

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

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POSTAL RATE AND FEE CHANGES, 2000)

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Docket No. R2000-1

INITIAL BRIEF
OF
AMAZON.COM, INC.

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STATEMENT OF THE CASE

Course of Proceedings

On January 12, 2000, the United States Postal Service filed a request, pursuant to the Postal Reorganization Act (39 U.S.C. sections 3622 and 3623), for a recommended decision by the Postal Rate Commission on certain rates and fees, including, *inter alia*, proposals relating to Standard B Mail rates, as well as certain changes to the Domestic Mail Classification Schedule.

On January 14, 2000, the Commission issued a Notice of Filing of the Postal Service's submission (Order No. 1279). In accordance with Order No. 1279 and Rule 20a of the Commission's Rules of Practice and Procedure (39 CFR 3001.20a), Amazon.com, Inc. filed its notice of intervention as a limited participator on February 14, 2000.

The Postal Service's Request

The Postal Service's Request for a Recommended Decision initiating this proceeding requested rate and fee changes affecting all classes of mail, and asserted that without those changes the Postal Service would incur a revenue deficiency of \$3.7 billion in the requested test year (FY 2001). According to the Postal Service's initial filing, the requested rates would approximately break even, generating a small revenue deficit of approximately \$21.8 million in the test year.

Witness Michael K. Plunkett (USPS-T-36), the Postal Service's rate witness for Parcel Post, stated that his rate design in this docket generally follows the approach used by the Commission (and the Postal Service) in prior dockets.¹ However, he observes that this methodology would have resulted in certain "rate increases that were excessive" while other "rates in certain zones and categories would have received large discounts." Therefore, the proposed rates were adjusted (away from their cost-based foundation) so that increases could not exceed 10 percent. Additionally, DDU and DSCF rates were prevented from moving more than 2 percent in either direction.² In fact, the proposed DDU rates are identical to current rates.³

¹ USPS-T-36, p. 13.

² *Id.*, p. 13-14.

³ Response to AMZ/USPS-T36-7, Tr. 13/4978.

Discovery of the Postal Service's Case-in-Chief

Amazon.com conducted written cross-examination of three Postal Service witnesses with respect to their direct testimony.

Witness George S. Tolley (USPS-T-6)	Tr. 9/3605-08
Witness Jennifer L. Eggleston (USPS-T-26)	Tr. 13/5100-02
Witness Michael K. Plunkett (USPS-T-36)	Tr. 13/4969-85

Amazon.com Joint Direct Testimony

Amazon.com joined Direct Marketing Association, Inc., as well as several other intervenors (Advo, Inc., Alliance of Nonprofit Mailers, American Business Media, Association for Postal Commerce, Association of Priority Mail Users, Inc., Dow Jones & Company, Inc., Florida Gift Fruit Shippers Association, Greeting Card Association, Magazine Publishers of America, Mail Order Association of America, Major Mailers Association, Parcel Shippers Association, and Time Warner Inc.) in sponsoring the direct testimony (DMA-T-1, Tr. 22/9528-58) and supplemental testimony (DMA-ST-2, Tr. 38/17183-203) of Lawrence G. Buc (although Amazon.com's name inadvertently did not appear on the Buc supplemental testimony), with regard to the revenue requirement component of the Postal Service's case-in-chief. During the hearings, the Postal Service conducted oral cross-examination of witness Buc on his direct testimony (Tr. 22/9596-607), and on his rebuttal testimony (Tr. 38/17204-37). A separate initial brief on the revenue requirement has been filed by the above-listed intervenors, termed the "Consortium."

Direct Testimony of Other Intervenors Concerning Parcel Post

Florida Gift Fruit Shippers Association sponsored the direct testimony of witness Joseph E. Ball (FGFSA-T-1) criticizing the Postal Service's allocation of transportation costs (Tr. 30/14289-314). This testimony offered alternative methodologies for allocating certain transportation costs. No oral cross-examination of witness Ball was conducted.

