting firm, provided by the Postal
15 Service that specifically focuses on assessing the Permit system that is
16 the basis of the BRPW estimates. The Executive Summary of the
17 "PERMIT System Data Validation Study" provided in library reference
18 USPS-LR-I-279 summarizes the study's findings as follows:

19
20 Our procedures did not identify any significant variances in
21 the accumulation of Postage Statement data on the
22 PERMIT Systems. However, we did identify insignificant
23 variances which suggests that it may be appropriate for the
24 Postal Service to routinely reconcile the AP PERMIT data
25 to the PQ RPW data to verify that such variances continue
26 to be insignificant. USPS-LR-I-279 at 1.

mail rate is less than the Standard (A) mail rate. Domestic Mail Manual, Issue 54, Section E612.4.6. As noted above, Parcel Post rates are uniformly higher than Standard (A) rates.

⁵ For example: "Internal controls governing the acceptance and input of business mail need to be strengthened to ensure that all revenue due the Postal Service is properly safeguarded." USPS-LR-I-323 at 31, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (August 1998), at 18. "Verifications of Periodical mailings and supporting documentation are needed to protect Postal Service revenues and to ensure publications continue to be eligible to mail at Periodical rates of postage, according to their authorizations." USPS-LR-I-323 at 71, Postal Inspection Service Audit Report: Financial Audit, Case No. [redacted] (April 1998), at 22.

- 1 • Analysis of Plant-Verified Drop Shipment (PVDS) Verification and
2 Clearance Forms (PS Forms 8125). Mr. Sellick reviews more than 500
3 PS Forms 8125 provided in sealed library reference USPS-LR-I-314.
4 These forms are a subset of the Forms 8125 reviewed in preparing the
5 audit report on the plant-verified drop shipment system that was provided
6 in library reference USPS-LR-I-176. It is important to note that the audit
7 investigated three “judgmentally selected” sites, not a randomly selected
8 set of sites. USPS-LR-I-176 at 2. Out of these, Mr. Sellick identifies two
9 that appear to indicate Standard (B) mail with weights appropriate for
10 Standard (A) mail. Tr. 31/15043-15044 (Sellick). Since the sites for the
11 audit were not randomly selected, it is not possible to generalize to all
12 Forms 8125, but even if the sites had been randomly selected these
13 possible errors would represent an error rate of less than 0.4 percent.

14
15 Furthermore, Mr. Sellick provides no evidence that these two forms
16 indicate that incorrect data was entered into the BRPW system. As he
17 notes in his testimony, it is postage statements that are used for entry into
18 the PERMIT system that is the basis of the BRPW estimates. Tr.
19 31/15024 (Sellick). However, Mr. Sellick provides no evidence that the
20 postage statements corresponding to the two aforementioned Forms 8125
21 would likely have been for Standard (B) mail.

22
23 In fact, there is evidence to the contrary. In the first case, the Form 8125
24 indicates that the type of mail is “letters” and in the second case, the Form
25 8125 indicates that the type of mail is “flats” that are “automation
26 compatible” – but the postage statement Forms 3605-R and 3605-PR for
27 permit imprint Parcel Post mail do not include either letters or automation
28 flats as possible mail types. Tr. 31/15050, 15052 and 15056-15057
29 (Sellick). On the other hand, the postage statement for Standard (A)
30 Regular mail does include these possible mail types.

31

1 It is therefore likely that the postage statements corresponding to these
2 two Forms 8125 were Standard (A) postage statements and that the only
3 mistake made was in indicating the class on the Form 8125.⁶ If the
4 corresponding postage statements were correct, then there is no reason
5 to believe that the Forms 8125 that Mr. Sellick discusses were associated
6 with any errors being entered into the BRPW system.

7
8 Mr. Sellick has not provided an argument that BRPW data record errors are likely
9 to have caused a significant impact on Parcel Post estimates. He does not show
10 either that (1) the rate of BRPW errors is large, or that (2) they lead to a bias that
11 would cause an overestimate of Parcel Post revenue.

12
13 Third, Mr. Sellick argues that the new BRPW/DRPW method could lead to
14 double-counting for Parcel Post. He argues that this could occur, for example, if
15 some permit imprint Parcel Post pieces were incorrectly recorded as metered
16 pieces in the DPRW. If this happened, then those permit imprint Parcel Post
17 pieces would not be removed from the DRPW system and so would be counted
18 by both the BRPW system and the DRPW system. Tr. 31/15045-15048 and
19 15169-15171 (Sellick). However, Mr. Sellick fails to take into account that if such
20 errors occur, then they are likely to occur in the reverse direction also. The
21 reverse error would result, for example, in some metered Parcel Post pieces
22 being incorrectly categorized as permit imprint pieces. As a result, these
23 metered Parcel Post pieces would not be counted by either the BRPW system or
24 the DRPW system. Mr. Sellick acknowledged in cross-examination that this
25 reverse error would lead to under-counting of Parcel Post. Tr. 31/15171-15173
26 (Sellick). Thus, the general type of data collector errors that Mr. Sellick

⁶ Indeed, it is not even clear that both forms indicate Standard (B) mail as Mr. Sellick asserts. On the second form, the error may lie only in Mr. Sellick's interpretation, since both strokes of the "X" mark touch the box for Standard (A). Tr. 31/15057 (Sellick). Even if Standard (B) was checked on the two forms identified by Mr. Sellick, it was probably due to sloppiness since the Standard (A) and Standard (B) boxes are separated by less than 1/8" on the PS Form 8125. Because the Standard (A) and Parcel Post postage statements are separate forms, such sloppiness could not have caused Standard (A) revenue to be recorded as Parcel Post revenue in the BRPW system.

1 discusses could lead to some double-counting and some under-counting. On
2 balance, these effects would tend to cancel each other out, which would reduce
3 the impact of this issue (if it is an issue at all) on Parcel Post estimates.

4

5 Therefore, Mr. Sellick has not provided a persuasive critique of the new
6 BRPW/DRPW method for estimating Parcel Post. On closer examination, none
7 of the three problems he describes is likely to cause a substantial impact on
8 Parcel Post estimates. As a result, they fail to provide an explanation of the
9 difference in the Parcel Post estimates produced by the new BRPW/DRPW
10 method and the old DRPW-only method.

