

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**INITIAL BRIEF
OF THE
SATURATION MAIL COALITION**

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The Saturation Mail Coalition hereby submits this Initial Brief to the Commission in this proceeding.

STATEMENT OF POSITION

It is the position of the Saturation Mail Coalition that:

- The Postal Service's proposed rates for Standard A Enhanced Carrier Route (ECR) mail are reasonable, prudent, and satisfy the statutory criteria of the Act.
 - Reasonable and affordable rates for ECR saturation mail produce important benefits to mail users (particularly small businesses), consumers, and the economy, and preserve viable and beneficial competition.
 - Absent reasonable, cost-based rates, saturation mail and the valuable contribution it provides to institutional costs would be at risk, to the detriment of mail users and the postal system.
- The Postal Service's proposed rate levels and rate structure for the ECR subclass are reasonable and well supported.
 - The moderate reduction in the excessive ECR pound rate still overcharges pound-rated mail in relation to weight-related costs, but is a needed step in the right direction.
 - The letter/flat rate differentials for high density and saturation ECR mail are cost-based and reasonable (but high because of their interrelationship with the pound rate).
- The Postal Service's treatment of city delivery carrier load time costs is flawed and substantially overstates ECR attributable costs. (This costing issues is addressed in the Initial Joint Brief of Advo, et al. Concerning Attribution of City Carrier Delivery Costs).

INTRODUCTION AND SUMMARY OF ARGUMENT

The Saturation Mail Coalition (SMC) intervened in this proceeding to support the rates proposed by the Postal Service for the Enhanced Carrier Route (ECR) subclass. The Postal Service's proposal, if recommended by the Postal Rate Commission, will establish postal rates that are more cost-based, and that will reflect the greater price sensitivity of saturation mail and the competitive realities of the marketplace for advertising materials.¹

This is now the third proceeding where the Postal Service has proposed a reduction in the pound rate for ECR mail. Its proposed reduction here is much more modest than that proposed in Dockets MC95-1 and R97-1.

On the evidentiary record in this case, it is incontrovertible that the current pound rate substantially exceeds the weight-related costs of ECR mail. The excessiveness of the pound rate is obvious on its face, even without a formal "cost study." For saturation mail, a doubling of weight results in a near doubling (98% increase) of the postage rate. The postage for *two* 4-ounce pieces is only 0.3¢ greater than the postage for a *single* 8-ounce piece. Although we believe that the cost evidence supporting a lower pound rate in those earlier proceedings was compelling, the evidence submitted in this case, both by the Postal Service and by intervenors, is even more convincing. USPS witness Daniel's analysis of cost data by ounce increment improves upon the earlier analyses

¹ Although the SMC supports the specific ECR rates proposed by the Postal Service, there are several costing and pricing aspects underlying those rates with which the SMC disagrees:

- City delivery carrier load costs are substantially overstated, for the reasons set forth in the Joint Initial Brief of Advo, et al., cited above.
- The letter-nonletter rate differential is intended to reflect cost differences due to shape. However, because the USPS letter-nonletter cost differential reflects the cost effects of not just shape but also weight, a full passthrough of that difference results in an excessive letter-nonletter rate differential.
- The cost coverage assigned to the Standard A ECR subclass is excessive, for the reasons set forth by Mail Order Association of America and Val-Pak/Carol Wright.

and employs conservative assumptions that address the Commission's criticisms in Docket R97-1. A number of other witnesses -- including Advo witness Crowder, MOAA witness Prescott, and USPS witnesses Moeller, O'Hara, Kay, and Bozzo -- have thoroughly addressed every costing and pricing issue raised either by the Commission in R97-1 or by the pound rate opponents here. Their testimony demonstrates beyond question that the current pound rate is excessive; and that even the proposed pound rate far exceeds weight-related costs and is a conservative move in the right direction.

Testimony addressing the marketplace and competition implications of the pound rate has been presented by SMC witnesses Buckel, Merriman, Giuliano and Bradpiece. In addition, the testimony of PostCom witness Harding (Chairman and CEO of Newspaper Services of America) brings a fresh and unique perspective on the importance of a lower pound rate -- from the vantage point of an expert in the print advertising distribution market whose business is representing the interests of the advertisers in their selection among the distribution choices, including newspapers, mail, and private delivery. The testimony of these witnesses demonstrates that the high pound rate has distorted the marketplace, impaired the competitiveness of saturation mail, and created a growing threat of diversion to private delivery. This testimony also shows that the lower pound will enhance, not impair, competition.

A troubling aspect of the past two Commission decisions on the pound rate is the failure to address important arguments and analyses that strongly support a lower pound rate. These points have been ignored by the opponents, as well. We have attempted in this brief to specifically highlight these unanswered justifications for a lower pound rate to ensure that they not be overlooked again.

ARGUMENT

I. SATURATION MAIL MAKES A MAJOR CONTRIBUTION TO INSTITUTIONAL COSTS AND PROVIDES A VALUABLE SERVICE TO SMALL BUSINESSES AND CONSUMERS.

A. Saturation Mail's Valuable Contribution to Institutional Costs.

ECR saturation mail is an important but vulnerable segment of the postal mailstream. Even as a rate category within the Bulk Rate Regular subclass before reclassification, carrier route mail had one of the highest implicit institutional cost coverages of any mail category and generated a high unit contribution to institutional costs. Although one of the reclassification objectives in establishing ECR mail as a separate subclass was better recognition of the high price sensitivity of this mail in setting rates, ECR mail continues to have one of the highest institutional cost coverages of any subclass and a high unit contribution.

At the Postal Service's proposed rates, ECR mail will make an average contribution of 8.2¢ per piece with a cost coverage of 209 percent. USPS-14M. This is higher than that for the Standard A Regular subclass (a 7.5¢ unit contribution and 133 percent cost coverage). *Id.* Saturation mail has the highest cost coverage within ECR mail. As shown by Advo witness Crowder, saturation nonletters, in particular, have both the highest unit contribution (8.7¢) and implicit cost coverage (263%) of any ECR mail category. See Tr. 44/19383 , and *infra* at 24.

These figures for ECR, based on the Postal Service's estimated costs and revenues, understate the true contribution at the proposed rates. First, the costs attributed to ECR are overstated (see Joint Initial Brief of Advo, et al., referenced at 1). Second, the Postal Service's projected ECR revenues understate the incremental pound-rate revenues that will be generated by its proposed lower ECR pound rate (*infra* at 25 n. 13).

The valuable contribution to institutional costs made by ECR mail, and especially by the even more price-sensitive saturation portion of ECR, cannot be taken for granted.

Saturation mail offers the best opportunity of any mail category for postal volume and revenue generation to offset competitive and technological inroads in other areas (and to regain former saturation mailers that have shifted to private delivery due to high saturation postage rates). However, saturation mail is also the mail category most at risk of diversion to non-postal delivery alternatives -- either as a result of saturation mailers losing customers to competitors, or saturation mailers themselves leaving the postal system and becoming direct competitors of the Postal Service, as has occurred and will continue to occur unless postal rates are cost-based and reflect the realities of the competitive marketplace.

B. Saturation Mail's Value To Small Businesses And The American Consumer.

In their direct testimony, SMC witness Buckel and AISOP witnesses Baro and Smith stressed the value of saturation mail to consumers. Through their collaborative efforts, mailers working with small business entrepreneurs develop advertising campaigns that bring important shopping information, services, and bargains to American consumers. Through the geographic targetability and coverage of the Postal Service's delivery network, this advertising information provides shoppers with valuable information about goods and services convenient to where they live.

Both Buckel and Baro described the importance of saturation mail to small businesses. Saturation mail serves hundreds of thousands of small retail and service businesses of every description, including individual entrepreneurs and service providers. For most of these small businesses, saturation mail is a vital communications link that enables their businesses to attract customers, and to survive, thrive, and grow. Tr. 22/9917 (Buckel); 30/14374 (Baro).

An excellent example is AISOP witness Richard Smith, who along with his wife runs his single-outlet, family-owned neighborhood grocery store, the Buttercup Dairy. His story of the challenges of running a small business competing with much larger

chains, and the critical need for affordable mail advertising, is compelling. His two messages: "Mail advertising is essential for the survival of small business," and "Our mail advertising is read and welcomed by consumers." AISOP-T-1 at 1, Tr. 30/14529. In addition, mail programs provide an effective means for "value conscious consumers" to comparison shop and find bargains on goods and services in their neighborhoods, which is "a convenience that for many time-pressed consumers is as valuable as a bargain price." Tr. 30/14380 (Baro).

II. MORE RATIONAL SATURATION RATES ARE ESSENTIAL TO DETER FURTHER EROSION OF POSTAL SERVICE ADVERTISING VOLUMES AND REVENUES.

ECR mail as a whole has one of the highest price elasticities of any subclass. Saturation mail is by far the major contributor to this high elasticity, for reasons that have long been well known. If anything, the price sensitivity of saturation mail has grown over the last few years, in large measure due to the high ECR pound rate. As discussed in Section IV, saturation mail has been losing market share because of its lessened ability to compete effectively for traditional preprints weighing more than an ounce. Because of the disparity between the pound rate and the costs of private delivery, private delivery is becoming an increasingly more feasible and attractive alternative. Within the last five years, there have been some significant shifts to private delivery that, although still modest in terms of total ECR volumes, are a clear warning that saturation postal rates are at a critical level. The testimonies of Buckel and Giuliano confirm this high and growing price sensitivity of saturation mail, and the growing risk that this portends for the mailers and the Postal Service, as discussed in Section IV.

NAA and AAPS have always tried to portray the Postal Service's participation in the delivery of advertising materials to American households as a sinister "stealth" plot to drive the newspaper and private delivery industries out of business, and as being

inconsistent with the Postal Service's traditional mission as an agency of the government. The truth is the Postal Service has always been a participant in the market for delivery of advertising materials, going back at least a century. A major part of the Postal Service's function, both historically and today, has been to facilitate commerce and trade through the delivery of all the articles essential to the economy, whether transactions between businesses, or transactions between businesses and consumers. The Postal Service fuels the American economy through the delivery of vital documents, bills and remittances, products like periodicals, books, and parcels, and, yes, even advertising materials to American households.

The Postal Service, in fact, has been losing ground in the important saturation mail product line. Giuliano's rebuttal testimony provides a history of these trends going back to the 1970s. The first business that the Postal Service lost was solo saturation mail distribution of retail preprints as a result of large rate increases in the 1970s. Although solo saturation mail never recovered from high postal rates, the Postal Service and saturation mailers gained ground in the early 1980s after the introduction of carrier route presort discounts and the shared mail concept. But this gain was set back by the large rate increases recommended by the Commission in its Docket R87-1 decision. Saturation volumes again declined and did not recover until the early 1990s. Moreover, the composition of advertising in saturation mail has shifted for the worse. Saturation mail was left with retail preprints under one ounce and single sheet inserts. Due to the high pound rate, saturation mail has been priced out of the market for traditional multi-page preprints. What was once carried abundantly in solo mail in the early 1970s has now been driven out of shared mail. SMC-RT-2 at 7-9, Tr. 44/18993-95.

The reality is that newspaper and *saturation* private delivery distribution of retail advertising preprints is healthy, growing and an increasing threat to advertising materials that are, historically and properly, delivered through the mails. That increasing threat, in part, comes from mailers themselves who are opening their eyes to the

potential of private delivery as an alternative to the Postal Service. Whether that heightened interest is driven by mailers sensing private delivery as an opportunity (such as to cut costs and enhance profitability) or by mailers feeling forced by business necessity to take that route in order to remain viable competitively, the end result is that postal customers will have become competitors, and the Postal Service will have lost that saturation mail's valuable contribution to institutional costs. The only way to prevent further erosion of postal volumes and revenues is to bring postal rates for saturation mail more in line with costs and the marketplace.

III. THE POSTAL SERVICE'S MODEST REDUCTION IN THE ECR POUND RATE IS FULLY SUPPORTED BY COMMON SENSE AND A VARIETY OF SOUND COST ANALYSES.

The Postal Service here, as in Dockets MC95-1 and R97-1, has proposed to reduce the pound rate for ECR mail to bring rates more in line with costs. Its proposal in this docket, in fact, is much more modest than in the prior proceedings. In recognition of the indisputable fact that ECR costs above the breakpoint are not purely weight-related, it proposes to:

- (1) reduce the pound-rate element applicable to pieces above the 3.3-ounce breakpoint from 66.3¢ per pound to 58.4¢ per pound (substantially higher than the 53¢ pound rate proposed in Docket R97-1)
- (2) correspondingly increase the piece-rate element applicable to such pieces. For saturation mail, the piece charge would increase from 0.3¢ to 2.8¢ -- more in line with the piece-related handling costs of the mail.

This is consistent with the fact that the costs of handling different-weight pieces above the breakpoint are not exclusively weight-related, but instead include significant piece-related handling costs. Advo witness Crowder at Tr. 44/19367.