Parcel Shippers Association ("PSA") sponsored the direct testimony of witness Win Zimmerman (PSA-T-1) proposing reductions in Parcel Post DBMC, DSCF, and DDU rates (Tr. 29/14123-50). This testimony sought to correct certain specific Parcel Post identified costs and supported a lower cost coverage. Oral cross-examination of witness Zimmerman appears at Tr. 29/14165-80.

All other intervenor direct testimony regarding Parcel Post was sponsored by United Parcel Service ("UPS"):

- Witness Stephen E. Sellick (UPS-T-4) attacking the Postal Service's new methodology for estimation of Parcel Post volume and revenue (Tr. 31/15017-57). Oral cross-examination of witness Sellick appears at Tr. 31/15154-215.
- Witness Ralph L. Luciani (UPS-T-5) proposing an alternative rate design and a different revenue target for Parcel Post (Tr. 25/11770-823). This testimony also attacked specific cost issues underlying the Postal Service's proposed Parcel Post rates. Oral cross-examination of witness Luciani appears at Tr. 25/11929-12020.

- Witness David E. M. Sappington (UPS-T-6) proposing an increased cost coverage for Parcel Post (Tr. 31/15219-267). Oral cross-examination of witness Sappington appears at Tr. 31/15472-640.

Amazon.com Discovery of Other Intervenors

Amazon.com submitted interrogatories and requests for production of documents to other intervenor witnesses, and responses to certain Amazon.com, interrogatories from witness Luciani (AMZ/UPS-T5-1-10, Tr. 25/11840-55) and witness Sappington (AMZ/UPS-T6-1-16, Tr. 31/15274-304) were designated as written cross-examination.

Counsel for Amazon.com orally cross-examined witness Luciani (Tr. 25/11929-47) and witness Sappington (Tr. 31/15472-512).

Rebuttal Testimony

Amazon.com sponsored the rebuttal testimony of witness John Haldi (AMZ-RT-1, Tr. 44/19519-52). Witness Haldi's rebuttal testimony exposes several errors relied upon by witness Luciani (UPS-T-5) in developing his DSCF- and DDU-entry Parcel Post rates. Witness Haldi also demonstrates why witness Sappington's proposed 24.9 percent (revised 6/22/2000) rate increase to Parcel Post (Tr. 31/15260, ll. 4-5) is not supported in the record.

Amazon.com also sponsored the rebuttal testimony of witness John L. Clark (AMZ-RT-2, Tr. 41/18123-41). Witness Clark's rebuttal testimony warns of the

deleterious effects which would result from implementation of UPS' proposed rates.

He also offers a consolidator's perspective on the value of service of both Parcel Post and the services of competitors, as well as on the question raised by UPS as to whether the Postal Service is acting as an unfair competitor.

The testimony of witnesses Luciani and Sappington with regard to Parcel Post also were rebutted by Postal Service witnesses Lloyd Raymond (USPS-RT-11, Tr. 39/17904-24), Nancy R. Kay (USPS-RT-13, Tr. 39/17754-811), and Jennifer L. Eggleston (USPS-RT-20, Tr. 41/18157-77), as well as Parcel Shippers Association witnesses Sander A. Glick (PSA-RT-1, Tr. 41/18057-88) and Jon Wittnebel (PSA-RT-2, Tr. 41/18041-48).

SUMMARY OF ARGUMENT

The Postal Service's proposed DDU Parcel Post rates, as presented in the Postal Service's case-in-chief by witness Plunkett, and as supported in rebuttal testimony by Amazon.com witnesses Haldi and Clark, PSA witnesses Wittnebel and Glick, and Postal Service witnesses Raymond, Kay, and Eggleston, should be recommended by the Commission.

UPS witness Luciani's proposals, which seek to add substantial attributable costs to Parcel Post, are not supported in the record and should not be adopted by the Commission. Likewise, UPS witness Sappington proposed purported justifications for a 38 percent rate increase, reflecting an increase in Parcel Post's cost coverage, also lack merit and should not be adopted.