11

12 In contrast to Mr. Sellick's speculations, the Postal Service has provided a viable
13 explanation of the substantial discrepancy between the new BRPW/DRPW
14 method and old DRPW-only method. This explanation shows that the problem
15 lies with the old system not the new one. Under the old method, permit imprint
16 Parcel Post was counted by the DRPW system even though permit imprint
17 Bound Printed Matter was not counted by the DRPW system. For this reason,
18 DRPW data collectors were told not to count permit imprint Bound Printed Matter,
19 but to still count permit imprint Parcel Post. USPS-LR-I-37 at 3-95.

20

21 The Postal Service believes that DRPW data collectors under the old system
22 were mistakenly applying the rule for not counting permit imprint Bound Printed
23 Matter to both Bound Printed Matter and Parcel Post, since both are Standard
24 (B). This mistake would have resulted in a systematic underestimate of permit
25 imprint Parcel Post under the old method. POIR No. 15, Question 2.

26

27 In fact, if only one out of every five DRPW data collectors misinterpreted this
28 instruction, that would explain the entire discrepancy between the two systems.
29 Specifically, the non-permit imprint DRPW piece estimate for Parcel Post was 78

Even Mr. Sellick agrees that having separate forms reduces the probability of erroneous reporting. Tr. 31/15129 (Sellick).

1 million. Tr. 2/714-715 (Pafford). Since the FY 1998 Parcel Post estimates were
2 266 million with the old DRPW-only system and 316 million with the new
3 BRPW/DRPW system, Attachment to POIR No. 17, Question 7, the permit
4 imprint estimate from the old system was 188 million while the estimate under the
5 new system was 238 million. Because the permit imprint estimate from the old
6 DRPW-only system is 21 percent less than the BRPW estimate, the erroneous
7 estimate from DRPW could have resulted from 21 percent of the data collectors
8 misinterpreting the DRPW procedures in the manner described by the Postal
9 Service.

10

11 Because the new BRPW/DRPW system corrects this data collection mistake,
12 which is the only reasonable explanation provided for the substantial discrepancy
13 between the old DRPW-only system and the new BRPW/DRPW system, the
14 Commission should use the new system to estimate Parcel Post RPW.

15 **2. In the absence of a new study of the effect of parcel weight on elemental**
16 **load costs, elemental load costs for parcels should continue to be**
17 **distributed based on parcel pieces.**

18 Neither Mr. Luciani nor the Postal Service has performed any quantitative
19 analysis of the effect of weight on elemental load costs. Therefore, the
20 Commission should continue to recommend that elemental load costs be
21 distributed to mail subclasses based upon mail volume within shape. Not only is
22 this consistent with the established distribution method, it is also consistent with
23 the established cost attribution method.

24

25 By his own admission, Mr. Luciani is not an expert on the effect of weight on
26 elemental load costs⁷ and performed no quantitative analysis of whether
27 elemental load costs are a function of weight. His decision to distribute

⁷ When asked "Do you regard yourself, and are you offering yourself to this Commission as an expert witness on the effect of weight on elemental load costs?" Mr. Luciani responded, "I certainly have expertise in Postal ratemaking and the impact in Postal ratemaking of the relationship between weight and cost." Tr. 25/11988 (Luciani). There is a significant difference

1 elemental load costs for parcels based upon weight therefore relies primarily on
2 Ms. Daniel's reexamination.⁸ Tr. 25/11988-11989 (Luciani). Thus, to assess
3 whether there is any merit to Mr. Luciani's decision, it is necessary to assess the
4 quality of Ms. Daniel's reexamination of the relationship between parcel weight
5 and elemental load costs.

6

7 Even a cursory review of the record indicates that Ms. Daniel's reexamination of
8 the traditional assumption that elemental load costs vary with pieces by shape
9 category is not sufficient for overturning the established distribution method.

10 First, Ms. Daniel, herself, admitted that neither she nor anyone else at the Postal
11 Service performed a quantitative analysis of the effect of weight on elemental
12 load costs: "It's my understanding that there hasn't been a quantitative study of
13 the impact of weight on street costs." Tr. 4/1395 (Daniel).⁹ Second, even Ms.
14 Daniel conceded that her assumption regarding elemental load costs is not
15 accurate: "I chose to allocate elemental load costs on the basis of weight,
16 although admitting that I felt it overstated the impact that weight may play in
17 elemental load." Tr. 4/1395 (Daniel).¹⁰ Apparently for this reason, Ms. Daniel
18 distributed elemental load costs based upon number of mailpieces when she
19 estimated unit delivery costs by rate category. USPS-LR-I-95, LR95del.xls,

between being an expert on the effect of weight on cost and understanding the impact of this relationship.

⁸ While Mr. Luciani and others have referred to Ms. Daniel's reexamination of the effect of weight on elemental load costs as a study, Tr. 25/11992 (Luciani), Ms. Daniel doesn't refer to it in this way. Rather, she simply states that she "reexamined previous assumptions." Tr. 4/1159 (Daniel).

⁹ Note that, contrary to Mr. Luciani's belief, Ms. Daniel's reexamination of the effect of weight on elemental load costs does not have "a number of workpapers behind it, that took much time, much time to put forth and took a lot of thought." Tr. 25/11992 (Luciani). Her workpapers simply apply her assumption about the effect of weight on elemental load costs among other assumptions.

¹⁰ Ms. Daniel justifies using a distribution method for elemental load costs that overstates the effect of weight on cost by stating "if anybody wanted to criticize or suggest that access and route time were weight-related, then this would be compensating for that." Tr. 4/1395 (Daniel). This is not the appropriate way to deal with such a situation. The appropriate way to have avoided this criticism would have been to perform a quantitative study of the effect of weight on access and route time costs. Furthermore, Ms. Daniel's argument that distributing elemental load costs to subclass based upon weight compensates for distributing route time costs based upon pieces is irrelevant for the purpose of distributing costs to subclass because the CRA distributes route time to subclass based upon weight. Tr. 4/1395-1397 (Daniel); USPS-LR-I-1 at 7-4.

1 worksheet "city load."¹¹ Therefore, there is no basis on this record for distributing
2 elemental load costs for parcels based upon parcel weight.