The moderate nature of the USPS proposal is shown in the following table comparing, for the current and proposed saturation mail rates, the percentage change in rates as weight increases above the breakpoint:

Current and Proposed Rates for ECR Saturation Mail

Weight (oz.)	Current Rate (¢)	Rate Increase Compared To A 3.5 oz. Piece	USPS Proposed Rate (¢)	Rate Increase Compared To A 3.5 oz. Piece
3.5	14.8	0%	15.6	0%
7.0	29.3	98%	28.4	82%
10.5	43.8	196%	41.1	164%
14.0	58.3	294%	53.9	246%

Compared to the current rate structure where the rate essentially doubles as weight doubles (a 98% rate increase), the Postal Service's proposal would produce an 82%

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rate increase as weight doubles. This proposed weight-rate relationship would still be quite high -- far higher than the low weight-cost relationship shown on this record -- but it is at least a modest improvement in the right direction.

The opponents of the lower pound rate have assiduously avoided presenting their own analyses of the ECR weight-cost relationship, opting instead to quibble with the analyses presented by USPS witness Daniel. Daniel's analyses, standing alone, provide convincing proof that the pound rate is too high, and that even the lower proposed pound rate far exceeds true weight-related costs. In addition, the record contains four other analyses that demonstrate the excessiveness of the pound rate:

- Advo witness Crowder's demonstration that the current pound rate, on its face, defies common sense: At current rates, the postage for *two* 4-ounce saturation mail pieces is virtually the same as for *one* 8-ounce piece -- grossly undercharging for piece-related handling costs and overcharging for weight-related costs.
- Crowder's analysis of the interrelationship between shape-related and weight-related costs: Because letter-nonletter cost difference includes the effects of both shape- *and* weight-related cost differences, it is interrelated with the pound rate issue. In R97-1, Haldi's analysis of this relationship demonstrated that the even-lower 53¢ proposed pound rate was "conservative" -- a conclusion that is even stronger with respect to the higher pound rate proposed here.
- Crowder's analyses of the average cost differences between letters and flats: Even under the extreme assumption that the entire cost difference between letters and flats is solely weight-related (with zero shape-or piece-related cost differences), the resulting implicit cost per pound would still be substantially less than the current pound rate.
- Crowder's analyses of the cost of flats above the breakpoint: Even under the absurd assumption that the entire cost of flats above the breakpoint is solely weight-related (with zero piece-related costs), the resulting implicit cost per pound would still be substantially less than the current pound rate.

Significantly, because these analyses do not depend upon Daniel's disaggregated unit costs by ounce increment, they are not subject to nit-picks about "tally thinness" or "fluctuations" from ounce to ounce. They provide independent proof that the pound rate is too high.

A. **Even Without A Cost Study, The Current ECR Pound Rate Is Clearly Excessive And Defies Common Sense.**

The opposition to the lower ECR pound rate has an air of unreality to it. The Postal Service has presented an improved weight-cost analysis, using conservative assumptions, that shows that weight-related costs are only a fraction of the current pound rate. The opponents of a lower pound rate, however, do not even attempt to defend the current pound rate as cost based. Nor do they present any alternative cost analyses. Instead, they have narrowly confined their arguments to technical criticisms of Daniel's analysis: quibbling that the IOCS tallies are "too thin," that the unit costs do not align in a perfectly smooth cost curve, that the unit cost jumps for the minuscule volume in the last 15-16 ounce weight increment, or that the IOCS data do not perfectly capture all weight-related costs. As Advo witness Crowder said, this "opposition" is reminiscent of the adage about "not seeing the forest for the trees." Tr. 44/19370.

Rates for saturation mail above the breakpoint are based almost entirely on the pound rate, with a tiny 0.3¢ piece-rate element -- as though costs were almost entirely weight-related with virtually no piece-related cost. Postage nearly doubles as weight doubles. As Crowder points out, it doesn't require cost analyses or testimony from costing experts to know that this counter-intuitive, purely pound-rated structure is non-cost-based and overcharges weight in relation to costs. *Id.*

The opponents of a lower pound rate do *not* contend that the current ECR pound rate and rate structure accurately reflect the true effect of weight on costs. Quite to the contrary, Val-Pak witness Haldi forcefully argues that it does not. He points out that workshared mail has lower weight-related costs than non-workshared mail that goes through more processing steps, and that "ECR mail, by definition requires far more worksharing than Standard A Regular Mail." Tr. 32/15883-84. Accordingly,

"Since the Service has to undertake *substantially more* processing per piece of Regular mail than per piece of ECR mail, I would expect ECR to have a relatively smaller amount of weight-related costs than Standard A Regular." *Id.* at 15884 (emphasis added).

Despite his clear acknowledgment that these “substantial” processing differences warrant a lower pound rate for ECR, Haldi proposes only a token 0.2¢ lower ECR pound rate -- 66.1¢ versus the current 66.3¢ rate -- a “reduction” of only 0.3%.

Haldi’s own arguments and concessions demonstrate conclusively that the ECR pound rate is too high, and that this overcharging for weight is most excessive in the case of ECR Saturation flats, especially those entered at destination delivery units:

- The ECR pound rate itself is too high, as Haldi implicitly acknowledged in his comparison to Standard A Regular mail. Tr. 15884.
- Because weight-related costs avoided due to presorting are not reflected in the ECR saturation discount, heavier weight saturation pieces pay too much in weight-related charges (or in Haldi’s words are “disadvantaged”) compared to lighter weight pieces. Tr. 32/15917-18, 15923-24.
- For the same reason, saturation pieces pay too much in weight-related charges compared to non-saturation pieces. Tr. 19372.
- Because the letter-flat cost differential includes not just shape-related but also weight-related cost differences, “passing through” the entire letter-flat cost differential over-charges flats with weight-related cost differences that are already charged to them through the (itself excessive) pound rate. Conversely, letters are under-charged. Tr. 19373.²

ECR saturation flats thus pay a too-high pound rate to begin with, but then get double-charged for weight with an excessive letter-nonletter rate surcharge, and yet do not get full credit for the weight-related costs avoided due to their finer level of presortation.

Rather than rectify the pound rate now, Haldi and Tye urge that the pound rate remain unchanged until the Postal Service produces a “definitive study” on the weight-

² In cross-examination, Haldi claimed to be “unsure” whether the letter-nonletter cost differential included weight-related cost differences (Tr. 15972-73), but he conceded that, if so, a full passthrough would overcharge nonletters (Tr. 15980-82). In fact, the letter-nonletter cost differential does include weight-related cost differences (Daniel, Tr. 4/1370), and both the Postal Service and Haldi proposed near 100% or higher passthroughs.

cost relationship. However, the excessiveness of the current pound rate can be proved without a "study."

On its face, the ECR pound rate is too high. The clearest demonstration, as Crowder explained, is the current rate for pound-rated saturation nonletters drop shipped to the destination delivery unit.³

"This mail currently pays a tiny piece charge of 0.3¢ per piece, plus a large pound rate of 53.7¢ per pound. The rate for a 4-ounce piece is 13.725¢, while an 8-ounce piece is charged 27.15¢. A doubling of weight thus results in a near doubling (98% increase) of the rate. Viewed another way, the postage for *two* 4-ounce pieces (27.45¢) is only 0.3¢ greater than the postage for a *single* 8-ounce piece (27.15¢)."

For this rate structure to accurately reflect costs, one would have to believe that the piece-related handling cost of these mail pieces is only 0.3¢ per piece, and that *all* of the remaining cost is due solely to weight. Stating the obvious, Crowder concluded:

"[N]o one could possibly contend that the true piece-handling cost is so minuscule, and that all of the rest of the cost of these mail pieces is purely weight-related. The notion that it costs the Postal Service only 0.3¢ more to handle two 4-ounce pieces than one 8-ounce piece is simply inconceivable. It is likewise inconceivable that this mail -- which is dropshipped to the destination delivery unit and thus bypasses substantial weight-related transportation costs -- could possibly have such huge weight-related costs." *Id.*

This comparison demonstrating the absurdity of the current pound rate is not new. Similar or identical comparisons were presented in Dockets MC95-1 and R97-1 (see, e.g., ADVO-RT-1 at 13, Tr. 34/18316, R97-1). In this R2000-1 rate case, USPS witness Moeller has again made the same point about the minuscule 0.3¢ piece charge: it is "illogical that the Postal Service would be that indifferent between processing and delivering two 4-ounce pieces, and one 8-ounce piece." USPS-T-35 at 21-22.

³ ADVO-RT-1 at 6, Tr. 44/19371 (emphasis in original).

Yet over the course of three proceedings, no witness opposing a lower pound rate has addressed this compelling demonstration of the illogic of the high pound rate, much less tried to offer a real-world explanation to support the rationality of such a tiny per-piece charge and large per-pound charge. It is also not addressed in the Commission's MC95-1 and R97-1 opinions. The reason for this silence is obvious: there is *no* plausible operational or cost-related explanation. But as Crowder stated:

"It is a point, however, that cannot continue to be ignored – because it demonstrates, even without the necessity of technical cost studies, that the ECR pound rate is too high and way out of line with any rational expectation of true piece- versus weight-related cost behavior." Tr. 44/19372.

B. Daniel's Improved Analysis Shows That Both The Current And Proposed ECR Pound Rates Are Excessive In Relation To Weight-Related Costs.

USPS witness Daniel has presented a weight-cost study for Standard A mail that improves upon the study presented by witness McGrane in Docket R97-1. In response to the Commission's criticism of McGrane's treatment of elemental load costs in Docket R97-1 (R97-1 Opinion at 402), Daniel assumed for purposes of her analysis that elemental load costs are entirely weight-related -- an extreme assumption that USPS witnesses Kay and Bozzo aptly describe as setting an "upper bound" for the effect of weight on city carrier costs. USPS-RT-13 at 4; USPS-RT-18 at 11-17, Tr. 19474-80. Daniel's analysis also improved the distribution of IOCS mixed mail and not handling tallies, as explained by USPS witness Bozzo. USPS-RT-18 at 2-7, Tr. 19465-70.

In response to interrogatories, Daniel also provided analyses that disaggregated and adjusted her original unit costs to account for differences in other cost-causing factors. Specifically, she provided (1) separate cost data for ECR letters and flats; (2) separate cost data for ECR basic presort flats and high-density/saturation flats; and (3) adjusted unit costs that normalize for differences in destination entry characteristics by

weight increment. Tr. 1209-20; 1351-59. By accounting for these other cost causing characteristics due to differences in shape, presort level, and destination entry, her adjusted unit costs properly isolate the effect of weight.⁴

Like the various studies preceding it, Daniel's analysis shows that costs decline over the first several ounces, then remain relatively constant to five or six ounces, and thereafter gradually rise.⁵ As shown in Chart 1, comparing her aggregated unit costs for all ECR flats with the proposed rates, the slope of the cost curve beyond the breakpoint is nowhere near as steep as even the proposed pound rate. Her disaggregated costs for ECR High Density/Saturation mail, in Chart 2, show an even more dramatic mismatch between the gradual slope of the cost curve and the steep pound rate.⁶

While there are variations from one ounce increment to the next, the overall pattern of gradually rising costs is readily apparent. This is especially obvious for High Density/Saturation mail, where the individual unit costs are closely aligned along a gradual slope over the entire 4-16 ounce range, rising far less steeply than the proposed Saturation DDU rate.⁷

⁴ This refutes NAA witness Tye's claim (Tr. 14777) that her analysis did not control for factors like shape and the level of presorting and drop shipment. He acknowledged in cross-examination that she did adjust for these factors, and he did not present any explanation or analyses to refute her adjustments. Tr. 14874-76.

⁵ The only exception is in the last 15-16 ounce increment where Daniel's unit cost jumps sharply. However, this jump does not occur with ECR High Density/Saturation mail, but is confined to the Regular presort category of ECR. This last increment is discussed later.

⁶ These graphs reproduce ADVO-XE-T35-1, Tr. 3986; and ADVO-XE-T35-2, Tr. 3987. USPS witness Moeller confirmed the accuracy of these comparisons. Tr. 3990.

⁷ Chart II is the same chart that NAA witness Tye characterized in discovery and in cross-examination as showing "rapidly increasing" costs for ECR High Density and Saturation flats. Tr. 14872, 14879-81. When asked whether he would describe the Saturation DDU rate on that chart as "even more rapidly increasing," Tye ducked and said "I would want to run the numbers and take a look and compare the slopes." Tr. 14883-84. Sometimes looks *can* be deceiving, but Chart II does not look to be such a case.