ARGUMENT**I. THE POSTAL SERVICE'S PROPOSED PARCEL POST RATES ARE BASED ON A CREDITABLE RATE DESIGN.**

Witness Plunkett, the Postal Service's rate witness for Parcel Post, states that rate design in this docket generally follows the approach used by the Commission in Docket No. R97-1. USPS-T-36, p. 13. He observed, however, that faithful application of this methodology would have resulted in some "rate increases that were excessive," while other "rates in certain zones and categories would have received large discounts." Therefore, the proposed rates were adjusted (away from their cost-based foundation) so that increases would not exceed 10 percent. Additionally, the two new rate categories adopted in Docket No. R97-1 (DSCF- and DDU-entry) were prevented from either increasing or decreasing by more than 2 percent. *Id.*, pp. 13-14.

Witness Plunkett proposes no change in the current DDU-entry Parcel Post rates. Response to AMZ/USPS-T36-7, Tr. 13/4978. Preliminary rates (used to calculate Parcel Post rates) were between \$0.12 and \$0.36 lower — 10-17 percent lower — than the current rates. Responses to AMZ/USPS-T36-8(a) and (b), Tr. 13/4979. Witness Plunkett's proposed DSCF destination entry rates reflect (i) current rates for mailpieces weighing up to 36 pounds, and (ii) his calculated preliminary rates for mailpieces weighing from 37 pounds through 70 pounds. Response to AMZ/USPS-T36-9, Tr. 13/4981. Thus, the Postal Service proposed DSCF- and DDU-entry rates that are generally identical to current rates — evidently because more cost-based rates would require rate reductions.

The Postal Service has asserted that these rates reflect a 100 percent passthrough of avoided cost. Response to PostCom/USPS-T37-2(d). However, witness Plunkett admitted that the constraints he placed on DDU rates (*e.g.*, increasing the 2 pound rate from the preliminary \$1.09 figure to the current \$1.23 figure) had the same effect as reducing the passthrough to 80 percent. Response to UPS/USPS-T36-6, Tr. 13/5009.

The Postal Service has also acknowledged that, while the Commission had recommended a cost coverage of 108 percent in Docket No. R97-1, the actual cost coverage for Parcel Post in the Test Year, FY 1998 (*i.e.*, before implementation of the Docket No. R97-1 rate increases), was 112.4 percent — higher than the Commission's recommendation. Response to PSA/USPS-T32-10(c), Tr. 11/4380. The average rate increase for Parcel Post in Docket No. R97-1 was 12.3 percent. Response to PSA/USPS-T32-10(b), (e), Tr. 11/4380.

Thus, the Postal Service could have proposed lower DSCF- and DDU-entry rates which would have been more cost-based than the rates which it has proposed in this docket. However, the rates which the Postal Service has proposed are reasonable and supported by the record, and should be recommended by the Commission.

II. UNITED PARCEL SERVICE'S PROPOSED PARCEL POST RATE INCREASES SHOULD NOT BE ADOPTED.

A. UPS Witness Luciani's DDU Parcel Post Cost and Markup Adjustments Are Not Supported and Should Not Be Recommended.

UPS witness Luciani (UPS-T-5) attacks the Postal Service's calculation of the DDU discount for Parcel Post. Witness Luciani also recommends a distinct DDU cost coverage. His cost and rate design proposals are at odds with well-established Commission procedures, are not supported in the record, and should not be adopted by the Commission.

1. Witness Luciani's Rejection of Unloading Cost Savings Is Speculative and Unsupported by Actual Practice, as Demonstrated on this Record.

Witness Luciani cited 1998 Mailers Technical Advisory Committee ("MTAC") meeting minutes, which he asserted had stated that Postal Service employees will assist in unloading mail at the DDU when they are available. He states that calculation of costs avoided by DDU dropshipment includes 4.36 cents for unloading costs. Witness Luciani further observes that, in Docket No. R97-1, the Commission deducted 2.1 cents from the Postal Service's calculated cost avoidance, reflecting costs incurred by sack shakeout at the DDU. The Commission had agreed with UPS that these costs were incurred by the Postal Service when mail was dropshipped to the DDU. Witness Luciani again asks the Commission to deduct 2.1 cents from the Postal Service's calculated cost avoidance (and discount) in this docket. UPS-T-5, pp. 27-28, Tr. 25/11800-01.

