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

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

Rebuttal Testimony of

DR. JOHN HALDI

Concerning

STANDARD A ENHANCED CARRIER ROUTE MAIL

on Behalf of

VAL-PAK DIRECT MARKETING SYSTEMS, INC.,
VAL-PAK DEALERS' ASSOCIATION, INC., AND
CAROL WRIGHT PROMOTIONS, INC.

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Carol Wright Promotions, Inc.

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1 reduction in rates for workshared First-Class Mail be funded by
2 increasing the coverage on Standard A Commercial Mail.

3 The positions of witnesses Tye and Clifton are elaborated on in the
4 sections that follow. Both witnesses are seen to have ignored a number
5 of critical reasons why the coverage on Standard A ECR Mail, rather than
6 being increased, should instead be decreased, as is explained in more
7 detail below.

8 **II. WITNESS CLIFTON PREFERS TO SOLVE HIS**
9 **DILEMMA BY INCREASING RATES**
10 **FOR STANDARD A MAIL**

11 Witness Clifton's principal concern is to have the Commission
12 reduce the rate for First-Class workshared mail. His various proposals
13 reduce revenue From First-Class, and he needs some way to offset the
14 revenue loss, which presents something of a dilemma. His main
15 complaint appears to be that the cost coverages and unit contributions
16 accorded to First-Class single-piece mail are too low in comparison to
17 those of First-Class workshared mail. He states, for example:

18 [w]hile First Class workshared mail is supposed to be part of
19 a single First Class letters subclass, it does appear
20 unmistakably that in the growing disparate trends between
21 cost coverages for single piece versus cost shared mail in the
22 allocation of institutional costs, workshared mail is being
23 singled out in an arbitrary and almost punitive way. This is
24 unfair, inequitable, and discriminatory treatment toward the
25 mailers whose substantial investments and ongoing

1 dedication now move 45 billion pieces of First Class Mail
2 through automated processing technology annually.
3 [Tr. 26/12460.]

4 Having said that, however, he stops short of a concrete proposal to
5 shift any part of the institutional burden from First-Class workshared
6 mail to First-Class single-piece mail. Instead, he trains his fire on
7 Standard A Mail.

8 My proposals in total would reduce test year revenue by
9 \$605 million, **and can be financed by a \$232 million**
10 **increase from Standard A revenues**, which also entails a
11 \$373 million reduction in USPS costs. [Tr. 26/12457,
12 emphasis added.]

13 In considering possible offsets to his \$605 million revenue deficit,
14 the primary option witness Clifton offers is to increase rates for Standard
15 A Commercial Mail, with a reduction in the Postal Service's contingency
16 allowance as a secondary option. He expresses no concern with where,
17 from within Standard A Commercial Mail, the additional revenue is
18 derived. His recommendation makes no effort, for example, to
19 distinguish the differences between Standard A ECR and Standard A
20 Regular Mail with respect to cost coverage and unit institutional
21 contribution.

22 The arguments of witness Clifton, insofar as they refer to Standard
23 A ECR Mail, are flawed. For reasons explained below, his arguments do

1 not support any increase in revenue from Standard A Mail, especially
2 ECR Mail.

3 **III. WITNESS TYE HAS A MYOPIC FOCUS ON**
4 **INCREASING COVERAGE AND RATES**
5 **FOR STANDARD A ECR MAIL**

6 One of witness Tye's chief concerns is with increasing the coverage
7 and rates for Standard A ECR. He expresses almost no concern with
8 rates for Standard A Regular Mail, but only with those for ECR. In this
9 respect, his position differs slightly from that of witness Clifton, who
10 appears indifferent as to the Standard A subclass from which additional
11 revenues might be derived.

12 The net effect of witness Tye's proposal, of course, would be to
13 increase the Postal Service's net revenues, as would witness Clifton's
14 proposal for all Standard A Mail. Unlike witness Clifton, however,
15 witness Tye makes no proposal whatsoever regarding how the
16 Commission should apply any increase in net revenue that would result
17 from the changes he advocates. That is, he neither proposes which other
18 subclass(es) should benefit, nor sponsors any specific discount (or any
19 other proposal) within any other subclass that is designed to use any of
20 the additional net revenue that he proposes to generate. Obviously, a
21 key objective of witness Tye is merely to drive up ECR rates.