Chart I

Comparison of Proposed ECR Basic and Saturation Flats Rates
With ECR Unit Costs by Ounce Increment

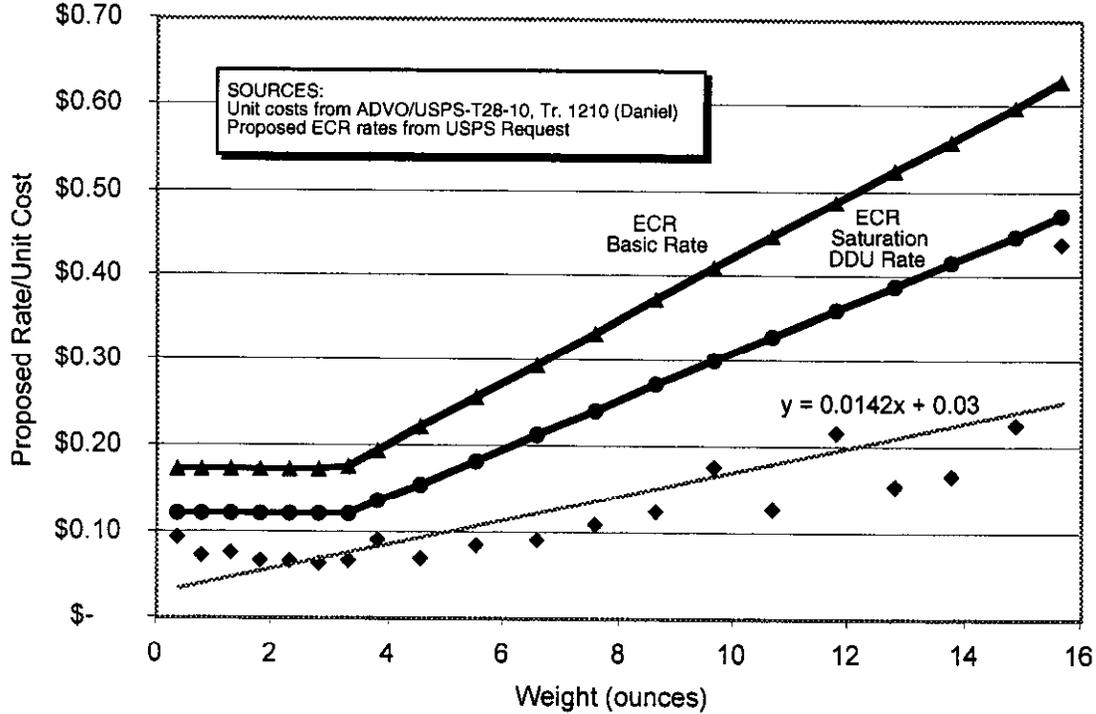
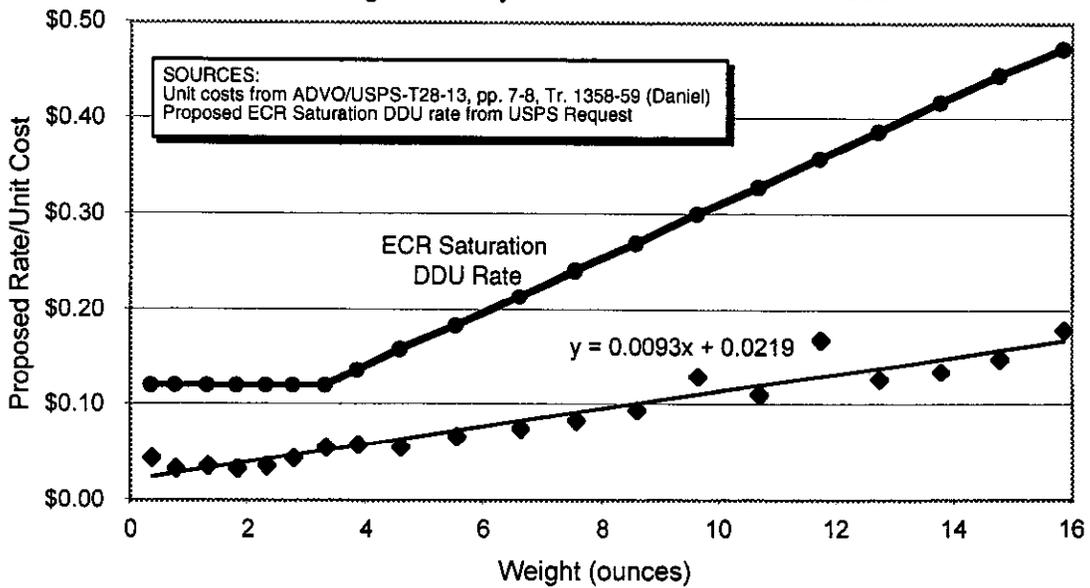


Chart 2

Comparison of Proposed ECR Saturation Flats DDU Rate
with High Density/Saturation Flats Unit Costs



C. The Relationship Between Shape- And Weight-Related Costs And The Letter/Flat Cost Differential Further Proves That The Current Pound Rate Is Greatly Excessive.

One of the most critical factors bearing on the weight-cost relationship is the inter-relationship between shape-related and weight-related costs. Ideally, an estimate of shape-related cost differences between letters and nonletters should reflect only those costs that vary solely with shape, and should exclude any weight-related cost differences. But in fact, as witness Daniel acknowledged, the Postal Service's estimated letter-nonletter cost differential reflects both shape- and weight-related cost differences:

- The letter-nonletter cost differential includes the costs for all flats, both above and below the 3.3-ounce breakpoint;
- Nonletters have an average weight three-times greater than letters (2.9 ounces or more for nonletters, compared to less than 1 ounce for letters); and
- The unit cost differences between letters and nonletters "include not only the effects of shape-related cost differences, *but also* the effects of weight-related cost differences." Tr. 4/1221 (emphasis added).

As Crowder thoroughly explained, this interrelationship further demonstrates that the current ECR pound rate (and even the lower rate proposed by the Postal Service) are excessive in relation to weight-related costs. ADVO-RT-1 at 14-17, Tr. 44/19379-82.

This is another issue that is not new. This interrelationship, and its obvious implications on the pound rate, were addressed extensively on the records in Dockets MC95-1 and R97-1. The opponents of a lower pound rate have persistently chosen to ignore it, and the issue has been overlooked in the Commission's MC95-1 and R97-1 opinions. The background on this issue, however, is illuminating, particularly as it relates to the shifting positions taken by Val-Pak witness Haldi.

In Docket MC95-1, Haldi proposed a larger passthrough of the ECR letter/nonletter cost differential while opposing any reduction in the pound rate -- just like his proposal here. In rebuttal, Crowder demonstrated the major inconsistency in Haldi's

proposal. The letter/nonletter cost differential, based on the *average* cost difference between letters and nonletters, includes the combined effects of both shape *and* weight, not just shape alone. Consequently, Haldi's letter/nonletter rate differential, based on a passthrough of the average cost differential, necessarily overstated shape-related cost differences. MC95-1 Tr. 32/14924-27. Crowder then demonstrated that the Postal Service's proposed lower pound rate substantially exceeded the *maximum* weight-related costs for ECR mail even under the extreme assumption that the *total* average cost difference between ECR letters and nonletters is due *solely* to weight, rather than shape. *Id.* at 14927-29.

In Docket R97-1, Haldi acknowledged this interrelationship between the letter/flat rate differential and the pound rate, and he developed an ECR rate proposal which attempted to avoid this double-counting. He developed two "bottom up" cost scenarios: Case I assumed a high pound cost while Case II assumed a low pound cost. In both cases, the letter-flat cost difference was adjusted to reflect the assumed pound cost.⁸ Although Haldi expressed uncertainty concerning the *precise* effect of weight on costs, he did *not* equivocate in concluding that the Postal Service's proposed 53¢ pound rate (much lower than proposed here) was "conservative."

In response to an AAPS interrogatory, Haldi explained that Moeller's proposed pound rate was "conservative" *because* of this interrelationship between shape- and weight-related costs. He pointed out that "increasing the portion of cost assigned to weight will decrease the per-piece cost of nonletters – and vice versa – but will not affect the unit cost of letters." R97 Tr. 27/15171. At his "moderately high" assumed weight-related cost, the remaining non-weight-related (i.e., shape-related) unit cost for

⁸ The "bottom up" costs he developed in R97-1, and his proposed ECR pound rate of 53.0¢ (well below the 58.4¢ USPS proposal here) were actually based on that analysis. Docket R97-1: VP/CW-T-1 at 10-20, Appendix A, and response to AAPS/VP-CW- T1-2, Tr. 27/15049-59, 15094-125, 15171-72.

saturation nonletters would have been *lower* than that for saturation letters. *Id.* at 15172. Noting that “this result is already hard to swallow” because it would imply a negative shape-related letter/nonletter cost differential, Haldi concluded:

“Using even higher pound rates, *such as those last approved by the Commission*, would cause a further reduction in the unit cost of nonletters below the corresponding cost of letters. In light of these considerations, *I consider witness Moeller’s recommended pound rate to be conservative.*” *Id.* (emphasis added).

Haldi’s R97-1 analysis was thus entirely consistent with Crowder’s conclusion that the Postal Service’s reduced pound rate is still high in relation to true weight-related costs, and that it substantially over-recovers weight-related costs. Haldi effectively conceded that the proposed pound rate alone would more than cover the entire letter/flat cost differential, even without a separate shape-based letter/flat rate differential.

In this Docket 2000-1 proceeding, Haldi appears to have forgotten his prior R97-1 testimony and analysis about the interrelationship between weight-related costs and the letter-nonletter cost differential.⁹ He equivocated on whether this interrelationship, and the resulting overlap between the letter-nonletter cost differential and the weight-related pound costs, exists.¹⁰ Despite his current rate proposal and testimony, Haldi’s R97-1

⁹ At the hearing, Haldi said that he did not believe there is any interrelationship between the letter-flat rate differential and the pound rate, or between the letter-flat cost differential and weight-related cost differences. Tr. 15976-77. He also claimed to have never done any analysis of such interrelationships, and had “never pondered” whether there is a point at which “an assumed pound related cost differential when applied to the volume of letters and flats would result in an imputed letter-flat cost differential that becomes irrational.” Tr. 15977-78. Yet these are precisely the interrelationships and kinds of analyses that he acknowledged and employed in Docket R97-1, in concluding that the proposed 53¢ pound rate was “conservative.”

¹⁰ At the hearing, Haldi agreed that the letter-nonletter cost differential ideally should reflect only shape-related costs, not weight-related costs. Tr. 32/15970. But he claimed not to know whether the USPS letter-nonletter cost differences included the effects of weight-related costs; he was unsure whether the flats costs included all flats up to 16 ounces; and he had assumed the cost differences reflected only shape-related differences (Tr. 15980-82). However, in response to an earlier interrogatory, he confirmed that the flat costs used in his estimates of letter-flat cost differentials included all flats weighing from 0-16 ounces (Tr. 15922), which necessarily means that his cost differentials include the effects of weight as well as shape.

analyses and statements remain true today -- particularly considering that the pound rate reduction proposed in this proceeding is much smaller than the one he demonstrated to be "conservative" in R97-1.

D. Crowder's Analyses Independently Confirm That The Pound Rate Is Excessive In Relation To Costs.

Crowder presented analyses showing that -- no matter how one looks at it -- the effect of weight on ECR costs is only a fraction of the current pound rate.¹¹ Significantly, several of her analyses do not depend on unit cost data by ounce increment, and are therefore not subject to claims about "thinness of tallies."

1. Estimates Based on Cost Differences Between ECR Letters and Nonletters.

As discussed in the previous section, the letter-nonletter cost differential includes the effects of both shape and weight. To further demonstrate the reasonableness of the proposed pound rate, Crowder presented an analysis similar to Haldi's in Docket R97-1, based on this cost differential. She assumed that the *entire* letter-nonletter cost difference was due *solely* to the weight difference between letters and nonletters, with zero shape-related costs. The resulting implied per-pound costs are set forth below:

¹¹ Crowder's analyses included some modifications to Daniel's data. In response to Haldi's criticism, Crowder shifted all volumes and costs of "heavy-weight letters" to the nonletter category, because letters weighing more than the breakpoint weight are treated for rate purposes as nonletters (although Haldi's use of this adjustment to increase the letter-nonletter rate differential is wrong, both in calculation and concept). ADV0-RT-1 at 10, 40, Tr. 19375, 19405. Crowder also corrected rural carrier costs to conform to USPS-LR-I-95.

Implied Per Pound Cost Estimates Assuming
The Letter-Nonletter Cost Difference Is Purely Weight-Related

Letter-Nonletter Differences:	Average Piece Cost Difference	Average Piece Weight Difference	Per Pound Cost Estimate
Basic Rate - Non-Dropship	3.57¢	2.67 oz.	21.42¢
Basic Rate - DDU	0.69¢	2.67 oz.	4.14¢
Saturation - Non-Dropship	2.15¢	1.98 oz.	17.41¢
Saturation - DDU	0.02¢	1.98 oz.	0.13¢

If the entire cost difference between letters and nonletters were due solely to shape (as Haldi simply assumed), then there would be no weight-related cost differences between the heavier nonletters and the lighter letters -- implying an extremely small or zero pound cost and pound rate. At the other extreme, if the letter-nonletter cost difference were due solely to weight, then there would be no shape-related cost difference between letters and nonletters -- and no basis for a letter-nonletter rate differential. Crowder's estimates of the implied cost per pound under this latter assumption (a purely weight-related cost difference) are thus conservative high-side estimates, since to the extent that the cost difference is partly shape-related, the remaining weight-related costs would be smaller than she estimated. Even under this conservative assumption, the resulting pound costs are only a fraction of the Postal Service's proposed pound rates.