3

4 On the other hand, there is evidence that elemental load costs for parcels do
5 vary with the number of parcels delivered. The established method for
6 estimating elemental load costs is to perform a regression with average load time
7 per stop as the dependent variable and mail pieces by shape among the
8 independent variables. PRC Op. R97-1, para. 3256. Therefore, to be consistent
9 with this attribution method, it is appropriate to distribute elemental load costs to
10 subclass using parcel volume. Furthermore, lacking a new study regarding the
11 effect of weight on elemental load costs, this regression analysis remains the
12 best evidence regarding the drivers of elemental load costs.

13 **3. The costs for "Exclusive Parcel Post Routes" should not be distributed**
14 **entirely to the Parcel Post subclass because, despite the unfortunate**
15 **choice of name, Parcel Post volume makes up only a small portion of the**
16 **mail delivered on these routes.**

17 In his testimony, Mr. Luciani recommends that all costs for Exclusive Parcel Post
18 Routes, \$37.4 million, be distributed to Parcel Post because "Exclusive Parcel
19 Post Routes are regular routes devoted entirely to the delivery of Parcel Post."
20 Tr. 25/11785 (Luciani). Despite the unfortunate choice of name, Exclusive Parcel
21 Post Routes are not devoted exclusively to the delivery of Parcel Post. In fact,
22 these routes aren't even devoted primarily to the delivery of Parcel Post. As the
23 Postal Service suggested in an interrogatory to Mr. Luciani, data collected in a
24 study presented in Docket No. R97-1 indicates that Parcel Post pieces comprise
25 only 12 percent of the pieces delivered on Exclusive Parcel Post Routes. Tr.
26 25/11868. To confirm that Parcel Post pieces comprise only a small portion of
27 volume on these routes, I analyzed the data collected for the R97-1 study and
28 was able to confirm the Postal Service's conclusion:

29

¹¹ Specifically, in this library reference, Ms. Daniel develops her unit delivery costs using Ms. Meehan's analysis of load costs, which distributes elemental load costs based upon number of

- 1 • On the 32 "Exclusive Parcel Post Route" route-days examined in the
2 study, 2,612 pieces were delivered, and only 353 (13.5 percent) of the
3 pieces delivered were Parcel Post pieces.
4
- 5 • On the 32 route-days, the percentage of deliveries that were Parcel Post
6 pieces ranged from a low of 0 percent to a high of 34 percent.
7
- 8 • Finally, there were 5 route-days where, out of the 421 deliveries made,
9 none of the pieces delivered were Parcel Post pieces.¹²
10

11 Therefore, because Parcel Post pieces comprise only a small portion of the
12 pieces delivered on Exclusive Parcel Post Routes, I recommend that the Postal
13 Rate Commission reject Mr. Luciani's proposal to distribute all costs for Exclusive
14 Parcel Post Routes to the Parcel Post subclass as clearly inappropriate. I also
15 recommend that the Postal Service consider renaming "Exclusive Parcel Post
16 Routes" to better reflect the variety of mail delivered on these routes.

17 **4. While Mr. Luciani's Destination Bulk Mail Center (DBMC) cost avoidance**
18 **model is flawed, so is the Postal Service's model. Therefore, neither**
19 **should be used to estimate the DBMC cost avoidance. I propose a middle**
20 **ground alternative.**

21 Mr. Luciani criticizes the Postal Service's DBMC mail processing cost avoidance
22 model primarily because it makes one incorrect assumption: DBMC parcels incur
23 no outgoing, non-Bulk Mail Center (BMC) mail processing costs. Primarily
24 because of this flaw, he rejects the model. Although this criticism is correct, his
25 alternative DBMC mail processing cost avoidance model is equally flawed. I
26 propose a middle ground approach.
27

pieces by shape.

¹² PSA-LR-I-1 contains a Microsoft Access 2000 data base containing the data from the Docket No. R97-1 study and the data queries I used to perform this analysis. This library reference also contains electronic versions of the SAS programs used to output the data to Microsoft Access.

1 Mr. Luciani's DBMC mail processing cost avoidance model uses Ms. Eggleston's
2 bottom-up cost models to determine cost differences between DBMC and intra-
3 BMC parcels at Origin Sectional Center Facilities (SCFs) and downstream
4 facilities. Then, because Ms. Eggleston's models do not include Origin Associate
5 Office (OAO) costs, he estimates costs avoided at OAOs using data from the In-
6 Office Cost System (IOCS). In this part of his model, he assumes that DBMC
7 parcels avoid outgoing mail processing costs at OAOs only in the LD43 (Unit
8 Distribution - Manual), LD48 (Customer Service), and non-MODS cost pools. Tr.
9 25/11798-11799 (Luciani).

10

11 Mr. Luciani's model is flawed for three reasons. First, Ms. Eggleston does not
12 believe that her bottom-up cost model is sufficient to estimate the DBMC cost
13 avoidance at Origin SCFs and downstream facilities:

14

15 In addition, to use the models in Attachment A [, which are
16 the ones that Luciani used to develop his DBMC cost
17 avoidance,] to calculate DBMC cost savings, it would be
18 necessary to collect detailed cost information about mail
19 processing activities at origin SCFs....Since the models in
20 Attachment A are currently only used to estimate the cost
21 differences between rate categories that both go through
22 origin SCFs, the assumptions do not have a large impact
23 on the estimated cost differences. The estimation of the
24 cost difference between [intra-BMC] and DBMC would
25 result in comparing a rate category that goes through the
26 origin SCF to one that does not. Therefore, the
27 assumptions used to estimate the costs at the origin SCF
28 would have a large impact on the estimated cost
29 difference. Therefore, more information would be needed
30 to use these models to [estimate] DBMC cost savings. Tr.
31 13/5167-5168 (Eggleston).

32

33 Second, while Mr. Luciani indicates that he based his OAO cost avoidance model
34 on "the response of Mr. Degen," Tr. 25/11979 (Luciani), he excluded costs for
35 some Function 4 cost pools¹³ despite Mr. Degen's statement that "Additionally,
36 costs for some, not necessarily typical, parcel pieces may appear in other

¹³ Function 4 cost pools represent operations that occur at customer service facilities. USPS-T-16 at 12, footnote [14]

1 Function 4 cost pools [other than LD43 and LD48]". Tr. 15/6548 (Degen).
2 Excluding costs avoided in these other Function 4 cost pools referenced by Mr.
3 Degen has the effect of understating the DBMC cost avoidance.