1 Among the arguments used in an effort to justify his position,
2 witness Tye compares the unit contribution of Standard A ECR with that
3 of First-Class Mail, and he complains that the former is too low. Tr.
4 30/14730-14732. In this respect, his argument has general similarity
5 with that of witness Clifton, and it is addressed in Section V, *infra*.

6 Witness Tye offers a number of additional arguments for increasing
7 the coverage on Standard A ECR, which can be summarized as follows:

- 8 ● **Ignorance:** USPS witness Mayes did not know
9 that she was proposing a [slight] decline in the
10 coverage of ECR mail. Tr. 30/14215-7.
- 11 ● **Rate design anomalies and distortions:** A
12 general increase in rates is a good way to cure
13 rate design anomalies. Tr. 30/14717-21.
- 14 ● **Compartmentalization [and circularity]:**
15 USPS witness Mayes blames USPS witness
16 Moeller, who in turn blames USPS witness
17 Mayes. Tr. 30/14721-3.
- 18 ● **Subjectivity:** USPS witness Mayes had no
19 objective reason to do what she did.
20 Tr. 30/14723-5.
- 21 ● **Forecasting flaws:** The method used by the
22 Postal Service and the Commission to project
23 after-rates volumes from before-rates volumes
24 can produce anomalous results and
25 overestimate net revenues. Tr. 30/14725-30.

26 These flawed arguments, which do not justify the solution
27 proposed by witness Tye, will be addressed in subsequent sections.

1 **IV. THE ARGUMENTS OF WITNESSES CLIFTON AND TYE**
2 **IGNORE KEY DIFFERENCES BETWEEN**
3 **FIRST-CLASS AND STANDARD A MAIL**

4 Witness Clifton's direct testimony states that:

5 [a]s a percentage of the total costs for a postal service,
6 delivery costs have the lowest degree of attribution of the
7 four major services in FY 1999 nearly 49% were
8 institutional. Because cost coverages are...determined by a
9 single mark-up over the attributable costs of all services,
10 First Class Mail ... has been shouldering **an extremely**
11 **unfair share** of institutional delivery costs for several years,
12 while Standard A mail **has unfairly benefited** from this cost
13 coverage convention.... This gaping issue has been around
14 for a long time. It was raised by NAA witness Sharon Chown
15 in R97-1, and also in R90-1. [Tr. 26/12460-12462,
16 emphasis added.]

17 This argument obviously goes to the non-cost fairness and equity
18 criterion contained in § 3622(b)(1) of the Postal Reorganization Act. A
19 comparison between the respective unit contributions by First-Class Mail
20 and Standard A Mail, as suggested by witness Clifton in the above
21 quotation, may appear straightforward. In my opinion, however, it is
22 overly simplistic and it clearly ignores a number of critical issues that
23 need to be considered, as the following sections explain.

24 **A. Standard A Mail Has a Decidedly Lower**
25 **Service Standard Than First-Class Mail**

26 The service standards for First-Class and Standard A Mail are
27 contained in the Postal Service's response to the Commission's Rule
28 54(n). First-Class Mail is generally considered to be "urgent" matter, and

1 the delivery standard for First-Class Mail ranges from overnight to 3
2 days, depending upon distance. First-Class Mail is transported by air
3 whenever the distance to be traveled warrants. First-Class Mail has
4 access to the collection system, and it receives free forwarding or return
5 service.

6 Standard A Commercial Mail consists largely of advertising matter.
7 It is considered to be non-urgent, and uses surface transportation almost
8 exclusively. Standard A Mail has a delivery standard that ranges between
9 2-10 days, depending upon the distance that the mail needs to travel.
10 Neither witness Clifton nor witness Tye mentions this difference, even
11 though it reflects value of service, one of the criteria in § 3622(b).

12 **B. Actual Performance for Standard A Mail, Although**
13 **Unmeasured, Is Far Less Reliable Than First-Class Mail**

14 All Standard A Mail is subject to deferral at each stage of
15 processing and delivery. Standard A Mail that is entered upstream of
16 any destinating facility runs a risk of being deferred, perhaps for an
17 extensive period, and most especially if it is used to level Postal Service
18 workloads during busy periods. Unfortunately, no systematic
19 performance data of any kind are available for Standard A Mail, despite
20 the fact that on several occasions the Postal Service has expressed its
21 intentions to initiate an end-to-end measurement system for Standard

1 A.¹ Consequently, no data are available for the percentage of time that
2 Standard A Mail is delivered within the standard shown in the response
3 to Rule 54(n).