2. Estimates Based on ECR Flat Costs.

As an alternate test of the reasonableness of the current pound rate, Crowder analyzed the cost of ECR flats under the extreme assumption that the costs were entirely weight-related, with zero piece-related cost elements. This assumes, for example, that the costs of processing and delivering an extremely light-weight flat would be nearly zero, or that *four* 3.5-ounce pieces cost the same as *one* 14-

ounce piece -- an obviously absurd assumption. For flats above the 3.3-ounce breakpoint, she derived an "implied" per pound cost under this assumption by dividing the total costs of such flats (adjusted to reflect DDU entry) by their total weight (Tr. 44/19376):

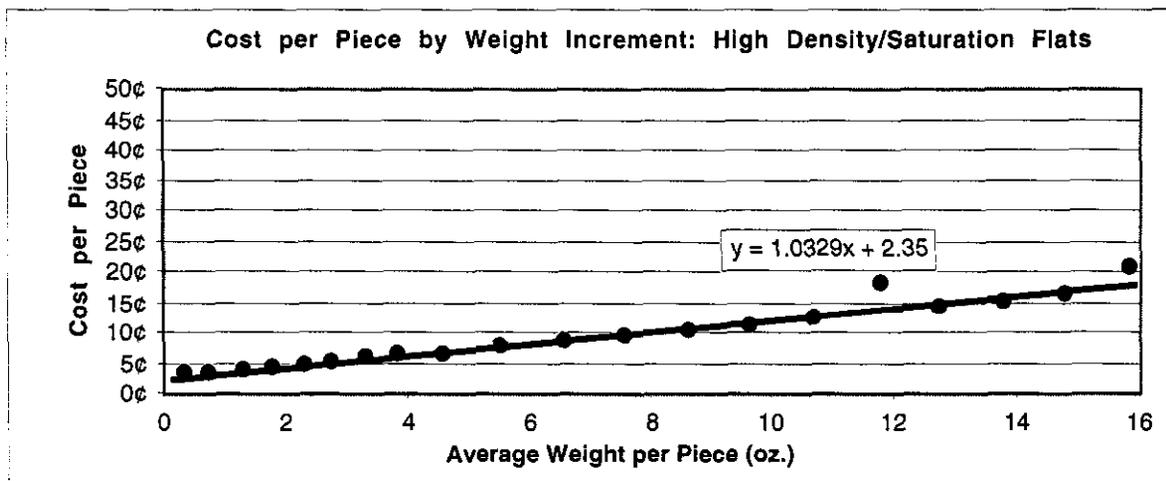
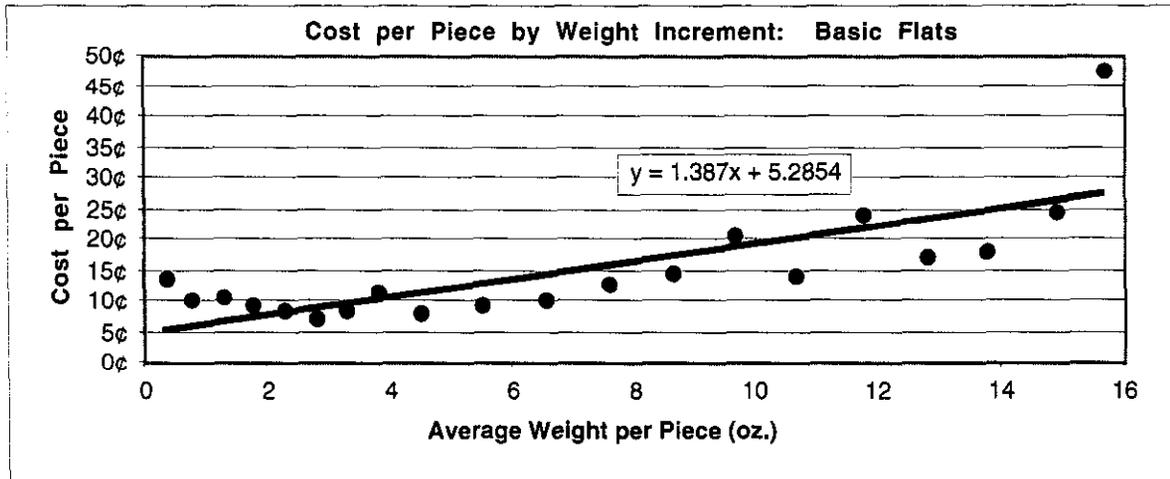
<u>Implied Cost Per Pound</u> <u>Assuming All Costs Are Purely Weight Related</u>		
<u>ECR DDU</u> <u>Basic Flats</u>	<u>High Density/</u> <u>Saturation Flats</u>	<u>ECR DDU</u> <u>All Flats</u>
26.8¢	19.9¢	24.3¢

As Crowder explained, these results are "beyond worst case" estimates under the absurd assumption that *all* ECR flat costs are purely weight-related, and are therefore "excessive and unrealistic in the extreme." In reality, all flats incur some piece-related costs related to the number or shape of pieces. Tr. 19377. Yet even these extreme implied pound costs are well below the proposed pound rate.

A more realistic outer bound would account for the fact that all flats incur *some* piece-related costs. Even the lightest weight ECR flats cost several pennies to process and deliver, most of which, given their light weight, is piece-related costs. In Daniel's analysis, for example, the lowest unit cost for saturation flats is in the 0.5-1.0 ounce increment, with a unit cost of 3.2¢. Tr. 1358. Because of its light weight, most of this cost is piece-related. Even if piece-related costs were as low as only 2.0¢ per piece, adjusting Crowder's analysis to factor out this small piece-related cost would dramatically reduce the resulting per pound costs.

3. Regression Estimates of ECR Flat Weight-Related Costs.

As another test, Crowder performed a simple unweighted regression of the cost data she developed, to derive an estimate of weight-related costs. The results, as shown in the following graphs, are per pound costs of 22.2¢ for ECR Basic flats and 16.5¢ for High-Density/Saturation flats. Tr. 19378.



Even with the excessive distribution of elemental load costs on the basis of weight, the costs of ECR flats do not increase nearly as steeply as the proposed rates.

E. At the Proposed Rates, ECR Nonletters Will Make A Greater Contribution to Institutional Cost Than Letters.

Crowder showed that even under the Postal Service's proposed rates, nonletters will pay a greater per piece contribution to institutional cost than will letters. Moreover, High Density/Saturation nonletters will pay the highest unit contribution of any ECR rate category (Tr. 44/19383):

ECR Letter and Nonletter Institutional Contributions	Average Piece Cost	Average Piece Revenue	Average Piece Contribution	Institutional Cost Coverage
Basic Letters	7.09¢	15.72¢	8.63¢	222%
Hi-Density/Saturation Letters	5.32¢	12.39¢	7.07¢	233%
All Letters	6.57¢	14.73¢	8.17¢	224%
Basic-Rate Nonletters	9.45¢	18.02¢	8.56¢	191%
Hi-Density/Saturation Nonletters	5.31¢	13.97¢	8.66¢	263%
All Nonletters	7.49¢	16.10¢	8.61¢	215%

Nonletters will pay a per-piece contribution that is almost a half penny greater than letters. For High-Density/Saturation mail, the contribution disparity is even greater -- nonletters will pay almost 1.6¢ per piece more in contribution than letters. This is the direct result of the combination of passing through a large portion of the letter-nonletter cost differential *and* also retaining a still-high pound rate -- overcharging for weight-related costs.¹²

Moreover, Crowder's contribution estimates, because they are based on Daniel's assumption that elemental load costs are 100% weight-related, likely substantially

¹² This circumstance would only be exacerbated by Haldi's recommendations to further expand the letter-nonletter rate differential and also retain the current high pound rate for nonletters over the breakpoint. (This is discussed in Section V.) It would also directly contradict his Haldi's rate design principle of equal unit contribution within a subclass. USPS/VP-CW-T1-23, Tr. 32/15936.

understate the true contribution and cost coverage of ECR mail generally, and especially pound-rated nonletters. USPS-RT-18 at 16.¹³

F. The Opponent's Criticisms Of Daniel's Analysis Are Unfounded.

1. Thinness of Tallies -- Ignoring The Overall Pattern of Costs.

NAA witness Tye claims that "thinness of IOCS tallies" in the heavier ECR weight increments makes Daniel's analysis unreliable. The Commission cited a similar concern in Docket R97-1 with respect to McGrane's analysis. There, the Commission claimed that thinness of tallies "results in erratic variation from increment to increment," citing as an example the "unusual outcome ... of a one-ounce piece and a 13-ounce piece costing the same." R97-1 RD at 400.

This selective comparison of the costs for just two discrete weight increments actually highlights the fallacy of the Commission's approach (and Tye's as well), looking at individual data points rather than the overall pattern of costs. The 0-1 ounce increment has always had a relatively high unit cost because of more-difficult-to-handle flimsy pieces (Tr. 34/18322-12, Docket R97-1); whereas in McGrane's FY 1996 data, the 12-13 ounce increment cited by the Commission had an abnormally low unit cost, noticeably way out of line with the pattern of gradually increasing costs over adjacent weight increments.¹⁴ In Daniel's analysis, based on FY 1998 data, the "unusual

¹³ Moreover, the Postal Service's volume and revenue projection method, based on "fixed weight" billing determinants, understates the amount of pound rate revenues that will be generated by the lower pound rate, thereby understating the contribution and cost coverage of ECR mail generally, and particularly pound rated flats. For technical reasons, the Postal Service simply assumed that the proportion of piece-rated vs. pound-rated volume, and the average weight of pound-rated pieces, would remain unchanged under the proposed rates. Clearly, the lower pound rate will generate both a higher proportion of pound-rated pieces (as new incremental weight shifts some pieces over the breakpoint), and a higher average weight and more total pounds of pound-rated mail. Both effects will generate greater pound-rated revenues than projected under the Postal Service's fixed-weight-revenue projections.

¹⁴ Ironically, the Commission cited this same 12-13 ounce increment as its example of "a large coefficient of variation" due to tally thinness. R97-1 Opinion at 401. Thus, the "unusual outcome" was, by the Commission's own acknowledgment, most likely a sampling "outlier" that should not have been given much weight in assessing the overall pattern of costs.

outcome” cited by the Commission disappears. After normalizing for worksharing differences, Daniel’s unit cost for the 12-13 ounce increment is 15.4¢, double the 7.7¢ unit cost for the 0-1 ounce increment, and much more in line with the pattern of gradually increasing costs above the breakpoint.¹⁵

In short, a single clearly “anomalous” data point, out of a series of otherwise reasonably consistent data points, should not and cannot be used to discredit or ignore the overall clear pattern of costs over the entire range of weights. There will inevitably be some “bumps and blips” in any analysis, whether based on IOCS data or any other kind of study.

What has remained consistent in both McGrane’s R97-1 data and Daniel’s R2000-1 data (and in every prior USPS weight-cost analysis over the last 18 years) is the overall pattern of cost behavior, and particularly the gradual slope of the costs compared to the steep pound rate. Individual data points fluctuate somewhat from one increment to the next, and from year to year -- an inherent byproduct of any analysis that disaggregates cost data into finer weight increments -- *but the overall pattern has remained the same*. Tr. 19401-02 (Crowder).

In Docket R97-1, the Commission dismissed Crowder’s demonstration that prior studies have shown similarly consistent overall cost patterns, stating that there was no evidence “demonstrating that ‘thinness’ was not an issue with those studies.” R97-1 Opinion at 401. This misses the point. The data are, indeed, relatively “thin” in the heavier weight cells of every study, simply because there is not much mail volume in those cells. But if “thinness” were truly a problem, one would expect wildly fluctuating unit costs and cost curves, with no consistent overall cost pattern from study to study.

¹⁵ Tr. 1210-11. Daniel’s 7.7¢ cost for the 0-1 ounce increment is derived by combining the 0-.5 and .5-1.0 ounce increments shown at Tr. 1212.

The fact that the same overall cost pattern has emerged in every study is strong evidence that "thinness" is not a problem at all.

The relevant consideration for rate design is not the accuracy of the unit cost for a particular weight increment, but the *overall pattern* of unit costs over the entire weight spectrum.¹⁶ Inherent in any analysis of disaggregated ECR costs by ounce increments is the fact that volumes thin out beyond 7 ounces. Disaggregation necessarily results in greater variation in unit costs from one weight increment to the next. In this case, Daniel's analysis is even more disaggregated than in prior weight cost studies, as she uses half-ounce increments up to 4 ounces and full-ounce increments all the way out to 16 ounces, rather than aggregating the increments over 8 ounces into fewer multiple-ounce increments.