4
5 Third, Mr. Luciani performed no independent checks of whether all of the cost
6 avoidances that aren't included in the OAO cost avoidance model are included in
7 the bottom-up model and vice versa. Tr. 25/11978 (Luciani). This is particularly
8 problematic since Ms. Eggleston views her model of origin SCF costs as
9 insufficient for the role that Mr. Luciani assigned it in his DBMC cost avoidance
10 modeling effort.

11
12 I propose a middle ground DBMC mail processing cost avoidance model that
13 resolves Mr. Luciani's major criticism of the Postal Service's model¹⁴ yet is not
14 infected by the issues with Mr. Luciani's model that I've identified above. Rather
15 than assuming that DBMC parcels incur no outgoing, non-BMC mail processing
16 costs, this DBMC cost avoidance model simply assumes that DBMC parcels
17 incur a smaller amount of outgoing, non-BMC mail processing costs than do non-
18 DBMC parcels. As Table 1 shows, this assumption is clearly correct.
19 Specifically, in FY 1998, DBMC parcels incurred 37.9 cents less mail processing
20 costs per piece in the Base Year than did non-DBMC parcels.

21

22 **Table 1. Calculation of Base Year DBMC Mail Processing Cost Difference**

	Total Cost	Volume	Unit Cost
	[1]	[2]	[3]=[1]/[2]
Outgoing, Non-BMC Costs for DBMC Parcels	\$9,342,929	209,712,994	\$0.045
Outgoing, Non-BMC Costs for Non-DBMC Parcels	\$45,090,994	106,434,805	\$0.424

[1] Tr. 25/11814 (Luciani)

[2] USPS-T-26, Attachment E

23

¹⁴Another one of Mr. Luciani's criticisms -- the DBMC cost avoidance model uses basic function information from IOCS -- is unimportant. While Mr. Luciani is concerned that IOCS data collectors don't accurately record basic function, his concern is merely speculation. Tr. 25/11975 (Luciani).

1 Because the unit cost avoidance for DBMC parcels should be calculated with
2 respect to intra-BMC parcels, Tr. 25/11797 (Luciani), I had to correct the
3 outgoing, non-BMC costs for non-DBMC parcels to reflect the entry profile of
4 intra-BMC parcels. Specifically, while non-DBMC parcels include parcels that
5 are plant loaded to or entered at BMCs, intra-BMC parcels are not entered at
6 BMCs. If they were entered at BMCs, they would be DBMC parcels instead.
7 Therefore, intra-BMC parcels incur more outgoing, non-BMC mail processing
8 costs than the average non-DBMC parcel.

9
10 To correct the non-DBMC unit cost to reflect this entry profile for intra-BMC
11 parcels, I assumed that the unit non-BMC, outgoing cost for non-DBMC parcels
12 entered at BMCs is the same as that for DBMC parcels.¹⁵ As Table 2 shows, this
13 assumption results in a 45.7-cent Base Year outgoing, non-BMC unit cost for
14 intra-BMC parcels. Using this unit cost and the DBMC unit cost developed in
15 Table 1, the Base Year and Test Year unit cost avoided by DBMC parcels can be
16 calculated. As shown in Table 2, the resulting Test Year DBMC unit mail
17 processing cost avoidance is 46.3 cents, which is approximately half way
18 between the cost avoidances developed by Ms. Eggleston and Mr. Luciani. Tr.
19 25/11799 (Luciani); USPS-T-26 at 14. I believe that this cost avoidance is
20 reasonable and should be used as the Test Year DBMC unit mail processing
21 cost avoidance.

22

¹⁵ The Postal Service's model essentially assumes that parcels deposited at any BMC avoid all outgoing, non-BMC costs. My assumption that non-DBMC parcels entered at origin BMCs incur some non-BMC, outgoing mail processing costs corrects for the same problem that my model corrects for DBMC parcels. USPS-T-26, Attachment F.

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Table 2. Calculation of Base Year and Test Year Unit Mail Processing Cost Avoidance for DBMC Parcels

		Total Cost	Volume	Unit Cost
Outgoing, Non-BMC Costs for Non-DBMC Parcels	[1]	\$45,090,99	106,434,805	\$0.424
Non-DBMC Parcels Entered at BMCs	[2]	\$391,96	8,710,275	\$0.045
Non-DBMC Parcels Not Entered at BMCs	[3]=[1]-[2]	\$44,699,03	97,724,530	\$0.457
Outgoing, Non-BMC Costs for Intra-BMC Parcels	[4]=[3]			\$0.457
Outgoing, Non-BMC Costs for DBMC Parcels	[5]			\$0.045
Base Year Unit Cost Avoided	[6]=[4]-[5]			\$0.412
Wage Rate Adjustment Factor	[7]			\$1.124
TYAR Unit Cost Avoided	[8]=[6]x[7]			\$0.463

[1] Table 1

[2] Unit Cost = DBMC Unit Cost from Table 1

Volume from USPS-T-26, Attachment F at 3

Total Cost = Volume x Unit Cost

[3] Unit Cost = Total Cost/Volume

[5] Table 1

[7] USPS-T-26, Attachment F at 2

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5. The Destination Delivery Unit (DDU) cost avoidance is larger than estimated by the Postal Service, not smaller.

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Mr. Luciani argues that the Postal Service-estimated DDU cost avoidance is too large. In this section, I rebut his argument and explain why the Postal Service's estimated DDU cost avoidance is actually too low.

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A. Because the Postal Service's proposed nonmachinable surcharges for intra-BMC and DBMC parcels are not cost based, the DDU discount should be based on an average of the machinable and nonmachinable DDU cost avoidances.

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Mr. Luciani argues that the DDU discount should be based upon only the machinable cost difference because "both intra-BMC and DBMC-entry non-machinable parcels are proposed to be assessed a cost-based surcharge." Tr. 25/11797, 11801 (Luciani). This is not the case. Mr. Plunkett is proposing to pass through only 35 percent of the nonmachinable cost difference. USPS-T-36 at 140. Such a passthrough results in a surcharge that is closer to zero than to the actual cost difference. Therefore, this surcharge is not cost based and Mr. Luciani's argument is irrelevant.