Witness Luciani's reduction of DDU Parcel Post avoided costs reflects an assumption that "[t]he 2.1 cents per piece avoided if the mailer sometimes shakes out sacks **must** be offset against the 4.36 cents incurred when the Postal Service sometimes helps unload the parcels." Response to AMZ/UPS-T5-1, Tr. 25/11840-42 (emphasis added). Yet he admits that he does not know (i) what precise assistance Postal Service employees allegedly provide in unloading DDU-entry mail, (ii) whether the same assistance is always provided, (iii) whether such assistance is provided only when Postal Service employees are available, or (iv) even how much (or how often) such assistance is related to sack shakeout. *Id.* He further acknowledges that, if no DDU-entry pieces are in sacks, no costs would be associated with dumping sacks. Response to USPS/UPS-T5-22, Tr. 25/11894.

Other than the ambiguous and prospective language from the MTAC meeting minutes cited above, and a statement made at a DDU that Postal Service employees "likely" would assist in unloading any DDU-entry trucks, no evidence supports witness Luciani's reduction from the Postal Service's cost avoidance. Response to AMZ/UPS-T5-1, Tr. 25/11840-42. Furthermore, in this docket, three witnesses have testified with regard to actual DDU-entry practices.

Witnesses Clark (AMZ-RT-2) and Wittnebel (PSA-RT-2) have testified regarding the DDU-entry experiences of CTC, now a subsidiary of R.R. Donnelley & Sons Co., engaged in consolidating and drop shipping parcels to destination entry points. Witness Wittnebel states that CTC is responsible for "the vast majority of all DDU parcels delivered by the Postal Service." *Id.*, pp. 2-4, Tr. 41/18044-46.

Witness Wittnebel observes that his testimony is not based on speculation (like witness Luciani's testimony), but on his "operational knowledge of what actually occurs at the more than 3,000 delivery units at which CTC enters DDU parcels." Witness Wittnebel testifies (and documents) that, "when CTC enters parcels at the DDU, our drivers follow one of two procedures. If the parcels are bed loaded, our drivers separate them (by five-digit zip codes) directly into/on mail transportation equipment on the receiving dock within 20 minutes of arrival. If the parcels are palletized, our drivers remove the pallets from our trucks and place them on the dock within 20 minutes of arrival." He observes that, "[e]ither way, our drivers are responsible for unloading our trucks." Witness Wittnebel further testified as to his understanding that "other mailers of DDU parcels follow similar procedures." *Id.*, pp. 2-3, Tr. 41/18044-45.

Witness Wittnebel was also in attendance at the May 14, 1998 meeting of the MTAC Parcel IRT cited by witness Luciani. As for witness Luciani's speculation that the Postal Service had committed to help mailers unload DDU parcels from mailer trucks, witness Wittnebel both "guarantee[s] that the Postal Service made no such commitment." and "state[s] categorically that, in practice, the Postal Service does not provide such assistance." *Id.*, p. 2, Tr. 41/18044.

Witness Clark testified that parcels delivered to DDUs (which are generally palletized or bed loaded) "are typically transferred by the driver to hampers, one for each zip code. The hampers are on wheels and they are then rolled into the Postal Unit for final sort to the routes." He observed that any parcels transported in sacks would

be emptied into the same hampers by the driver. AMZ-RT-2, pp. 14-15, Tr. 41/18138-39.

Witness Halstein Stralberg (TW-T-1, Tr. 24/11344-416) testifies, based upon Time Warner's entry of mail at DDUs, that "the driver for the mailer is required to unload the mail and place it on the DDU platform, thereby helping the Postal Service to avoid the DDU unloading costs it would have incurred if the mail were not dropshipped." He adds that "[t]here can be no doubt that mailers actually are required to unload their own mail when they dropship to the DDU, and that this policy is being enforced in practice." TW-T-1, p. 56, Tr. 24/11403, ll. 20-21. Witness Stralberg further observes that current practice is consistent with Postal Service Publication 804, entitled "Drop Shipment Procedures for Destination Entry," USPS-LR-I-296. *Id.*, p. 57, Tr. 24/11404.