USPS witness Moeller, himself, did not rely on any one data point from Daniel's analysis, but, appropriately, looked at the overall pattern which showed a cost trend that was much lower and more gradually sloped than his proposed pound rate. As USPS witness Bozzo stated:

"For small mail categories, the data are appropriately thin -- the few tallies correctly reflect the relatively small costs incurred by the associated mail category. Thus, the problem, if there even is one, would not be the data thinness, *per se*, but rather the effect it has on the relative standard errors of some narrowly-defined weight increments. The solution, when large increases in sample size are impractical (as is the case here), is to limit the reliance on individual point estimates that are subject to large sampling variation." Tr. 19471.

As Bozzo explained, this is exactly what Moeller did: relying on the overall pattern of data points over the entire relevant weight range above the breakpoint. Tr. 19471-72.

¹⁶ The Commission's apparent concern about thinness might have been legitimate if an individual unit cost were being used to directly set the rate for that increment (i.e., if the cost for the "anomalous" 12-13 ounce increment was the basis for setting a discrete rate for 12-13 ounce pieces). Here, the rate design objective is to set a *single* pound rate applicable to *all* mail over the 3.3-16 ounce range. The appropriate concern in this case is not the unit cost in a single weight cell, but the pattern of costs over the entire relevant range.

Bozzo demonstrated that the appropriately calculated coefficients of variation over this relevant range are generally small, especially for the commercial subclasses of Standard A. Tr. 19472-73.

In sum, "thinness" is not a problem that undermines the reliability of the study for the purpose of determining that the current pound rate is clearly too high in relation to costs.

2. The Last 15-16 Ounce Increment -- The Tail Wagging The Dog.

NAA witness Tye focused his attention on the unusually high unit cost in the last 15-16 ounce increment of ECR. Daniel's analysis shows a unit cost in this last increment that is well more than double that of the preceding 14-15 ounce increment (Tr. 1207), a result that Tye speculates is due to volume crossovers with Parcel Post (Tr. 30/14701). The volume in this last increment, however, is minuscule, accounting for less than 0.04% (four ten-thousandths) of total ECR volume. Tr. 1207.

In any event, even in this unusual last weight increment, Daniel's unit cost is lower than the lowest proposed ECR rate, as shown in the charts at page 16, *infra*. Thus, it is irrelevant whether the aberrationally high unit cost in this tiny increment is due to sampling error or to unusual mail characteristics such as a Parcel Post "crossover" phenomenon. In either case, the proposed rates cover even this cost.¹⁷

Tye's focus on this last tiny weight increment is incompatible with any sound concept of rate design. As Moeller testified, the pound rate applies to the entire weight spectrum over the breakpoint, and should therefore be based on the overall pattern of costs over the entire range, not just the last increment. Tr. 3990-91. Setting a pound rate solely on the basis of the cost for this last increment of volume would result in a

¹⁷ Crossover parcels would also be subject to the ECR parcel surcharge, further ensuring that the proposed rates cover costs.

pound rate that would be "much too high" for the other 99.96% of ECR volume. Tr. 3991.

3. **White's Carrier "Walking Time" Example Is Contrived And Contrary To USPS Delivery Operations And Data.**

As his only support for the contention that weight has a large impact on city carrier walking time, AAPS witness White offered an "example" of the supposed effect of weight on his own company's private delivery operations. His contention has been thoroughly disproved.

Even for his own company's operations, White's example was wrong. He claimed that a 1/2-ounce increase in the weight of his TMC product caused each of his carriers to have to walk an additional 100-200 miles per year to restock their satchels. Tr. 9960, 9988. But on cross-examination, he conceded that his carriers, on average, carry about 15 pounds of materials per loop, filling only about half of their available satchel capacity, and that the added "extra weight" amounted to only about one extra pound per walking loop. Tr. 10050-56. His example undermines his cost assertion, showing instead that incremental weight can normally be accommodated by excess satchel capacity with little or no impact on cost.

In the case of postal delivery, Crowder demonstrated that weight has very little effect on carrier loop- and dismount-related walking time. In Docket R97-1, her analysis of then-available USPS delivery data (using overstated mail weight per stop) indicated that carriers average only about 20 pounds of mail per loop, far below the 35-pound limit and leaving ample capacity to accommodate a marginal increase in piece weight.¹⁸

¹⁸ Tr. 44/19397, discussing her testimony in Docket R97-1 at Tr. 34/18325-31. Crowder also explained, from an operational standpoint, the many far more important non-weight-related factors that dictate the structuring of delivery routes and loops, and why the excess weight capacity is an incidental byproduct of those other more important route restructuring considerations. Tr. 19398, discussing her R97-1 testimony at Tr. 34/18327-28.

In this docket, Crowder was able to analyze more recent data from the Engineered Standards Database. This data, which directly measured actual satchel weights, shows a much lower average satchel weight of only 11 pounds -- far less than the 20 pound average Crowder estimated in R97-1, and only about one-third of the 35-pound satchel limit. Tr. 19399. About 90% of the satchels weighed 20 pounds or less.¹⁹ This substantial excess weight capacity in carrier satchels refutes White's flimsy claim that carrier walking time varies significantly with weight.

To the extent that there could possibly be any remaining doubt on this score, Daniel's overly-conservative assumption that elemental load costs are 100% weight related more than makes up for the difference. For ECR flats, elemental load cost is ten times greater than route time cost, and is also by far the major distribution key for street support costs (the second largest carrier cost component, four times larger than route time). Tr. 1211 (Daniel); 19396 (Crowder). The ripple effect of this 100% assumption results in a very large chunk of street support costs being allocated to weight, overwhelming even the wildest claim of extra walking time (which the record shows is *de minimus* at best).

4. **Haldi's Simplistic And Misguided Criticisms Of The Distribution of Mixed Mail And Not-Handling Tallies.**

Haldi criticized the use of IOCS data on the theory that the assignment of mixed-mail and not-handling tallies on the basis of direct tallies

¹⁹ In its Docket R97-1 opinion, the Commission dismissed Crowder's satchel weight analysis as "speculative." R97-1 Opinion at 401-402. This new ES data, which directly measured satchel weights, removes any element of speculation. The only speculative rationale on this issue is White's flimsy and self-contradictory "example."

The complex and controversial work sampling portion of the ES database, used by USPS witnesses Raymond and Baron to directly attribute carrier costs, is being challenged by a number of parties on account of its unreliability for purposes of apportioning carrier street time costs. The satchel weight data, although collected contemporaneously with the work sampling data, simply involved the routine quantitative task of weighing satchels at the start of a loop, substantially different from the much more judgmental and fraught with error task of interpreting and recording carrier activities at instants of time.

understates weight effects. His criticisms misconstrue the IOCS distribution system and the effects of bulk handlings. Indeed, the more likely direction of any bias in the IOCS distribution scheme is an overstatement of weight-related costs.

As witness Bozzo explains (USPS-RT-18), Haldi's arguments on both mixed mail and not handling tallies are based on misconceptions about how the current MODS-based IOCS distribution system works. Contrary to Haldi's assumption, these tallies are not assigned in an aggregate manner based on total direct handling tallies, but are instead carefully disaggregated and stratified by mail processing cost pool and item/container type, and then are allocated on the basis of only that portion of direct tallies that correspond to the same cost pool and item/container type. Tr. 19467. Thus, to the extent that heavier mail on pallets incurs proportionally more handling and direct tallies than lighter mail, this higher proportion is applied to the handling of mixed mail on pallets. This mixed-mail distribution method ensures that (1) the "weight-cost relationship for an activity will be reflected in the proportion of direct tallies by weight category for the activity," and (2) "the mixed-mail tallies have the same relationship." Tr. 19468. Not-handling tallies are likewise distributed within the operational cost pool in which they appear; while other activities such as obtaining and staging empty equipment "are treated as handlings" and "thus receive the appropriate weight distribution for the equipment type." Tr. 19468-69.

Crowder further explained the flaws in Haldi's assumptions. Because of scales of economy, bulk handling costs do not vary 100% with weight as Haldi implies. ADVO-RT-1 at 24-27, 29, Tr. 44/19389-92, 19394. Haldi's assumption that not-handling tallies are all associated directly with bulk handling operations is also incorrect: "Not-handling tallies are just that -- measures of time when neither mail nor mail equipment are being handled in any operation (and not just bulk handling operations)." *Id.* at 30-31. Haldi is even incorrect in his assumption that the direct tallies used as distribution keys are purely piece-related. In fact, those direct tallies themselves reflect the effects of weight

5. **Haldi's Call For A "Comprehensive Study" Is Unnecessary And Only An Excuse To Indefinitely Defer An Overdue Moderation Of The Clearly Excessive Pound Rate.**

Haldi's ultimate fallback argument is that the effect of weight on costs is too complex and multi-faceted to be considered on this record, and that the pound rate should therefore remain unchanged pending a future "comprehensive" (but ill-defined) study of all conceivable aspects of the issue. He claims, for example, that there are not one, but many, weight-cost relationships within ECR: that the effect of weight varies by, among other things, presort level, entry and dropship characteristics, and mail makeup. He suggests modeling studies, engineering studies, time-and-motion studies, and simulation studies, as well as various reviews of Postal Service data and operations. Under his concept, the objective of this mega-study would be to identify each of these different weight-cost relationships and incorporate them as different, discrete mini-pound rates applicable to each category of ECR mail: e.g., one pound rate for Basic presort flats; and a different, lower pound rate for Saturation flats. VP/CT-T-1 at Appendix B.

As Crowder observed, the diversity within ECR cited by Haldi "is also the reason why it would be exceptionally difficult (if not impossible) to identify system-wide, rate-category-specific, weight-related costs through an industrial engineering, modeling or some other non-IOCS-type approach." Tr. 44/19393 . Given the multiplicity of supposed "problems" that pound rate opponents claim in identifying weight-related costs underlying the current single ECR pound rate, one can only imagine their glee in conjuring up even more "problems" with complex, multi-faceted studies that attempt to slice-and-dice the pound rate issue into multiple mini-pound rates applicable to each rate category within ECR.

More fundamentally, it is not necessary to undertake complex new studies to know, based on this record and common sense, that the current pound rate is too high and should be moderated now. As Crowder stated:

**IV. THE EXCESSIVE POUND RATE DISTORTS THE MARKETPLACE;
THE MODEST PROPOSED REDUCTION WILL ENHANCE, NOT
HARM, COMPETITION.**

A total of eight "industry" witnesses presented testimony in this proceeding concerning the competitive market for print advertising distribution.

Five witnesses from the saturation mail industry testified, representing shopper publications, free newspapers, and shared mailers: Buckel (SMC-T-1), Merriman (SMC-T-2), Baro (AISOP-T-2), Bradpiece (SMC-RT-1), and Giuliano (SMC-RT-2). Four of these five come from companies that have used both mail and private delivery for their saturation distribution.

Two witnesses from companies that compete with saturation mailers testified: White (AAPS-T-1) and Wilson (NAA-RT-1). Both are affiliated with the newspaper industry. Wilson's company, Knight-Ridder, is one of the largest newspaper chains in the country; while White's company, DSO, is a division of the publisher of the dominant Oklahoma City daily newspaper. The "private delivery" that their companies perform is a specialized segment of the private delivery industry -- *nonsaturation* distribution to newspaper nonsubscribers as part of a daily newspaper total market coverage (TMC) program.

One other industry witness testified: Scott Harding, Chairman/CEO of Newspaper Services of America (Postcom-RT-1). NSA represents retail and national advertisers in choosing among and placing print advertising in all media, including mail, newspapers, newspaper TMC programs, and private delivery. Unique among the industry witnesses, Harding's company is not a "competitor" in the advertising distribution market, but rather helps advertisers choose among the competitive alternatives.

As would be expected, the testimonies of these witnesses, while sharing some common threads, differ in important respects when it comes to the state of competition in the print advertising distribution market. The newspaper-affiliated witnesses claim

that the private delivery industry (or at least the specialized nonsaturation TMC segment of that industry) is on the ropes, and imply that any reduction in the pound rate would be the death knell. The saturation mailer witnesses claim that the high pound rate has lessened their competitiveness with alternatives, created a growing incentive to consider private delivery, and caused shifts from mail into private delivery distribution.

The one "non-combatant" among the witnesses, Harding, offers a different perspective from the standpoint of the advertisers. He debunks Tye's notion that there has been a shift of advertising from newspapers to mail; he confirms the dominant position of the newspaper industry in the print distribution market, particularly with respect to heavier preprints; he explains that the high pound rate places advertisers with heavier preprints at a disadvantage due to the lack of competitive choices; he urges that the proposed pound rate be adopted; and he concludes that the lower pound rate will not harm newspapers, but will enhance competitive choices and provide far reaching benefits to all consumers. Postcom-RT-1.