1
 2 Furthermore, while Mr. Luciani is correct that the DDU discount of 73.0 cents that
 3 Mr. Plunkett used in his preliminary rates is 5.7 cents per piece higher than the
 4 machinable cost avoidance, Tr. 25/11801 (Luciani), he fails to point out that the
 5 discount for nonmachinable DDU parcels implicit in Mr. Plunkett's preliminary
 6 rates is 60 cents less than the nonmachinable cost avoidance calculated by Ms.
 7 Eggleston. (See Table 3 below.) The fact that the discount for some subset of
 8 mail within a rate category is overstated and the discount for another subset is
 9 understated is a typical result of rate design and does not justify basing the DDU
 10 discount only on the cost avoidance for machinable parcels.¹⁶

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Table 3. DDU Cost Avoidances and Plunkett's Effective Discounts

		Machinable	Nonmachinable
Mail Processing Cost Avoidance	[1]	\$0.673	\$1.780
DDU Discount Implicit in Preliminary Rates	[2]	\$0.730	\$1.180
Difference	[3]=[2]-[1]	\$0.057	(\$0.600)

14 [1]USPS-T-26, Attachment J
 15 [2]USPS-T-36, Attachment H. The implicit discount for nonmachinable parcels is equal to the
 16 DDU discount plus the DBMC nonmachinable surcharge.

17 **B. Contrary to Mr. Luciani's belief, DDU parcels do avoid sack shakeout**
 18 **costs. This is because, as Parcel Shippers Association (PSA) witness**
 19 **Wittnebel (PSA-RT-2) testifies, DDU parcels are not delivered to the Postal**
 20 **Service in sacks. As Mr. Wittnebel further testifies, DDU parcels also avoid**
 21 **Postal Service unloading costs at the DDU.**

22 Ms. Eggleston's model for estimating the DDU mail processing cost avoidance
 23 assumes that DDU parcels avoid unloading and sack shakeout costs at the DDU.
 24 USPS-T-26 at 17; USPS-T-26, Attachment A. Based upon a review of the DMM
 25 and minutes from Mailers' Technical Advisory Committee (MTAC) work group
 26 meetings, Mr. Luciani speculates that DDU parcels do incur sack shakeout costs
 27 at the delivery unit and therefore the DDU-entry cost avoidance should exclude

¹⁶ It is also worth noting that were it not for the low passthrough of the nonmachinable cost difference, the DBMC rate for machinable parcels (and therefore the DDU rate for machinable parcels) would be lower.

1 sack shakeout costs. Mr. Luciani further argues that even if sack shakeout costs
2 are avoided some of the time, "[e]xcluding only the 2.1 cents in sack shakeout
3 costs is a reasonable way of accounting for the likelihood of Postal Service
4 assistance in unloading and the lack of firm guidelines on DDU-entry policy in
5 this regard." Tr. 25/11800-11801.

6

7 Based upon his operational knowledge of DDU entry procedures and his
8 company's documentation of its entry procedures, Mr. Wittnebel testifies that
9 DDU parcels do avoid sack shakeout and unloading costs at the delivery unit.
10 PSA-RT-2 at 2-3. This is because mailers of DDU parcels do indeed unload their
11 own trucks and don't deliver DDU parcels to the Postal Service in sacks.¹⁷
12 Therefore, witness Ms. Eggleston's model is correct.

13 **C. As PSA witness Zimmerman (PSA-T-1) testified, the Cost and Revenue**
14 **Analysis (CRA) adjustment should be applied to the modeled Parcel Post**
15 **costs used to determine the Destination Sectional Center Facility (DSCF)**
16 **and DDU cost avoidances.**

17 As stated by Mr. Zimmerman, "the Postal Service has understated the amount of
18 cost avoidance in DSCF and DDU because USPS witness Eggleston failed to
19 apply the normal CRA adjustment factor for Parcel Post" without a reasonable
20 justification. Tr. 29/14144 (Zimmerman). Ms. Eggleston's statement that the
21 CRA adjustment shouldn't be applied because the DSCF and DDU rate
22 categories are new is simply wrong. USPS-T-26 at 11. By no means does
23 newness of a rate category justify the rejection of an accepted method. This is
24 particularly true in the case of the CRA adjustment because not performing the
25 adjustment has the known impact of understating the cost avoidance. USPS-T-
26 26 at 11; Tr. 13/5109-5110 (Eggleston). Therefore, Ms. Eggleston's mistake
27 must be corrected. The question, therefore, is which of the two CRA adjustment
28 factors -- Ms. Eggleston's or Mr. Luciani's -- presented in this case should be
29 used.

¹⁷ Mr. Luciani agrees that "if DDU entry pieces are not in sacks, there would be no cost associated with dumping sacks." Tr. 25/11894 (Luciani).

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Ms. Eggleston's factor should be used because Mr. Luciani developed his factor using inconsistent data. Specifically, Mr. Luciani included costs at DDUs and OAO costs in his weighted average modeled costs, but didn't include these same costs in the proportional CRA unit cost that he used to develop the proportional CRA adjustment. UPS-Luciani-WP-1F. As I detail in Exhibits PSA-1A and PSA-1B, including DDU and OAO costs in the proportional CRA unit cost increases Mr. Luciani's CRA factor to 1.162, which is slightly higher than Ms. Eggleston's CRA adjustment factor of 1.154. Table 4 summarizes this correction.

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Table 4. Correction to Luciani's Proportional CRA Adjustment Factor

	Modeled Cost	Proportional CRA Cost	CRA Adjustment
Postal Service	0.8405	0.9698	1.154
Luciani	0.9581	0.9698	1.012
Luciani (As Corrected)	0.9581	1.1134	1.162

Source: Exhibit PSA-1A

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14

6. Contrary to Mr. Luciani's suggestion, the Postal Service's method for distributing Alaska air costs to rate category is appropriate.

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Ms. Eggleston used two methods to develop unit transportation costs by rate category and zone. To determine Test Year unit transportation costs for rate categories that existed in the Base Year (inter-BMC, intra-BMC, and DBMC), Ms. Eggleston basically rolled forward Base Year costs for these categories to the Test Year. To do this, she first allocated Base Year costs to transportation function (e.g., local, intermediate, long distance). Then, she applied a Base Year distribution key (developed from these Base Year costs by function) to Test Year costs (before final adjustments) to develop Test Year costs by transportation function. Finally, she allocated Test Year costs to rate category based upon the

1 extent to which each rate category and zone uses each transportation function.
2 USPS-T-26, Attachment M and N.¹⁸

3

4 This general approach to estimating unit transportation costs for rate categories
5 that existed in the Base Year is appropriate because it assigns Test Year costs
6 before adjustments have been made to reflect changes in mail mix (and therefore
7 only reflect costs for the rate categories that existed in the Base Year) to the rate
8 categories that existed in the Base Year.