Under witness Luciani's own reasoning, therefore, no costs exist to be deducted from the DDU-entry cost avoidance. Amazon.com submits that witness Luciani's proposal to eliminate 2.1 cents per piece from the DDU-entry cost avoidance should be rejected by the Commission, as contrary to the record evidence in this docket.

2. Witness Luciani's Criticism of Averaging Machinable and Nonmachinable Parcel Costs in the Calculation of DDU-entry Parcel Post Cost Avoidance Lacks Merit.

Witness Luciani further criticizes the Postal Service's calculation of DDU cost avoidance because it incorporates an average of machinable and nonmachinable cost avoidances. He notes that the Postal Service has proposed that DBMC-entry nonmachinable parcels be subject to a surcharge, and concludes that this averaging

leads to a “nonsensical result” — a “parcel with 67.3 cents per piece of mail processing costs avoid[ing] 73.0 cents of costs if entered at the DDU.” Based upon his analysis, witness Luciani asks the Commission to reduce the DDU cost avoidance by another 5.7 cents per piece. UPS-T-5, p. 28, Tr. 25/11801, ll. 18-20. He states that the Postal Service’s methodology results in a “double-count of savings.” Response to AMZ/UPS-T5-2, Tr. 25/11843-44. In other words, witness Luciani does not want the calculated cost avoidance to reflect the mix of machinable and nonmachinable parcels receiving DDU entry.

Of course, averaging is an integral component of Postal ratemaking, as when the Postal Service averaged the costs associated with parcels from four distinct Standard A subclasses — parcels with widely disparate costs (and physical characteristics) in the formulation of a single Standard A residual shape surcharge.

Furthermore, witness Glick (PSA-RT-1) demonstrates that the nonmachinable parcel surcharge reflects only 35 percent of the additional costs incurred by nonmachinable parcels. PSA-RT-1, pp. 17-18, Tr. 41/18076-77. Witness Clark (AMZ-RT-2) observes that the costs avoided by the Postal Service are being incurred by the alternative source of transportation, which needs an adequate financial incentive to perform the work. AMZ-RT-2, p. 15, Tr. 41/18139. Since additional cost avoidance (not reflected in the nonmachinable surcharge) is achieved through DDU-entry of nonmachinable parcels, such cost avoidance is appropriately reflected in the overall DDU-entry cost avoidance calculation. Witness Luciani’s 5.7 cent reduction in DDU-entry cost avoidance should be rejected by the Commission.

3. Witness Luciani's Attribution of Alaska Air Costs to DSCF- and DDU-entry Parcel Post Is Not Based on Record Evidence and Should Not Be Adopted.

Witness Luciani observes that, in conformance to the Commission's practice in Docket No. R97-1, the Postal Service attributes all Alaska air costs to inter-BMC and intra-BMC parcel post. Arguing that the Postal Service attributes Alaska air costs in this way because only these categories are available in Alaska, and that DSCF- and DDU-entry rates are also available in Alaska, he asserts that, under the Commission's methodology, Alaska air costs must be reflected in DSCF and DDU rates. UPS-T-5, p. 30, Tr. 25/11803, ll. 7-8. Witness Luciani proposes allocating the \$9.44 million of Test Year Alaska air costs for transportation to reflect DSCF- and DDU-entry parcels incurring one leg of transportation, in comparison to two legs for intra-BMC and inter-BMC volume, which would increase the transportation cost for DDU-entry and DSCF-entry parcels by 8.5 cents per cubic foot, while reducing the transportation cost for inter-BMC and intra-BMC by 3 cents per cubic foot. *Id.*, ll. 11-14.

Witness Glick observes that witness Luciani's methodology results in double counting. Witness Glick points out that Postal Service witness Eggleston had already accounted for Alaska air costs in her modeling of DSCF and DDU costs; thus, the attribution of additional Alaska air costs to DSCF- and DDU-entry Parcel Post, as witness Luciani proposes, would result in duplicative cost attribution. PSA-RT-1, p. 23. Tr. 41/18082.

It is also noteworthy that the Commission's cost allocation and rate design methodology from Docket No. R97-1 reflected the establishment of DSCF- and DDU-

entry Parcel Post. Thus, the burden would be on UPS to demonstrate that the Commission's methodology was inadequate or incomplete — a burden which has not been met.