Harding's highly relevant testimony, from the viewpoint of an expert in the advertising distribution industry, refutes the picture of the marketplace that NAA and AAPS try to paint. Yet neither NAA nor AAPS chose to cross-examine Harding, leaving his testimony unchallenged.

A. The High Pound Rate Has Made Saturation Mail Less Competitive With Alternatives, And Has Caused Shifts To Private Delivery.

The high pound rate has demonstrably caused a shift of heavier weight preprints from the mail to competitors. As Giuliano testified, because of the pound rate, "shared mail today is less competitive with newspapers and private delivery for the distribution of traditional multi-page preprints than it was in the mid-1980s."

"Until the large Docket R87-1 rate increase, Advo's shared mail carried a substantial number of preprints weighing more than an ounce. Because of the pound rate, those heavier preprints are gone. In most cases they were diverted to newspapers as inserts, although in some cases the advertisers reduced the number of pages and weight of their

inserts to make it affordable to remain in shared mail (but with the tradeoff of carrying less advertising information)." SMC-RT-2 at 9, Tr. 18995.

For some mailers like the Maryland Pennysaver, the high pound rate effectively precludes them from competing for preprint advertising. As Bradpiece explained, "high postal costs have made our paper too expensive to effectively compete for any significant volumes of insert advertising." Tr. 18918. "We currently are basically capped with the business we can do by the difference between the piece rate and the pound rate." Tr. 18941. "We're very careful to try and manage our weights so that we don't go into the pound rate." Tr. 18960.

In addition to effectively pricing mail out of the market for traditional preprints weighing more than an ounce, the high pound rate creates a wide cost disparity between mail and private delivery. This has created not only the opportunity, but an incentive, for mailers to explore and switch to private delivery themselves.

The high pound rate is the primary reason Advo expanded into private delivery, beginning in 1992. Because its private delivery operations are not shackled with an excessively high pound rate, "Advo has been able to compete successfully in those markets for a share of the mid-to-heavier weight multi-page preprints that had been priced out of the mail." SMC-RT-2 at 16, Tr. 44/19002. Because of the combined effect of lower private delivery costs and the ability to offer competitive rates, these markets have become more profitable as a result of their conversion to private delivery, adding millions to Advo's bottom line. Tr. 19003.

Giuliano described the contrast between the declining share of preprints in Advo's mailed programs and the growth of preprint volumes and weights in its private delivery operations:

"Our privately delivered volumes average 40% more preprint inserts per package than our mailed volumes, and those privately delivered preprints have a higher average weight than those in the mail. In fact,

the mailed preprints have declined in weight over the last six years, due to the high pound rate." SMC-RT-2 at 16, Tr. 44/19002-03.

Advo's *total* mailed "shared mail" volumes have also declined since 1995; half of that mailed-volume reduction is due directly to conversions to private delivery. Tr. 19002.

Advo's private delivery operations currently encompass five major metropolitan areas, with a combined weekly circulation of more than 2 million households and annual volumes of 107 million pieces -- constituting almost 4 percent of Advo's total "shared mail" distribution.²¹ In total, Advo distributes about 800 million to 1 billion advertising pieces annually through these programs. Tr. 19017, 19066.

Witness Buckel described his experience with Newport Media's shopper publications in the Long Island market, where private delivery now dominates the preprint market:

"[In] the New York market every major preprint circular is now carried in private delivery or newspapers. The major private delivery operation in that area is Delivery Services of America. Their program is so filled with preprints, particularly heavier preprints weighing one to three ounces, that their packages frequently exceed 16 ounces in total weight." Tr. 9927

The reason for this loss of preprints from mail, as Buckel explained, was the huge disparity between the high postal pound rate and the low cost of private delivery:

"This loss to private delivery has occurred over the last five or so years, and is due to the fact that the high pound rate makes saturation mail non-competitive except for light-weight pieces. Although we made efforts to entice several major retailers back into the mail, we were told

²¹ Counsel for AAPS attempted to minimize Advo's expansion into private delivery on the ground it has grown to 3.7% of Advo's total volumes over the last 8 years, which he characterized as a "rate of less than one-half of one percent per year." Tr. 19032. But viewed from a more recent perspective, Advo's private delivery circulation has grown from 1.7 million to 2.3 million households just since January of this year, an increase of 35% in nine months. Tr. 19002. Obviously, neither of these dramatically different "growth" figures provides a "reliable" indication of future trends. What is known is that Advo's private delivery initiatives have been driven by the high ECR pound rate, that its private delivery has been expanding, and that Advo is continuing to explore further expansion. Tr. 19022.

that our rates were not close to those offered in private delivery.” Tr. 9927..

“The cost disadvantage is significant. For a 12-ounce shopper including inserts, postage is \$406 per thousand (\$366 at the proposed rates), compared to a private delivery cost of around \$125 per thousand.” Tr. 9927.

As a result of this postal-private delivery cost disparity, “shared mail is not competitive in this market, and mailed shoppers are basically confined to carrying very light weight preprints and single-sheet inserts.” Tr. 9927.

Because of this cost disparity, Newport Media, like Advo, shifted part of its shopper distribution from mail to private delivery. The contrast between the mailed and privately delivered publications is dramatic. Newport Media’s lighter papers are “customers of the Postal Service.” Tr. 9916. However,

“Our biggest paper, and the one carrying the most retail preprints, was delivered by our own carriers. The ability of our private carrier paper to generate incremental profits by selling additional pieces at heavier weights was substantial. We could deliver our basic paper for 50% of the cost of mail. Additional inserts could be sold into the paper at a very low distribution cost to us and produced significant profits.” Id.

Newport Media’s private delivery paper did not just compete for business that might have otherwise gone to other shared mail programs or newspapers, “we were also able to compete against the Postal Service and draw advertisers out of the mail and into the pages of our hand delivered paper.” Tr. 9916.

As Buckel observed, “the current high pound rate is causing many shared mailers to think twice about becoming postal service competitors.” Tr. 22/9916. Bradpiece’s testimony provides just such an example. He had not previously given thought to private delivery for his mailed shopper, but since discovering the magnitude of the cost differential, he is now considering private delivery as an option. Tr. 44/18928. As Buckel concluded:

“Advertisers need and want a way to get shopping news into the hands of customers near their stores. Consumers want and

value this information. The market *will* find a way to link advertisers and consumers together.

Members of the Saturation Mail Coalition have been trying to provide this service for small and large customers alike through saturation shared mail programs. The current, noncompetitive, non-market based pound rate is making this task more difficult and is forcing many mailers to reevaluate and weigh our long-term future, either as Postal Service customers or competitors.”
Tr. 22/9917

The moderately lower pound rate is fully cost-justified, and *on that basis alone* should be adopted. In addition, the lower pound rate will give mailers a chance to begin competing once again for at least some portion of this lost market. And while private delivery will continue to be a potentially attractive option for mailers even at the lower pound rate, this change would enhance the Postal Service’s ability to remain the provider of choice for most saturation mailers.

B. Impact On Newspapers.

1. The Lower Pound Rate Will Not Lessen The Newspaper Industry’s Dominant Position In The Market.

NAA witnesses Tye and Wilson try to create the impression that the proposed reduction in the ECR pound rate would seriously harm the newspaper industry and lead to a reduction in newspaper editorial content for the American public. Tye, for example, claims that because the (high) pound rate has not been increased since 1995, there has been a “significant shift of advertising from newspapers to ECR mail over the last five years.” Wilson claims that every dollar of advertising lost to competitors is one less dollar for news.

Conspicuously absent from either of their testimonies is any discussion about the status of the newspaper industry in the market for print advertising distribution. Although there have been many changes in the marketplace over the years, as described by SMC witness Giuliano, neither Wilson nor Tye make any claim that newspapers have been harmed by postal rate changes in the past, or that the proposed

pound rate will threaten in any way the continued ability of the strong and highly profitable newspaper industry to compete aggressively and effectively in the marketplace.²²

The reason for this silence is that the newspaper industry always has been, and remains, by far the dominant competitor in the print advertising distribution market. The most credible evidence on this score comes from PostCom witness Harding, whose company, NSA, is responsible for helping advertisers compare and choose among the print distribution alternatives. As he testified, over 90% of the advertising placed by NSA is with newspapers, accounting for 19 *billion* newspaper inserts -- a significant portion of total newspaper inserts. Tr. 19581-82.

Harding specifically dispels Tye's contention of a "significant shift of advertising from newspapers to ECR mail over the last five years" due to the constant pound rate.²³ As he states, "the mix of distribution options has remained relatively stable. This means that if advertisers use heavier and larger preprints, they typically are distributed via newspapers." Tr. 19585.

Harding also addresses the negative impact of the high ECR pound rate on customers and competition:

"The current costing scenario places clients that utilize larger, heavier preprints at a disadvantage as they seek options to most newspaper insertion costs. While most clients may still choose to utilize newspapers as their primary advertising carrier, they find it expensive to

²² In the "battle of profit margins," newspapers win hands down. As Giuliano noted, Advo's single-digit 7.4% operating profit margin in its best year would be considered "anemic" by newspaper standards. Tr. 44/19067. See also Tr. 19178 (Knight-Ridder margins) and Tr. 18912 (Inland Press Association study).

²³ Harding has extensive experience in the retail advertising business, including 22 years with Sears, Roebuck & Co. before joining NSA. NSA's clients include major retailers and national advertisers, and many regional advertisers. NSA negotiates print media services with over 7,800 suppliers including newspapers, shared mailers, and shopper publications (Tr. 19581, 19584), and is quite knowledgeable about products, pricing, and shares in the marketplace. Inasmuch as his company negotiates services with *all* of the competitors, he has unique knowledge of differences between the various media that even the competitors do not have.

supplement the newspaper's distribution shortfall with a mailed product alternative." Tr. 19585.

This, of course, confirms the testimony of witnesses Buckel and Giuliano that the high pound rate has progressively priced saturation mail out of the market for heavier preprints, shrinking the portion of the market for which mail can compete, and leaving the newspaper industry with a *de facto* monopoly for this segment. Moreover, Harding's statement makes clear that a reduction in the pound rate will not cause newspapers to lose any significant portion of this business: "most clients may still choose to utilize newspapers as their primary advertising carrier." *Id.*

Although Wilson does not directly allege any specific harm to the newspaper industry due to a lower pound rate, the record shows that any potential impact will be *de minimus*. Wilson's cross-examination revealed that the great bulk of preprints carried by the *Miami Herald* newspaper are sheltered from diversion to the mail due to factors other than price -- such as advertisers' preferences for newspaper reader demographics and/or Sunday distribution. He testified that many of the *Miami Herald's* advertisers prefer nonsaturation newspaper distribution over saturation distribution because of the attractive demographics of newspaper readers. Tr. 19174. Indeed, about 85-90% of the *Miami Herald's* total preprint volume is nonsaturation, newspaper-only distribution. In addition, he testified that Sunday is by far the advertisers' preferred day for preprint distribution, accounting for 80% of the *Miami Herald's* preprint volume. Tr. 19173-74. Sunday, of course, is the one day of the week that mail cannot be delivered.

The combined effect of these two newspaper non-price advantages -- demographic and Sunday delivery preferences of advertisers -- is that a very substantial portion of the preprints carried by newspapers are largely insulated from saturation mail competition. Not coincidentally, PostCom witness Harding's statement that newspapers account for "over 90% of the advertising placed by NSA" gives some idea of the magnitude of these advantages.

Even of the remaining relatively small segment of the market where mailers are not disadvantaged by non-price factors, the ability of mailers to be price competitive will still be constrained. Because of the modest nature of the proposed pound rate reduction, mail will still be noncompetitive for a substantial portion of heavier weight preprints. As Buckel stated:

"The modest reduction in the pound rate proposed by the Postal Service will not substantially change this balance. However, it will help shared mailers retain some of the business we need from medium to large customers and be more competitive for the distribution of lighter weight preprint pieces." Tr. 22/9916-17.

In short, the notion that a moderately reduced ECR pound rate will cause newspapers to lose a significant share of their advertising preprints to saturation mailers is fanciful.²⁴

The beneficiaries of a lower pound will be the nation's advertisers, and ultimately consumers. As Harding explained:

"While we are client advocates and remain objective to all print alternatives, we feel that advertisers are best served by a market place of choices. We believe a reduced pound rate will give the retail industry a competitive choice. Retailers are in a highly competitive market and extremely cost conscious, any action to reduce costs will give far reaching benefits to all consumers." Tr. 45/19585-86.

A lower pound rate will provide "affordable, efficient print media options" and will help to "make the 'playing field' more competitive." *Id.* at 19585.