9

10 Because the DDU and DSCF rate categories did not exist in the Base Year, Ms.
11 Eggleston had to use a second method to model unit transportation costs for
12 these rate categories. Specifically, because DSCF parcels only incur local
13 transportation costs and because "all parcel post pieces travel on the same
14 transportation from BMCs to P&DCs," she assumed that "the DSCF unit cost of
15 transportation is equal to DBMC local unit costs." Docket No. R97-1, USPS-T-16
16 at 18 (Hatfield); USPS-T-26 at 27. She then modeled the unit transportation cost
17 difference between DDU and DSCF parcels in order to determine DDU
18 transportation costs.

19

20 Implicit in this method is the assumption that those DSCF and DDU parcels that
21 destinate in Alaska incur the same attributable costs as DSCF and DDU parcels
22 not delivered in Alaska. USPS-T-26 at 27-28.¹⁹ The cost above this amount is
23 due to the "universal service obligation" to serve Alaska and therefore Ms.
24 Eggleston does not distribute them.

25

¹⁸ Note that in implementing this method she distributed all plant load and nonpriority Alaska air costs to the intra-BMC and inter-BMC rate categories because, by definition, these costs cannot be incurred by DBMC parcels. USPS-T-26 at 22.

¹⁹ As discussed above, Ms. Eggleston states that she explicitly assumed that "the DSCF unit cost for transportation is equal to the DBMC local unit cost." USPS-T-26 at 27. Because the DBMC rate category is not available in Alaska, this is equivalent to the aforementioned implicit assumption. Furthermore, because the DDU cost savings is calculated relative to the DSCF transportation cost, the implicit assumption also applies for DDU parcels.

1 This implicit assumption is consistent with the Postal Rate Commission's
2 principle for distributing nonpriority Alaska air costs to subclass. In Docket No.
3 R90-1, the Postal Rate Commission first recommended that only a portion of
4 nonpriority Alaska air costs should be distributed to subclasses, stating:

5
6 The record supports a finding that nonpriority Alaska air
7 costs are attributable only to the extent that they substitute
8 for the surface costs that would be incurred if that
9 transportation service were available. The remaining
10 costs, which we refer to as the 'universal service obligation
11 premium,' are institutional. Those costs are caused by the
12 Postal Service's statutory obligation to serve the entire
13 nation. PRC Op. R90-1, para. 3720.
14

15 Furthermore, in this same decision, the Commission indicated that the Alaska Air
16 costs that are caused by the universal service mandate are not caused by any
17 particular class of mail and therefore should not be allowed to distort the rates
18 and services supplied to the entire country:

19
20 Congress has made a determination to have universal mail
21 service. Part of that mandate is to offer the same rates to
22 each person in the country. Costs which are found to have
23 been incurred solely to meet that mandate, however, are
24 caused by the statute and not by any particular class of
25 mail. **Those costs, moreover, should not be permitted**
26 **to distort the rates and services supplied to all the**
27 **country.** Costs which are not caused by parcel post
28 should not be allocated to that subclass. Furthermore, it is
29 neither rational nor reasonable that rates paid by Priority
30 Mail -- which is constrained by the Private Express statutes
31 for part of its volume -- should be affected by the necessity
32 to fly parcel post to remote areas of Alaska.
33

34 Some parcel post users argue that none of the costs from
35 nonpriority air should be attributed to their subclass.
36 However, those parcels are being transported to a
37 domestic delivery address, and it is appropriate that the
38 **usual** costs of transportation be included in the rate base
39 (emphasis added). PRC Op. R90-1, para. 3769-3770.
40

41 On the other hand, Mr. Luciani's proposed adjustment to Ms. Eggleston's
42 methodology clearly "distort[s] the rates and services supplied to all the country"

1 by allocating more than the "usual" transportation costs to DDU parcels.
2 Specifically, his adjustment doubles the unit transportation cost of all DDU
3 parcels, not just the cost for those DDU parcels that destinate in Alaska. Tr.
4 25/11819 (Luciani). The fact that Mr. Luciani's method has such a significant
5 influence on the unit transportation cost for all DDU parcels clearly conflicts with
6 the Commission's aforementioned decision.

7
8 In addition, Mr. Luciani's adjustment amounts to double counting. Specifically,
9 Mr. Luciani explicitly allocates a portion of Alaska air costs (above and beyond
10 the amount distributed by Ms. Eggleston) to the DSCF and DDU rate categories.
11 Tr. 25/11803 (Luciani). Because Ms. Eggleston already accounted for Alaska air
12 costs in her DSCF and DDU models as discussed above, Mr. Luciani's allocation
13 amounts to assigning Alaska air costs to the DSCF and DDU rate categories
14 twice.

15 **7. Just as it did in Docket No. R97-1, the Commission should pass through**
16 **nearly 100 percent of the DDU cost avoidance. UPS has provided no**
17 **justification for passing through less.**

18 Mr. Luciani's proposed fifty percent passthrough of the DDU cost avoidance is
19 inconsistent with Commission precedent and is based upon flawed logic. In this
20 section, I first discuss Commission precedent for a 100 percent passthrough of
21 the DDU cost avoidance. Then, I discuss the flaws in Mr. Luciani's arguments for
22 a limited passthrough.

23 **A. In Docket No. R97-1, the Commission passed through nearly 100**
24 **percent of the DDU cost avoidance. The Commission should do the same**
25 **in this case.**

26 In its discussion of Parcel Post rate design in its Docket No. R97-1 Decision, the
27 Commission twice noted the importance of cost based rates.²⁰ First, it noted:

²⁰ Because 100 percent passthroughs set discounts equal to costs avoided, 100 percent passthroughs result in cost based discounts.