4 Also, for Standard A Mail that fails to make the delivery standard
5 set forth in the Postal Service Rule 54(n) statement, no data are available
6 for the number of days by which the standard is missed. Although
7 Standard A Mail not delivered within the period specified in the Rule
8 54(n) statement is usually late, it can be and sometimes is delivered
9 ahead of the day specified. Although such "outstanding" performance
10 apparently occurs rarely, its principal effect is only to increase the
11 variation and uncertainty for those endeavoring to plan based on the
12 estimated time of the mail's arrival.

13 On the basis of reports received from Standard A mailers over the
14 years, it would appear that the amount of time required to deliver
15 Standard A Mail can be and is subject to a wide range of uncertainty.²
16 Moreover, the further upstream in the postal network that mail is

¹ The availability of independently measured and regularly reported end-to-end performance data for First-Class Mail ("EXFC"), coupled with the fact that no performance data of any kind is available for Standard A Mail, enhances the value of service of First-Class Mail relative to Standard A Mail.

² For Standard A Mail that must travel long distances, between 15 and 20 days to delivery is not unheard of.

1 entered, the less certain is the time when final delivery will occur.³
2 Under the existing six days per week delivery system, mailers can neither
3 predict with any accuracy when their mail **will arrive**, nor do they have
4 any assurance that it **will not arrive** on some specified day. In their
5 comparison of coverages, neither witness Clifton nor witness Tye
6 discusses the poor and uncertain performance received by Standard A
7 Mail, and the low value of service in comparison to First-Class Mail.

8 **C. Standard A Mail Needs Day-Certain Delivery Far**
9 **More Than Irregular Six-Days-a-Week Delivery**

10 The knowledge that (i) delivery of Standard A Mail in accordance
11 with the Rule 54(n) statement can range from 2 to 10 days, and (ii) actual
12 delivery is routinely subject to much wider variation and
13 unpredictability, should help one to understand why Standard A Mail
14 would benefit far more from an alternate delivery system that offered
15 non-daily, but day-certain delivery than it does from a postal system that
16 provides highly unpredictable delivery 6 days a week. Direct mail
17 advertising campaigns are planned well in advance. Often, a direct mail
18 campaign is timed to coincide with other sales promotions, such as
19 advertising on television or radio. When this occurs, delivery on a
20 specified day, or within a narrow window, becomes increasingly

³ By itself, consideration of this extensive uncertainty markedly reduces the value of service, thereby offsetting the fairness and equity argument.

1 important. Because of the long lead time involved in direct mail
2 advertising campaigns, mailers could readily accommodate to an
3 alternate postal system that provided day-certain delivery on only 3 or 2
4 days per week – or perhaps even only 1 day per week.

5 The arguments of witnesses Clifton and Tye both appear to make
6 the implicit assumption that Standard A Mail requires delivery 6 days a
7 week. To the extent that this is their view, I disagree. Such delivery
8 requirements apply to First-Class Mail and Periodical Mail with high
9 frequency of publication (*e.g.*, daily newspapers most especially, as well
10 as semi-weekly or weekly publications), not Standard A Mail. As
11 explained below, this is an extremely important factor to keep in mind
12 when comparing the contribution of Standard A Commercial Mail with
13 that paid by First-Class Mail.

14 **D. The Substantial Contribution to the Postal Service's**
15 **Institutional Cost by Standard A Commercial Mail**
16 **Reduces the Costs for Other Subclasses**

17 Witness Clifton acknowledges that the contribution to the Postal
18 Service's institutional cost by Standard A Commercial Mail exceeded
19 volume variable costs by \$5,035 and \$4,576 million in FY 1998 and FY
20 1999, respectively (Table 13). Tr. 26/12461. However, witnesses Clifton
21 and Tye, each for their own reason, assert that the contribution from
22 Standard A Commercial Mail should be still higher.