²⁴ The assertions in Wilson's testimony about the "comparability" of newspaper and mailer competitive pricing in the Miami market, and specifically his allegations about the supposed prices Advo charges, warrant brief comment. At the hearing, Advo witness Giuliano was eager to discuss Advo's pricing in the Miami market to refute Wilson's allegations. The Presiding Officer declined to allow him to do so in direct examination, stating that "in the absence of some cross-examination...that would enable you to move that information into the record on redirect, I am not sure at this stage of the game how we get it into the record." Not surprisingly, neither NAA nor AAPS asked Giuliano any questions about pricing. Thus, the absence of information about Advo's pricing relative to newspapers is not due to any reluctance on Giuliano's part, but to the reluctance of NAA and AAPS to ask. Subsequently, cross-examination of Wilson by counsel for AISOP revealed that Wilson, in fact, did not know that much about the competitors' pricing or even the Miami Herald's. Tr. 44/19183, 19231, 19238-39.

2. **The Lower Pound Rate Will Benefit Many Newspapers And Their Customers.**

The benefit of a lower pound rate will inure not only to advertisers that use the mail, but also to those that use newspapers. The proposed reduction in the pound rate is not limited to ECR saturation mail, but will also reduce the rates for ECR High Density mail used by newspapers (like Wilson's Knight-Ridder papers) for their mailed TMC products. In fact, the proposed ECR rates are *more* favorable for High Density mail than for Saturation mail.

As Harding stated, advertisers that use newspapers as their primary advertising carrier for distribution of larger preprints "find it expensive to supplement the newspaper's distribution shortfall with a mailed [TMC] product alternative." Tr. 19585. In this respect, a lower pound rate will reduce the newspapers' TMC costs, and make their mailed TMCs more affordable -- thereby enabling them to better serve their *own* customers.

Yet even though many newspapers and their advertising customers would be among the beneficiaries of a lower pound rate, the newspaper industry (at least as represented by NAA) prefers to maintain an artificially high, non-cost-based pound rate that serves no purpose other than to protect them from competition.

Finally, in considering the impact of the proposed lower pound rate on "newspapers," it is important to distinguish between types of newspapers. The newspapers represented by NAA are primarily larger daily metropolitan newspapers, such as the *Daily Oklahoman* and the large dailies owned by Knight-Ridder. Most of these newspapers do not use the mail for distribution of their newspapers.

On the other hand, the membership of the National Newspaper Association (NNA) consists primarily of smaller daily and weekly newspapers, as well as free-circulation community newspapers. Many of these smaller newspapers depend upon the mail for delivery of their paper to readers. Moreover, NNA's members make

substantial use of ECR mail to distribute nonsubscriber products, most of which are saturation walk-sequenced, DDU-drop shipped flats that weigh over the breakpoint -- the precise kind of mail targeted by NAA for steep rate increases.²⁵

Thus, even within the broad newspaper industry, there are a number of newspapers that would benefit directly from the lower proposed ECR pound rate -- both at the nonsaturation and saturation ECR rates.

C. Impact On Private Delivery.

Although hardly mentioned in the testimony of the two newspaper/ TMC private delivery witnesses in this case, there are two distinct forms of private delivery: (1) saturation private delivery going to all households; and (2) selective non-saturation private delivery going only to newspaper nonsubscriber households, conducted as part of a newspaper TMC program. These two forms of private delivery differ significantly in their purpose, focus, design, and economics.

Selective newspaper TMC private delivery, by purpose and design, is built around delivery of the newspaper's weekly TMC product *only* to nonsubscriber homes. Tr. 19164 (Wilson). Because fixed overhead and route costs are spread over fewer deliveries, selective non-saturation TMC delivery has a higher cost-per-delivery than saturation delivery. Selective delivery to nonsubscribers also experiences more delivery volatility due to fluctuations (or "churn") in households that subscribe to the newspaper. Tr. 19167 (Wilson). Moreover, in order to deliver an additional separate *saturation* piece

²⁵ Tr. 46-B/20559-63. This is based on an NNA survey of its members which suggests that they may actually make greater use of Standard A mail than Periodicals mail. The survey showed total periodicals volumes of 2.558 million, compared to total Standard A volumes of 2.576 million (consisting of 2.524 million nonsubscriber products and .053 million newspapers mailed at Standard A). Over 90% of the Standard A nonsubscriber product volumes in the survey were mailed at ECR rates. Of those ECR volumes, 70% were saturation walk-sequenced and DDU drop shipped, and 60% weighed above the breakpoint. As Max Heath (an NNA witness in this case and the individual responsible for the study) concluded, "Saturation mail is very important to NNA members." Tr. 46-B/20562. See also Docket R97-1, Tr. 14778-82.

going to *all* houses, the delivery carrier would have to incur the additional incremental cost of accessing subscriber homes that would not otherwise be served, solely to deliver the non-TMC product. Consequently, selective newspaper TMC delivery is “much more difficult to deliver and the cost for delivering it is much more than the saturation form.”

Tr. 19021 (Giuliano).

Saturation private delivery, by contrast, is usually built around delivery of a regular weekly base product (typically a shopper publication or a “shared mail” program) going to every house. Tr. 9942 (White). In addition to having a lower cost-per-delivery for the base product (fixed costs spread over more deliveries), saturation private delivery does not incur any additional incremental access cost when another saturation advertising piece is added to this delivery, because all homes are already being accessed to deliver the base product.

1. **Saturation Private Delivery.**

Ironically, the only witnesses in this proceeding from companies that *actually use or provide regular weekly saturation private delivery* are the Saturation Mail Coalition witnesses: Buckel, Bradpiece, and Giuliano. AAPS witness White’s company, the TMC distribution division of a daily newspaper publisher, focuses on non-saturation (or selective) distribution of the newspaper’s weekly TMC product to nonsubscriber households, with some distributions to subscriber households on an irregular basis. Tr. 10039. NAA witness Wilson’s company, the Knight-Ridder newspaper chain, offers private delivery only on a non-saturation basis to nonsubscriber households for its newspaper TMC products. Tr. 19164.

White had surprisingly limited knowledge about the saturation private delivery industry. He noted that saturation private delivery is usually built around the regular weekly delivery of a shopper publication or shared mail program. Tr. 9942. Yet remarkably, he had “no idea” what percentage of shopper publications were delivered

privately. Tr. 10033, 10090-91. In fact, a majority of shopper publications are delivered privately.²⁶ He also had no idea about Advo's private delivery volumes. Tr. 10036.

White's knowledge of private delivery's market share was likewise rudimentary and confused. In discovery, he stated that "my only market share 'information' is that alternate delivery has roughly 2-3% of the market for the primary materials we are permitted ...to deliver." Tr. 10025. Cross-examination revealed that this purported market share was not for "alternate delivery" in total, but was based on volumes of *only* AAPS members as a percent of USPS saturation mail volumes, and was a "rough, seat-of-the-pants opinion." Tr. 10088-89. Based on 1999 saturation mail volume of 11.8 billion, his 2-3% estimate equates to annual AAPS-member volume of about 240-360 million. Yet Advo's private delivery volumes alone amount to about 1% of total USPS saturation mail volume, are about 25-40% as large as White's estimate of total AAPS-member volumes. His AAPS-member volumes also undoubtedly omit a substantial chunk of the volumes of privately delivered shoppers, about which he appeared to know nothing.

For shoppers and "shared mail" programs that are delivered privately, the mail alternative is the Postal Service's solo saturation postage rate (not a shared mail rate) -- since those types of publishers do not want to be delivered as an insert inside a competitor's shopper or shared mail program. The "threat" that the modest reduction in the pound rate will cause any significant shift of shoppers/shared mailers out of private delivery and into the mail is nonexistent. Although they may be some shifts at the margins, the cost disparity between private delivery and the pound rate (including the extra mailing costs of labeling, etc.) would still be too great. As Giuliano testified,

²⁶ Approximately 75% of the shopper publication members of the Independent Free Papers of America (IFPA) and 50% of the members of the Association of Free Community Papers (AFCP) use private delivery to deliver their publications. Tr. 15685 (Merriman), 19019 (Giuliano). IFPA and AFCP are the two major trade associations for the shopper publication industry.

“We are not going to shift volumes out of our alternate delivery programs back into the mail. There would have to be a dramatic, dramatic reduction in postal rate to make those items shift, and I think the same thing would have to occur in ... Mr. White’s area. If there was a dramatic drop in the pound rate, then maybe that would happen, but not the small, modest reduction.” Tr. 19016.

For the same reason, even with a moderated pound rate, there will still be a dramatic disparity between the cost of ECR saturation mail and the far lower cost of regular *saturation* private delivery. That cost advantage of saturation private delivery will insulate against any significant diversion of advertising. More fundamentally from the standpoint of postal policy, any diversion that does occur will not be because of predatory postal prices. To the contrary, it would be due to the moderation of an excessive, non-cost-justified pound rate that has acted as an artificial barrier in the marketplace, insulating competitors from fair and efficient competition. Given the modest nature of the reduction, with a pound rate that would still be far above costs, this re-balancing of the market would likewise be modest.

2. Selective Nonsaturation TMC “Private Delivery”.

Wilson’s testimony raises the question of “who are the competitors,” and “what do they compete for?” He claimed that newspapers do not compete with the Postal Service, but that their privately-delivered nonsubscriber TMC programs do. His dichotomy fell apart under cross-examination. First, nonsubscriber TMC programs are not separate creatures distinct from the newspaper; they are an integral part of the newspaper company’s advertising distribution offerings. The purpose of nonsubscriber TMC programs is not to deliver to every house, but rather to allow advertisers to reach households missed by the newspaper: “...really all [we] need, and all the advertiser wants is the combined saturation coverage to the newspaper plus the TMC.” Tr. 19164. Second, the focus of a TMC program is to deliver the newspaper’s TMC product: “[W]e don’t go forth as an alternate delivery company and seek to take away from the mail and deliver for non-newspaper companies.” Tr. 19260. The “competition” that Wilson spoke

about is not really competition between the TMC operation and the Postal Service for the delivery of advertising. Rather, he was using competition "in the sense that the Postal Service competes for the newspaper's decision as to which alternative [mail or private delivery] to use" for delivery of its TMC product. Tr. 19260.

AAPS has likewise tried to confuse the pricing comparison for DSO's "saturation private delivery" rates, pretending that they are comparable conceptually with the rates that saturation mailers charge to preprint advertisers. The typical retail preprint advertiser that wants saturation distribution does *not* pay DSO's "saturation private delivery" rate. Rather, it pays the *Daily Oklahoman's* much lower combined newspaper insert/TCM rate. The very purpose of a newspaper TMC program, as Wilson testified, is to offer a combination "newspaper insert/nonsubscriber TMC" distribution option to retail advertisers. Tr. 19164.

DSO's "saturation private delivery" rate, by contrast, is primarily used by customers that *do not want to be delivered as an insert inside the newspaper* to subscribers. A prime example would be a shopper publication that competes with the newspaper, and that prefers to be delivered separately rather than as an insert inside the competition's newspaper (some newspapers will not even accept shoppers as inserts, because the shoppers are advertising competitors). For this shopper publication that wants to be delivered as a *standalone* product rather than inside a competitor's product, the mail alternative is the *Postal Service's solo saturation rate* -- not a competitor shared mailer's insert rate. Tr. 44/19453-57.

As Crowder's analysis of DSO's rate card shows, for the shopper publication or advertiser that wants *standalone* saturation distribution (i.e., that does *not* want to be inside a "shared distribution" environment as an insert in a newspaper, shopper, or shared mail program), DSO's saturation private delivery rates are substantially below the Postal Service's saturation postal rates. Its rate of 7.3¢ for pieces up to 5 ounces is

40% below the Postal Service's minimum 12¢ rate, and 50% below the postal rate for a 5 ounce piece.²⁷

White also professed a near complete lack of knowledge about the prices charged by the *Daily Oklahoman* newspaper, DSO's sister company. Although he alleged that the *Oklahoman* was DSO's major "competitor," he claimed he did not know whether the newspaper's rate for combined newspaper/TMC distribution was lower than DSO's solo saturation rate (Tr. 10042), and had "no idea" of the range of insert rates charged by the newspaper (Tr. 10047).

As to White's alleged "competition" between the *Oklahoman* and DSO (a division created by the newspaper publisher as the newspaper's vehicle to supplement its subscriber insert distribution to achieve TMC coverage), it is clear that newspaper TMC delivery operations -- by virtue of their selective-delivery purpose and design -- are inherently *not* competitive with the newspaper for distribution of typical saturation retail advertising. For the TMC company, delivery of a saturation advertising preprint to subscriber households (i.e., the addresses not covered by the regular nonsubscriber TMC product) represents a "standalone" delivery cost. The added incremental cost of accessing a subscriber household to deliver one standalone preprint is obviously far higher than the newspaper's cost of delivering that same preprint as an insert (along with many other "shared distribution" inserts) inside the newspaper.