1 Although limited passthroughs may be in order in specific
2 cases, the Commission rejects a blanket recommendation
3 of low passthroughs as general guidance. **Cost based**
4 **rates** are important, and there has been a trend in
5 reclassification generally and in this case to recognize cost
6 evidence to a greater degree (emphasis added). PRC Op.
7 R97-1, para. 5653.
8

9 Second, in its discussion of the DDU discount, the Commission stated: "The
10 resulting cost avoidance is 72.4 cents per piece, at the level of cost attribution the
11 Commission estimates for Parcel Post. A discount of 72 cents [nearly 100
12 percent of the DDU cost avoidance] per piece is recommended. The discounted
13 category is fair, equitable, and **cost based**. It recognizes the interests of mailers
14 and promotes worksharing (emphasis added)." PRC Op. R97-1, para. 5695.
15

16 Furthermore, a passthrough less than that recommended in Docket No. R97-1
17 would be inconsistent with the Commission's longstanding approach of "gradually
18 increasing levels of passthrough as improved cost estimates become available."
19 PRC Op. R97-1, para. 5525. While the passthrough should not be increased
20 above 100 percent, decreasing it would certainly be inconsistent with the
21 Commission's longstanding approach.

22 **B. Setting the implicit markup on DDU parcels equal to the explicit markup**
23 **on Priority Mail is a flawed method.**

24 Mr. Luciani argues that the passthrough of the DDU cost avoidance should be
25 set to ensure that the markup for DDU parcels is equal to that for Priority Mail
26 because "there is little or no difference between the parcel handling practices for
27 Priority Mail and for Parcel Post once the parcels arrive at the DDU." Tr.
28 25/11805 (Luciani). In this section, I explain why setting the implicit markup for a
29 rate category equal to the explicit markup on a mail subclass that receives similar
30 handling practices is a flawed concept.
31

32 First, under Mr. Luciani's method, rate anomalies would be common practice.
33 Because Priority Mail parcels are handled with higher priority at the destination

1 SCF than are Parcel Post parcels, but are handled with similar priority as Parcel
2 Post parcels at the DDU, the intrinsic value of service for DSCF parcels is lower
3 than that for DDU parcels. For this reason, Mr. Luciani's implicit markup method
4 would assign a lower markup to DSCF parcels than to DDU parcels. Therefore,
5 the "implicit markup" rate for DDU parcels could easily be equal to or higher than
6 the "implicit markup" rate for DSCF parcels despite the fact that DDU parcels are
7 much less costly for the Postal Service to handle than DSCF parcels. This is an
8 anomalous result and is clearly inconsistent with the important goal of developing
9 cost based rates.

10

11 Second, Mr. Luciani's method assigns rate categories the same implicit markup
12 as subclasses that receive similar handling practices (or similar value of service),
13 Tr. 25/11805 (Luciani), despite the fact that explicit markups are not based solely
14 on value of service. Specifically, explicit markups are based upon an evaluation
15 of all of the noncost criteria identified in Section 3622(b) of the Postal
16 Reorganization Act. Therefore, to determine the appropriate implicit markup for a
17 rate category, one would first have to make adjustments to account for
18 differences in other noncost criteria between the rate category and the analogous
19 subclass before applying the subclass's markup to the rate category.

20

21 Not making such a correction would be equivalent to arguing that Standard (A)
22 Nonprofit and Standard (A) Regular should have the same markup because they
23 receive a similar intrinsic value of service and that Periodicals should have a
24 higher markup than Standard (A) because Periodicals mail receive a higher
25 intrinsic value of service than Standard (A) mail. Neither of these outcomes
26 would be reasonable based upon an analysis of all of the noncost criteria.

27 **C. Mr. Luciani misinterpreted the reason why Mr. Plunkett passed through**
28 **only 80 percent of the DDU cost avoidance.**

29 Mr. Luciani argues that the DDU passthrough should be no higher than 80
30 percent because "Mr. Plunkett has noted that he constrained DDU-entry rates to

1 take value of service issues into account. Tr. 13/5005-06. He limited the DDU-
2 entry passthroughs to 80% in this manner." Tr. 25/11806 (Luciani). Mr. Luciani
3 clearly misinterpreted Mr. Plunkett's logic. Specifically, Mr. Luciani based his
4 contention that Mr. Plunkett reduced the passthrough to 80 percent to take value
5 of service into account solely on the following interrogatory response:

6 The use of a 100 percent passthrough reflects my view
7 that these rates ought to reflect, as nearly as is consistent
8 with the statutory ratemaking criteria, the value of the work
9 contributed by mailers and or consolidators performing
10 worksharing activities. In considering the value of service
11 of these particular rate categories, I did not consider the
12 value of service of the worksharing passthroughs apart
13 from the other elements used in rate design. The
14 constraints that I imposed as the final stage in rate design
15 [, which had the effect of reducing the passthrough to 80
16 percent,] were intended to capture value of service
17 considerations, and were applied to the rates themselves,
18 rather than the passthroughs used to develop the rates.
19 Tr. 13/5005-5006 (Plunkett).

20

21 Although Mr. Plunkett could have been clearer in his response, Mr. Luciani's
22 implication that Mr. Plunkett imposed constraints to capture value of service
23 alone is simply wrong. In fact, Mr. Plunkett indicated that he didn't even
24 "consider the value of service...apart from the other elements used in rate
25 design." Tr. 13/5005 (Plunkett).

26

27 Furthermore, Mr. Plunkett's testimony is very clear on the reason why he
28 imposed constraints. Specifically, he stated that he imposed constraints to
29 mitigate rate changes: "Therefore, in the second phase of rate development, I
30 imposed constraints in order to mitigate rate changes. Rates have been
31 constrained such that no rate is allowed to increase by more than 10 percent.
32 Moreover, for the newest rate categories, rate changes were restricted so that no
33 rate could change by more than 2 percent in either direction." USPS-T-36 at 13-
34 14.

35

36 Because I am proposing a DBMC cost avoidance that is smaller than that
37 developed by Ms. Eggleston and used by Mr. Plunkett, mitigating rate changes is

1 much less necessary. Therefore, Mr. Plunkett's logic would argue for passing
2 through significantly more than 80 percent of the DDU cost avoidance should the
3 Commission use the DBMC cost avoidance that I propose.

4 **8. Mr. Luciani's bottom-up model of DDU costs is incorrect. Therefore, his**
5 **related criticism of the Postal Service's rate design approach is irrelevant.**

6 To assess whether the Postal Service's general rate design approach is
7 reasonable, Mr. Luciani attempted to develop a bottom-up DDU cost estimate
8 and then to compare this estimate with the DDU unit cost implicit in Mr. Plunkett's
9 proposed DDU rate. Mr. Luciani apparently believes that if there is a discrepancy
10 between the two estimates then some input into the Postal Service's rate design
11 must be wrong. Tr. 25/11806-11807 (Luciani). While there is a discrepancy
12 between the two estimates, the discrepancy is due to a flaw in Mr. Luciani's
13 model.