1 Given the magnitude of the contribution to institutional cost, a few
2 things seem clear. First, revenues from Standard A Commercial Mail
3 exceed incremental cost by a substantial margin, hence Standard A Mail
4 is clearly not the recipient of any cross-subsidy.⁴ Second, without
5 Standard A Commercial Mail, other subclasses would have to bear more
6 costs and pay a higher rate than they do now. In FY 1998, for example,
7 excluding the volume of Standard A Commercial Mail (69.4 billion
8 pieces), the remaining volume of domestic mail amounted to 127.6 billion
9 pieces (all other subclasses combined). Had those other pieces been
10 required to pay the \$5.035 billion that Standard A Commercial
11 contributed to institutional costs in FY 1998, an additional revenue of
12 3.9 cents per piece would have been required. But that is not the end of
13 the story.

14 **E. A Separate Delivery System for Standard A Mail**
15 **Could Have a Lower Stand-alone Cost**

16 Of all Standard A Commercial Mail, the portion most subject to
17 competition at the present time is saturation ECR. The major source of
18 competition is from newspaper inserts. These can be of any weight.
19 Based on casual observation, however, they usually are not too heavy;

⁴ Witness Clifton minimizes the role of the incremental cost test, stating that "[i]n my own view, the Postal Service's development of an elaborate incremental cost test for cross-subsidization has been in part a chimera designed to take the focus off this specific issue [the contribution to institutional cost]." Tr. 26/12462.

1 *e.g.*, some inserts are one or two sheets, such as coupons, and most of
2 the newspaper inserts which I see would appear to weigh less than 3
3 ounces. The volume of newspaper inserts grew from 56.0 billion in 1990
4 to 82.0 billion in 1997, which is considerably greater than the volume of
5 ECR mail, and somewhat greater than the combined volume of all
6 Standard A Commercial Mail.⁵ Newspaper inserts, of course, are the
7 special concern of witness Tye.

8 Alternate delivery companies also compete with ECR.⁶ Although
9 alternate delivery of hard-copy advertising materials is small compared to
10 the volume of newspaper inserts or Standard A Commercial Mail, it does
11 exist. Alternate delivery companies generally provide each address in the
12 area which they cover with delivery service only a limited number of days
13 per week.

14 Any critique that would compare the appropriate contribution of
15 Standard A Commercial Mail with that of First-Class Mail should

⁵ NAA Institutional response to VP-CW/NAA-T1-11, and the web site referenced therein. Tr. __/____. During the years 1990-1997 the newspaper insert business has handily survived competition from Standard A ECR (formerly third-class carrier route presort), as evidenced by the 46 percent growth in volume between 1990-1997. According to that response, data for 1998 and 1999 are expected to be posted on the web site some time during September, 2000.

⁶ See testimony of John White, AAPS-T-1, Harry J. Buckel, SMC-T-1, and Roger Merriman, SMC-T-2; Tr. 22/9935-62, 22/9903-17, and 32/15656-69, respectively.

1 consider the stand-alone cost of a separate alternate delivery system
2 designed to handle primarily (or even exclusively) Standard A Mail.
3 Neither witness Clifton nor witness Tye does so, however. Any such
4 alternate delivery system would reduce delivery costs sharply by
5 providing service only 1, 2, or possibly 3 days per week. Because any
6 such alternate delivery system would focus on advertising mail, it likely
7 would attempt to convert the seeming "weakness" of limited delivery days
8 into a strength by offering day-certain delivery.

9 Contemplation of such an extensive alternate delivery network may
10 at this time represent a hypothetical situation for the United States, but
11 it nevertheless is an important consideration when comparing the
12 fairness and equity of the coverage of Standard A Commercial Mail
13 versus that of First-Class Mail.⁷ The economics of this situation have
14 been explored in a pioneering article by Bernard Roy of La Poste.⁸ In that
15 article he demonstrates that under certain conditions the stand-alone
16 cost of such an alternate delivery system for advertising mail would

⁷ Sweden has completely repealed its monopoly statutes, and the firm of City Mail has for several years competed with Sweden Post to deliver advertising mail. At present, City Mail reportedly provides delivery two days per week in Sweden's three largest cities. Relaxation of the monopoly statutes in other European countries could result in further competition of this sort.

⁸ "Technico-Economic Analysis of the Costs of Outside Work in Postal Delivery," in *Emerging Competition in Postal and Delivery Services*, ed. by Michael A. Crew and Paul R. Kleindorfer. Boston: Kluwer Academic Publishers, 1999.