In short, White's claim that DSO "competes" with either the newspaper or shared mail for distribution of saturation preprint advertising is a fiction. Newspaper

²⁷ Tr. 44/19387. White's assertion that private delivery has been driven out of the market for "light weight pieces" under 3 ounces (Tr. 9986) is ludicrous. For light weight pieces wanting "shared saturation" distribution, the newspaper TMC product that DSO delivers carries many light weight pieces, even single-sheet ads. Tr. 10044. For light weight pieces wanting solo delivery, DSO's own saturation rates are below the postal rates. Similarly, for any true saturation private delivery company that delivers a regular weekly shopper or shared mail program (as is usually the case), the incremental delivery cost of adding another light weight piece to the delivery is quite low and undoubtedly competitive.

nonsubscriber TMC operations, to the extent that they also deliver saturation materials, are in a different market from the "shared distribution" newspaper and shared mail market -- the market for "standalone" distribution. In *this* market, competing with the Postal Service for distribution of standalone shopper publications, DSO's prices are far below the Postal Service's.

Indeed, the selective distribution TMC operations established by newspapers to complement their newspaper subscriber distribution typically are not independent "competitors" in the market for retail preprint advertising. The "competitor" is the newspaper, competing with shared mailers and shoppers. The advertisers in the TMC product are not "private delivery" customers but the newspaper's customers. The TMC operation is simply the distribution vehicle by which the competitor newspaper is able to achieve saturation distribution for the advertiser. If a newspaper shifts its TMC program from selective private delivery to the mail, or vice versa, that shift does *not* represent a shift in the saturation distribution marketplace. The advertisers in the TMC product, whether delivered by mail or privately, are still the newspaper's customers -- and have not shifted from one competitor to another.

NAA witness Wilson's claim that private delivery is in trouble -- citing recent decisions by newspapers to convert their nonsubscriber TMC programs from selective private delivery to ECR mail -- likewise misconstrues the fundamental distinctions between selective newspaper TMC private delivery and *saturation* private delivery. His testimony does not cite any evidence that there has been any shift from *saturation* private delivery to the mail. As Giuliano's testimony shows, in the saturation distribution market, the shift has been the other way -- from saturation mail into saturation private delivery. SMC-RT-2 at 15-17, Tr. 44/18999-19003.

The shift of TMC programs cited by Wilson is therefore not evidence of any shift in the saturation distribution market. Rather, it is simply a reflection of the significant

operational and cost differences between selective TMC delivery and saturation delivery, as described above. As Giuliano pointed out,

“[Newspaper TMC delivery is] the other type of private delivery that I’m talking about. They’re not saturation-based; they are the selective distribution, the less-than-saturation, and that’s much more difficult to deliver and the cost for delivering it is much more than the saturation form.

“So that’s why I think some of those shifts are occurring” Tr. 19021-22.

The fact that some newspapers have not been successful in managing the more difficult and higher cost economics of selective TMC distribution, and have shifted to nonsaturation ECR mail, is therefore no reflection on the status of saturation private delivery in the marketplace.

In sum, Wilson’s description of the “private delivery” market is nothing of the sort. At most, he describes only the “selective newspaper TMC delivery” segment, which itself is not truly an independently-competitive participant in the market for saturation advertising distribution, and which is distinctly different from saturation private delivery. Even to the extent that some newspapers have chosen to shift their TMCs from selective delivery to mail, as Wilson says, that has not changed the landscape of the marketplace. The newspapers were, are still, and will continue to be the dominant competitor in the marketplace, whether they choose mail or selective delivery for their TMCs.

This brings us to witness White’s attempt to portray “his company” as a private delivery entrepreneur struggling to compete with the behemoth, monopolistic Postal Service bent on driving its competitors out of business. Contrary to the picture he paints, the Oklahoma City market is a good example of the dominance of combined newspaper-private delivery distribution. As Giuliano testified, Advo started a shared mail program in the Oklahoma City market in the 1980s. However, shortly after DSO was created in 1991 as the TMC private delivery arm of the *Daily Oklahoman* newspaper, Advo was forced to discontinue its shared mail program, unable to compete

with the newspaper/TMC combination. SMC-RT-2 at 10-11. Giuliano described the current competitive picture in this market:

"The *Daily Oklahoman*/DSO combination dominates the market, distributing every major multi-page preprint advertiser. As witness White acknowledged, the *Daily Oklahoman*/DSO carries a number of preprints that weigh in excess of one ounce, whereas he knew of none carried by competitors. Tr. 22/10032-33." SMC-RT-2 at 11.

White, of course, resisted all questions relating in any way to the *Daily Oklahoman* newspaper -- its circulations, its preprint volumes, its pricing, its market share -- claiming either that the information was confidential or that he "knew nothing" because the newspaper was his "competitor." The one thing that we do know is that White has provided no evidence, on this record, that the proposed pound rate will in any way jeopardize the heavily dominant position of the *Oklahoman*/DSO combination in the marketplace.

D. Section 3622(b)(4) Requires A Balancing Of Interests, And Is Intended To Protect Competition, Not Competitors.

Section 3622(b)(4) of the Postal Reorganization Act directs that the Commission consider as one of the factors in setting rates:

"(4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters."

In Docket R97-1, the Commission invoked this section (criterion 4) as a ground to reject the Postal Service's proposed reduction in the ECR pound rate. We believe that it is appropriate to take a closer look at the purposes and policies underlying this criterion.

On its face, criterion 4 is not focused solely on private competitors, but also looks to the effects on the general public and business mail users. This latter category, business mail users, encompasses not only mailers that compete with private delivery companies for distribution of advertising, but also the ultimate end users of the mail -- the advertisers themselves, such as AISOP witness Smith's Buttercup Dairy and the national and retail advertisers served by PostCom witness Harding's NSA. As Harding

observed, “a reduced pound rate will give the retail industry a competitive choice,” and “will give far reaching benefits to all consumers.” Tr. 19585-86. Criterion 4 contemplates a balancing of these often differing interests.

Moreover, criterion 4 is not a one-way street that dictates raising postal rates on account of competitors. As the D.C. Circuit held just last year,

“...UPS’s reading of the statutory provisions it invokes is unduly narrow. By its terms, §3622(b)(4) allows the Commission to consider lowering rates in order to protect ‘the general public [and] business mail users,’ as well as raising them in the interests of ‘enterprises in the private sector ...engaged in the delivery of mail matter.’ ”

United Parcel Service, Inc. v. United States Postal Service, 184 F.3d 827, 845 (D.C. Cir. 1999).

And of course, the most pertinent judicial pronouncement interpreting criterion 4 is that, in setting rates in a competitive environment, “the PRC’s task is to protect *competition*, not particular competitors.” *Direct Marketing Association v. United States Postal Service*, 778 F.2d 96, 106 (1985) (emphasis in original). Significantly, the petitioner in *DMA v. USPS* that sought unsuccessfully to invoke criterion 4 was the predecessor of AAPS, the Coalition of Non-Postal Media (CNPM).

From the statute and these judicial interpretations, it is clear that the party invoking relief under criterion 4 bears the burden of demonstrating not just some commercial harm to its business interests as a “competitor,” but harm that impinges in some concrete and meaningful way on “competition.” The competitive process, by its nature, involves the dynamic of shifts in business between competitors. The loss of any business to a competitor could, in the broadest sense, be deemed “harmful” (in the sense that it is not “beneficial”). But harm in the context of criterion 4 requires

substantially more.²⁸ The mere fact that a pricing change will produce some shift in volume is not itself “harm” within criterion 4. Otherwise, this criterion would become transmogrified into a prohibition against any change that is beneficial to mailers relative to competitors, regardless of how well the change is justified. It would, quite simply, become a device to “protect competitors from competition.”

Even if a competitor presents concrete evidence of substantive harm, that does not end the inquiry. If the harm would arise from the removal of a non-cost-based pricing barrier that has acted to shelter that competitor from competition, then the logic of *DMA v. USPS* would not support use of criterion 4 as a device to perpetuate that pricing barrier. Such a perverse use of criterion 4 would restrict efficient competition, distort the marketplace, and encourage mailers to leave the postal system, turning postal customers into competitors to the detriment of the postal system.²⁹

The best way to set rates that are fair to both customers and competitors, economically sound, and consistent with the interest in maintaining a viable postal system, is to establish cost-based rates. In this case, the ECR pound rate proposed by the Postal Service is a moderate move in that direction. Consequently, NAA and AAPS do not have a legitimate claim -- legal, policy, or otherwise -- that this more-cost-based proposed pound rate is in any manner inconsistent with the Postal Service’s proper “mission” or with the policies of the Act, including criterion 4.

²⁸ In cross-examination of SMC witness Giuliano, counsel for AAPS seemed intent on establishing that if postal rates were reduced, and if volumes shift, and “if some of those volumes come from alternative delivery companies, that would hurt those companies, wouldn’t it?” Tr. 19015. The answer to this question is “yes,” since *any* volume loss would technically “hurt” *any* business. But this is the *wrong* question under the standards of criterion 4 and *DMA v. USPS*. The relevant question is whether the loss of volumes would hurt *competition*.

²⁹ As NAA witness Crandall testified in Docket MC95-1, “it is good for [non-postal competitors] to have competition” from the Postal Service so long as the postal rates do not constitute “predation.” Tr. 20/9318, Docket MC95-1.

This brings us to the Commission's rationale for invoking criterion 4 in Docket R97-1. The crux of the Commission's reasoning was the statement that:

"However, rate reductions not firmly supported by reliable cost evidence that may jeopardize the visibility of small businesses, such as the alternate delivery services represented by AAPS, are not consistent with 39 U.S.C. § 3622(b)(4)."

This rationale has two *conjunctive* components: (1) that the proposed rate reductions lack "reliable cost evidence" *and* (2) that they "may jeopardize the visibility of small businesses." On the record in *this* proceeding, the Postal Service's substantially-more-modest proposed reduction in the pound rate meets the test of being "firmly supported by reliable cost evidence." Thus, under the R97-1 rationale, the pound rate proposal is *not inconsistent* with criterion 4.

V. HALDI'S CONCEPTUALLY DEFECTIVE PROPOSAL TO INCREASE THE ECR LETTER-NONLETTER RATE DIFFERENTIAL SHOULD BE REJECTED.

Haldi's proposal to increase the ECR letter-nonletter rate differential (for the High-Density and Saturation categories) is based on a flawed analysis of letter and nonletter volumes and costs derived from the ECR weight-cost study presented by USPS witness Daniel in USPS LR I-92. To correct for what he believed was a misallocation of the costs of heavy-weight (above the breakpoint) letters to the letter category rather than the nonletter category, he used cost estimates from the ECR weight-cost study to re-shift "heavyweight letter" costs from letters to nonletters. He then used the resulting increase in the letter-flat cost difference to expand the letter-flat rate differential. On top of this, he also increases the pound rate for nonletters above the breakpoint.

There are two key flaws in Dr. Haldi's analysis.

First, he overstated the effect of heavy-weight letters on the costs for letters and flats. That is a minor technical matter which Crowder corrected. Compared to Haldi's estimate of a 0.291¢ increase in the letter/flat difference, Crowder's analysis shows an

increase of only 0.077¢. Her explanation and analysis of this adjustment are set forth in ADVO-RT-1 at 40-41, Tr. 44/19405-06.

Second, and far more importantly, Haldi inappropriately used his overstated letter-flat adjustment to propose an expanded letter-nonletter rate differential. He incorrectly assumed that the entire letter-flat cost difference is purely shape-related, ignoring the fact that a portion of that cost difference is due to weight. Accordingly, by adopting a passthrough of near 100% (or more) of the letter-flat cost differential, he charged flats with both the letter-flat shape-related and weight-related cost differences. Thus, the combination of a high passthrough of the letter-flat cost difference, *plus* a separate high pound rate, results in a double-charging of weight-related costs to flats. It would charge flat mail, in the guise of a shape-related surcharge, with weight-related costs that are already over-recovered by the pound rate. ADVO-RT-1 at 41-43, Tr. 19406-08.

For these reasons, there should be no upward adjustment to the letter-flat rate differential proposed by witness Moeller. Moeller's own proposal is based on a very high passthrough of the USPS letter-flat cost differential, and thus suffers the same problem of double-counting of weight-related costs in conjunction with the pound rate. His double-counting, however, is at least mitigated by his lower proposed pound rate. Haldi's proposal, which would further increase an already high, double-counted letter-nonletter rate differential *and then compound the overcharge* by increasing the pound rate above that proposed by the Postal Service, is wrong in concept and inequitable in the extreme.

This inequitable and counter-intuitive situation only demonstrates why it is important to start moving the pound rate in the right direction – downward.

CONCLUSION

For the above reasons, the Saturation Mail Coalition urges the Commission to recommend to the Governors adoption of the Standard A ECR rates proposed by the Postal Service in this proceeding.

Respectfully submitted,



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CERTIFICATE OF SERVICE

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



Thomas W. McLaughlin

September 13, 2000