14
15 The discrepancy identified by Mr. Luciani is that his bottom-up cost model
16 produces a cost estimate of \$1.14 while he derives a DDU cost of 96 cents from
17 Mr. Plunkett's rate design. Tr. 25/11806 (Luciani). As I discuss in testimony filed
18 under seal, because it discusses evidence filed under seal, the discrepancy
19 vanishes once Mr. Luciani's model is corrected to reflect a mistake he made in
20 estimating rural carrier costs for DDU parcels.

21
22 Once this mistake in Mr. Luciani's model is corrected, the model produces a unit
23 cost for a DDU parcel of approximately 94 cents, two cents less than the unit cost
24 Mr. Luciani derived from Mr. Plunkett's analysis. Tr. 25B/11919-11921 (Luciani).

1 **Exhibit PSA-1A Development of Consistent CRA Adjustment Factor**

2 **(Revised Version of UPS-Luciani-WP-1F)**

3

All Figures are in Test Year Dollars

		Inter-BMC		Intra-BMC		DBMC		TOTAL	CRA	CRA Multiplier
		Machinable	NMO	Machinable	NMO	Machinable	NMO			
Postal Service As Filed										
[1]	Model Weight							100.0%		
[2]	Model Cost	\$/piece								
	Wtd Modeled Cost	\$/piece								1.154
Cost with DDU Sort + Origin AO (Luciani's Estimate)										
	Model Weight							100.0%		
	Model Cost	\$/piece								
[3]	DDU Sort	\$/piece								
[4]	AO Cost	\$/piece								
	Model Cost + DDU Sort + AO	\$/piece								
	Wtd Modeled Cost	\$/piece						0.9581	0.9698	1.012
Cost with DDU Sort + Origin AO and Consistent CRA Costs (Corrected Version of Luciani's Estimate)										
	Model Weight							100.0%		
	Model Cost	\$/piece								
[3]	DDU Sort	\$/piece								
[4]	AO Cost	\$/piece								
	Model Cost + DDU Sort + AO	\$/piece								
	Wtd Modeled Cost	\$/piece						0.9581	1.1134	1.162

Notes:

- [1] USPS Witness Eggleston (USPS-T-26), Attachment A
- [2] USPS Witness Eggleston (USPS-T-26), Attachment A
- [3] The cost of the manual DDU sort is assumed to be the same cost as the manual sort at the DSCF. See USPS Witness Eggleston (USPS-T-26), Attachment A.
- [4] Exhibit UPS-T-5F.
See LR-I-103 for outgoing MODS pool costs.
See UPS-Sellick-WP-3 for outgoing non-MODS pool costs.

4

1 **Exhibit PSA-1B Parcel Post Mail Processing CRA Cost Pools**

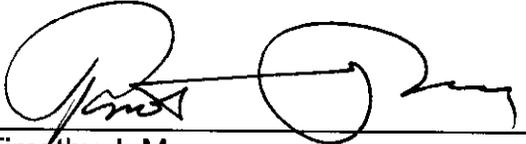
2 **(USPS-T-26, Attachment A at 2 revised to develop CRA adjustment factor using**
 3 **Mr. Luciani's weighted average modeled cost)**

From USPS LR-I-81

Cost Pools		Total (Cents)	Proportional (Cents)	Fixed (Cents)
MODS 11	BCS/	0.004		0.004
MODS 11	OCR/	0.007		0.007
MODS 12	FSM/	0.565		0.565
MODS 12	LSM/	0.000		0.000
MODS 13	MECPARC	0.328	0.328	
MODS 13	SPBS OTH	1.618		1.618
MODS 13	SPBSPRIO	0.347		0.347
MODS 13	1SACKS_M	0.916		0.916
MODS 14	MANF	0.138		0.138
MODS 14	MANL	0.254		0.254
MODS 14	MANP	2.398	2.398	
MODS 14	PRIORITY	0.303		0.303
MODS 15	LD15	0.000		0.000
MODS 17	1BULK PR	0.036		0.036
MODS 17	1CANCMPP	0.240		0.240
MODS 17	1OPBULK	1.357		1.357
MODS 17	1OPREF	2.595		2.595
MODS 17	1PLATFRM	10.853	10.853	
MODS 17	1POUCHNG	2.059		2.059
MODS 17	1SACKS_H	1.938		1.938
MODS 17	1SCAN	0.169		0.169
MODS 18	BUSREPLY	0.245		0.245
MODS 18	EXPRESS	0.011		0.011
MODS 18	MAILGRAM	0.000		
MODS 18	REGISTRY	0.278		0.278
MODS 18	REWRAP	0.231		0.231
MODS 18	1EEQMT	0.178		0.178
MODS 19	INTL	0.841		0.841
MODS 41	LD41	0.011		0.011
MODS 42	LD42	0.000		0.000
MODS 43	LD43	5.411	5.411	
MODS 44	LD44	0.335		0.335
MODS 48	LD48 EXP	0.000	0.000	
MODS 48	LD48_SSV	0.203	0.203	
MODS 49	LD49	0.146		0.146
MODS 79	LD79	0.218	0.218	
MODS 99	1SUPP_F1	0.439		0.439
MODS 99	1SUPP_F4	1.068		1.068
Mods Subtotal		35.741	19.411	16.330
BMCS	NMO	6.682	6.682	
BMCS	OTHR	25.058	25.058	
BMCS	PLA	26.864	26.864	
BMCS	PSM	9.370	9.370	
BMCS	SPB	3.628	3.628	
BMCS	SSM	3.452	3.452	
BMC Subtotal		75.052	75.052	0.000
NON MODS	ALLIED	6.822	6.822	
NON MODS	AUTO/MEC	0.119	0.119	
NON MODS	EXPRESS	0.000	0.000	
NON MODS	MANF	0.199	0.199	
NON MODS	MANL	0.401	0.401	
NON MODS	MANP	8.131	8.131	
NON MODS	MISC	1.179	1.179	
NON MODS	REGISTRY	0.028	0.028	
Non Mods Subtotal		16.877	16.877	0.000
Total		127.670	111.340	16.330

CERTIFICATE OF SERVICE

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



Timothy J. May

Dated: August 14, 2000