1 enable the operator to charge rates less than those charged by the
2 incumbent postal administration for delivery six days a week. Broadly,
3 these conditions are as follows:

- 4 ● **Feasibility:** the volume of advertising mail
5 must be sufficient to support an alternate
6 delivery network.
 - 7 ● **Coverage:** the coverage of delivery stops by
8 non-advertising mail on carrier routes is
9 substantially below 100 percent.
 - 10 ● **Rates:** the rates for advertising mail are based
11 on sharing the cost of daily delivery.
- 12 Under the conditions described above, diversion of advertising mail
13 to an alternate delivery system would substantially reduce coverage of
14 delivery stops on routes receiving daily delivery of urgent mail, thereby
15 driving up cost (while reducing revenues), and thereby revealing the
16 extent to which advertising mail has helped reduce the cost for daily
17 delivery of urgent mail. Roy points out that if the stand-alone cost of the
18 alternative delivery operator is less than the amount charged by the
19 incumbent postal administration, then under such circumstances
20 **advertising mail can be seen as being in the position of cross-**
21 **subsidizing some of the cost of daily delivery for urgent (i.e., First-**
22 **Class) mail**, which is totally contrary to the assertions of witnesses
23 Clifton and Tye.

1 The higher the share of advertising mail, the more likely it is that
2 without such mail stop coverage will be reduced on routes that receive
3 daily delivery.⁹ Since Standard A Commercial Mail constituted about 35
4 percent of total domestic U. S. mail volume in 1999, it likely has a
5 significant impact on coverage. Were free competition to be allowed, the
6 Postal Service would be highly vulnerable to “cherry-picking” by new
7 entrants, who would charge a lower rate equal to their stand-alone cost.
8 Is this a possibility? The data in Table 1, below, help put the Postal
9 Service’s current situation in perspective.

10 As shown in column 1 of Table 1, in FY 1999 the Postal Service’s
11 total delivery costs (city and rural carriers combined) amounted to some
12 \$16.5 billion. Of this amount, slightly over \$2.8 billion represented
13 volume variable costs charged to Standard A Commercial Mail. In
14 addition, Standard A Commercial Mail contributed \$4.6 billion to the
15 Postal Service’s institutional cost.

⁹ See the article by Roy, footnote 7, *supra*, for a more complete and technical discussion of the conditions.

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Table 1			
Volume Variable Delivery Costs			
FY 1999, millions			
	(1)	(2)	
	All Mail	Standard A	Commercial
City Carriers, cost segments 6 & 7	\$ 12,639	\$ 2,089	
Rural Carriers, cost segment 10	<u>3,892</u>	<u>746</u>	
Total	\$ <u>16,531</u>	\$ <u>2,835</u>	
One-sixth	\$ 2,755		

Source: Exhibit USPS-ST-44M.

15 How much would it cost to operate an alternate nationwide
16 delivery network to every business and residence in the country 1 or 2
17 days per week? As shown in the bottom row of Table 1, one-sixth of
18 \$16.5 billion amounts to some \$2.755 billion.¹⁰ Thus, the amount for 1
19 day per week universal delivery is just slightly less than the volume
20 variable cost charged to Standard A Commercial Mail for delivery. For

¹⁰ Note that this is one-sixth of the Postal Service's total cost for city and rural carriers; *i.e.*, it assumes that an alternate delivery company would pay the same wage rate (including benefits) as the Postal Service and provide service as universal as that provided by the Postal Service. Further, carrier costs shown in Table 1 include some amount for unfunded pension liability that is also included in the \$2.755 billion.

1 universal delivery 2 days per week, one-third of the total cost amounts to
2 about \$5.5 billion. Although this amounts to somewhat more than the
3 volume variable delivery cost charged to Standard A Commercial Mail, it
4 is almost \$2 billion less than \$7.4 billion, the sum of volume variable
5 delivery cost (\$2.8 billion) plus contribution to overhead (\$4.6 billion).
6 Although by no means definitive, these numbers would suggest that the
7 revenues from Standard A Commercial Mail are already more than
8 sufficient to support a universal stand-alone alternate delivery system.¹¹

9 The testimonies of witnesses Clifton and Tye fail to address the
10 possibility that daily delivery of First-Class mail may be cross-subsidized
11 by Standard A Commercial Mail, especially Standard A ECR Mail.

12 Neither the testimony of witness Clifton nor that of witness Tye gives any
13 consideration to the various factors, discussed above, which indicate that
14 Standard A Commercial Mail would be better off with day-certain delivery
15 of, say, 2 days per week. Nor do they consider the stand-alone cost of
16 such an alternate delivery system. If Standard A Mail is cross-
17 subsidizing daily delivery by virtue of paying rates higher than those
18 necessary to support a stand-alone system, the consequence is that the

¹¹ If an alternate delivery system were to provide less than universal service — *i.e.*, cherry-pick the areas to be served — the cost of 2-day per week delivery would likely be substantially less.

1 rates for Standard A ECR Mail should be reduced, not increased,
2 contrary to the assertions of witnesses Clifton and Tye.

3 Increasing the coverage and rates for Standard A ECR Mail
4 increases the potential profitability for would-be entrants to the hard-
5 copy delivery business. Successful establishment of alternate delivery
6 could have the effect of diverting large volumes of advertising mail (and
7 potentially, Periodicals as well) from the Postal Service and (i) driving up
8 rates for First-Class Mail, contrary to the result desired by witness
9 Clifton, and (ii) reducing the rates for independent delivery of advertising
10 mail, thereby intensifying the competition for newspaper inserts,
11 contrary to the result desired by witness Tye. As the familiar saying
12 goes, people should be careful about what they ask for, because they just
13 might get it.

14 **V. WITNESSES CLIFTON AND TYE FAIL TO**
15 **DISTINGUISH PROPERLY BETWEEN**
16 **STANDARD A ECR AND REGULAR**
17 **WITH RESPECT TO COVERAGE**

18 Witnesses Clifton and Tye both raise the same issue: if a highly
19 workshared subclass has a coverage near the systemwide average, then
20 its unit contribution could be less than that of subclasses which use the
21 postal network more extensively. Witness Clifton (Tr. 26/12461) focuses

on the non-attributed (institutional) portion of delivery cost and offers comparisons between:

- All First-Class Mail and Commercial Standard A;
- First-Class workshared mail and Commercial Standard A; and
- First-Class workshared mail and First-Class single-piece mail.

And in a similar vein, witness Tye states:

It is important to consider unit contributions. First, they highlight the actual contribution being made by the average piece. **This can facilitate comparison among similar subclasses.** Second, unlike cost coverage percentages, unit contributions are not distorted by the differing degrees of worksharing among the various subclasses. [Tr. 30/14732, emphasis added.]

A. Comparisons Between the Two Standard A Subclasses

The unit contributions of Standard A ECR and Standard A Regular are compared in my direct testimony on Standard A ECR Mail.¹² As pointed out there, the unit contribution of ECR persistently exceeds that of Standard A Regular. The Postal Service spends almost twice as much for a piece of Standard A Regular Mail as it does for a piece of ECR mail, but it earns a lower unit contribution. Thus, any comparison between the two subclasses of Standard A, such as that advocated in witness

¹² See VP/CW-T-1, pp. 38-53, Tr. 32/15792-15807.

1 Tye's testimony, would support a reduction in the unit contribution of
2 ECR and directly undercuts witness Tye's position.

3 Since a key purpose of witness Tye's testimony is to increase rates
4 for Standard A ECR, he strives to avoid any such comparison. When
5 asked repeatedly how he defined "similar subclasses," or whether he
6 considered Standard A Regular and Standard A ECR to be similar
7 subclasses, he declined to provide a responsive answer. Tr. 30/14844-
8 45, 14859-60, 14889-91, and 14970-90. However, witness Tye does
9 agree that "[i]f the applicable avoided costs from worksharing are
10 correctly calculated and if passthroughs are set to 100 percent, and all
11 else is equal, then the unit contributions would be equal." Tr. 30/14863.
12 That is, the unit contribution on Standard A ECR should be reduced, not
13 increased.

14 **B. Comparisons Between First-Class and Standard A Mail**

15 Witness Clifton compares the unit contribution to institutional cost
16 of First-Class and Standard A Mail as follows:

17 [t]he cost coverage for First Class workshared mail has
18 become highly discriminatory since 1994 relative to
19 Standard A commercial mail and First Class single piece
20 mail, and should be reduced. [Tr. 26/12458, underlining
21 and capitalization omitted.]

22 Witness Clifton (i) compares coverages of different subclasses with
23 virtually no reference to the non-cost criteria in § 3622(b), which underlie

1 all cost coverages, and (ii) ignores the fact that Standard A mail may
2 already be in the position of cross-subsidizing daily delivery of First-
3 Class Mail, as discussed above.

4 In addition, much of witness Clifton's core argument on behalf of
5 First-Class workshared mail is equally applicable to Standard A ECR
6 Mail because the cost coverage of Standard A ECR is among the highest
7 of any subclass. Yet, in proposing an across-the-board rate increase for
8 Standard A Commercial Mail, witness Clifton would impose a rate
9 increase on Standard A ECR, notwithstanding that the latter is in a
10 highly analogous situation to that which he describes for First-Class
11 workshared mail.¹³ In effect, witness Clifton proposes to remedy one
12 perceived inequity (affecting First-Class workshared mail), which he
13 roundly denounces, by exacerbating another, closely comparable,
14 inequity (pertaining to Standard A ECR mail).

15 Witness Tye, for his part, draws on the following old chestnut:
16 the by now generally accepted principle that heavily work-
17 shared subclasses will have high cost coverages precisely
18 because of the cost avoidance from worksharing. [NAA-T-1,
19 p. 3; *see also* pp. 24, 40-42, 51].

20 Like witness Clifton, witness Tye would also (i) compare coverages
21 of different subclasses with virtually no reference to the non-cost criteria

¹³ The excessively high coverage of ECR is discussed in detail in my testimony, VP/CW-T-1, 38-47. Tr. 32/15792-15801.

1 in § 3622(b), and (ii) ignore the fact that Standard A commercial mail,
2 and most especially the ECR subclass, may already be in the position of
3 cross-subsidizing daily delivery of First-Class Mail, as discussed above.

4 **VI. WITNESS TYE'S CONCERN ABOUT A REVENUE SHORTFALL**
5 **ARISING FROM THE BEFORE AND AFTER RATES**
6 **VOLUME FORECASTING METHOD RAISES AN**
7 **OLD ISSUE, PROVIDING NO BASIS**
8 **FOR IMPROVEMENT**

9 Witness Tye asserts that the Postal Service has overstated Test
10 Year ECR revenues. He explains that this occurs because the Postal
11 Service ignored likely shifts in the billing determinants in the Test Year
12 due to changes in rate design. Tr. 30/14726. In particular, he discusses
13 the fact that rates for some categories of Standard A ECR Mail increase
14 while others decline. According to witness Tye, the after-rates volumes
15 are derived from a two-step process used by both the Postal Service and
16 the Commission that:

17 results in perverse upward-sloping demand curves for some
18 rate groups. Basic economic principles state that as prices
19 (rates) increase, quantity (volume) should decrease. This is
20 not always the case in Postal Service predictions.... Such
21 results indicate that the volume forecasting model is not
22 fully compatible with the rate proposal. [Tr. 30/14728-29.]

23 Witness Tye proposes no solution for the issue that he identifies —
24 *i.e.*, developing a more accurate forecast of after rates volumes for each
25 rate category (or rate cell). His observations and comments are not new.

1 In Docket No. R97-1, virtually the identical issue was raised in
2 conjunction with Priority Mail, along with a proposed solution.

3 The Commission rejected the solution proposed for Priority Mail, in
4 part because the "method does not exactly reproduce the aggregate
5 volume forecasts that the Commission derives from witness Musgrave's
6 econometric model and forecasting methodology."¹⁴ The Commission
7 went on to add that more research on the issue is needed, and it invited
8 "the Postal Service and other parties to conduct empirical studies and to
9 suggest improvements to the two-step process" relied upon by the
10 Commission.

11 Witness Tye apparently has not conducted any empirical research
12 on the issue that he identifies. He does state that:

13 [w]itness Moeller's method of using "before rates" billing
14 determinants to calculate the percentage rate increase is to
15 *overestimate* the actual percentage rate increase in rates that
16 will be realized by the rate proposals, as it does not account
17 for the shift in volumes in response to relative price changes.
18 This is an example of a well-known problem in index
19 numbers. [Tr. 30/14730, *emphasis in original*, footnote
20 omitted.]

21 Since witness Tye identifies the situation as an example of a well-
22 known problem, it presumably has a well-known solution. It is therefore
23 regrettable that witness Tye does not indicate how that solution might be

¹⁴ See Docket No. R97-1, *Op. & Rec. Dec.*, App. H, pp. 7-10.

1 employed to improve the forecasting methodology relied upon by the
2 Commission. It may well be possible to improve the existing forecasting
3 methodology. In the absence of such constructive input, however,
4 witness Tye's criticisms are to little avail. For now, the Postal Service's
5 revenue projections must be relied upon.

6 **VII. WITNESS TYE'S CONCERNS ABOUT ANOMALIES**
7 **AND DISTORTIONS IN RATE DESIGN FOR**
8 **STANDARD A MAIL APPEAR DISINGENUOUS**

9 Witness Tye expresses concern about what he describes as
10 anomalies and distortions in the design of rates for Standard A Mail.

11 Tr. 30/14717-14721. For Standard A Regular Mail he provides details
12 on 10 passthrough categories, and states that:

13 [i]t is clear that the Regular Mail passthroughs are driven –
14 understandably – by the desire to have qualified letter mail
15 submitted at Regular automation rates rather than ECR
16 Basic rates. **This leads to passthroughs that vary**
17 **considerably from the optimal.** [Tr. 30/14719, emphasis
18 added.]

19 His concerns appear misplaced for a number of reasons. First, his
20 testimony does not carry through with his expressed concern for
21 developing optimal passthroughs. He presents a rather detailed critique
22 of the passthroughs in Standard A Regular (Tr. 30/14718), but makes no
23 proposal on how they should be improved. When asked why he did not
24 compare the Test Year contributions of Standard A Regular as proposed

1 by the Postal Service along with those of ECR and First-Class Mail
2 presented at page 41 of his testimony (Tr. 30/14731), witness Tye
3 responded "[o]ptimal rates for Standard A Regular mail are outside the
4 scope of my testimony." Tr. 30/14860. Nor does he present a set of
5 rates for Standard A ECR mail that he considers optimal. Were he
6 seriously concerned about anomalies and distortions, he should have
7 submitted a proposal designed to improve matters.

8 Second, desired incentives for Standard A ECR, including the
9 desired relationship with the rate for Standard A Basic Automation
10 letters, are achieved both in the rate designs proposed by Postal Service
11 witness Moeller (USPS-T-34) and in my direct testimony (VP/CW-T-1¹⁵).

12 Third, since new rates were implemented on January 1, 1999, the
13 volume of ECR Basic non-automated letters has already declined
14 substantially, from 7.2 billion in FY 1998 to 5.6 billion in FY 1999, a
15 year-to-year reduction of some 22 percent.¹⁶

16 Fourth, the desire to have qualified letter mail submitted at
17 Regular automation rates rather than ECR Basic rates is not such an
18 overriding objective as to warrant changes in rate level as proposed by

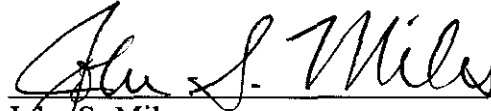
¹⁵ Tr. 32/15808-10.

¹⁶ USPS-LR-I-125 and USPS-LR-I-259, respectively. Since the higher rates were only in effect for nine months of FY 1999, a comparison of the last nine months of each respective year may reflect a reduction of more than 22 percent.

1 witness Tye. In FY 1999 the contribution by Standard A ECR (in excess
2 of volume variable cost) exceeded that of Regular by some \$408 million,
3 despite the fact that the volume of Regular was some 19 percent greater,
4 and the total volume variable costs for Regular exceeded those of ECR by
5 150 percent. Standard A ECR is a far more profitable subclass than
6 Standard A Regular. Further, both at current rates and at proposed
7 rates, ECR Basic letter mail is highly profitable to the Postal Service. It
8 makes no sense to offer such a classification (which also happens to be
9 widely popular), and then inflate the rate out of all proportion to the cost,
10 in some misguided effort to eliminate it as a category.

CERTIFICATE OF SERVICE

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



John S. Miles

August 14, 2000