4. Witness Luciani's Bottom-up Parcel Delivery Costs Are Based on Improper Assumptions and Do Not Offer a Credible Basis for Increasing DDU Rates.

Witness Luciani developed bottom-up DDU-entry parcel delivery costs, identifying a delivery cost of **\$1.14 per piece** (contrasted to the **\$0.96 per piece** in witness Plunkett's analysis). Witness Luciani explains that his bottom-up methodology used the Engineered Standards to estimate (i) loading and access costs and (ii) volume variable costs for route time and in-office costs, then added the cost of one manual sort to carrier route conducted by a clerk/mailhandler at the DDU. UPS-T-5, p. 33, Tr. 25/11806, ll. 13-18. Witness Luciani states that the Engineered Standards study tends to understate actual costs incurred (observing that they reflect "more efficient operations than are now conducted"), and he proposes that the Commission address the concerns regarding the Postal Service's cost data by (further) reducing the passthrough of costs avoided. *Id.*, p. 34, Tr. 25/11807, ll. 1-5.

Clearly, however, witness Luciani's cost analysis is deficient. Witness Haldi developed bottom-up DDU-entry parcel delivery costs using (i) CRA costs from BY 1998 and FY 1999 and (ii) Parcel Post volumes preferred by UPS as well as those preferred by the Postal Service. Depending on the assumptions used, he calculated parcel delivery costs range from \$0.39 to \$0.60 — generally less than half the size of witness Luciani's calculated parcel delivery cost, and substantially below that of

witness Plunkett. AMZ-RT-1, p. 21, Tr. 44/19542. Obviously, witness Luciani's calculations were never reconciled with CRA data.

Witness Glick testifies that, even using the Engineered Standards study data, witness Luciani's calculations were flawed. According to witness Glick, an accurate calculation of parcel delivery costs from such data would result in a delivery cost per piece of \$0.94 — 2 cents less than the cost identified by witness Plunkett. PSA-RT-1, p. 27, Tr. 41/18086.

In sum, witness Luciani's bottom-up parcel delivery cost calculations are based upon a misapplication of the underlying data (which data may reflect higher-than-actual parcel delivery costs), reflect errors in calculation, were never reconciled to CRA data, and do not provide a credible basis for increasing DDU-entry Parcel Post rates.

5. Witness Luciani's Assignment of a Distinct Implicit Cost Coverage to DDU-entry Parcel Post Is Meritless and Would Set a Dangerous Precedent.

Witness Luciani also proposes that the Commission should use a separate implicit cost coverage when determining the passthrough to use for DDU-entry Parcel Post. He asserts that, in DDUs, Parcel Post is generally handled the same as Priority Mail or First-Class Mail, and receives next day delivery 97 percent of the time. Therefore, witness Luciani proposes that DDU Parcel Post receive the same markup as Priority Mail, which he stated was 63 percent. He states that this markup would produce an average DDU revenue per piece of \$1.57. UPS-T-5, pp. 32-33, Tr. 25/11805-06.

Such a proposal is problematic on several counts. Witness Haldi expresses concern that witness Luciani's approach would establish a precedent whereby each mail product with a DDU-entry rate category would elicit distinct implicit markups for that rate category, requiring consideration of performance data from the DDU to the addressee, and perhaps efforts to obtain equalization of cost coverages between DDU-entry rate categories. AMZ-RT-1, pp. 24-25, Tr. 44/19545-46. Witness Haldi also observes that witness Luciani's justification for his proposed DDU-entry Parcel Post markup fixates on only one of the Section 3622(b) non-cost criteria — value of service — raising the question as to whether some other (or all) non-cost criteria should also be considered, if passthroughs for workshared rate categories are to be based on implicit markups, rather than cost avoidance.

Witness Clark testifies that witness Luciani exaggerates the value of DDU-entry Parcel Post to mailers. He observes that DDU-entry Parcel Post has very few users, because the service is not really accessible unless both an adequate network and sufficient volume are established. He notes other limitations on the actual service received by mailers — for example, the inability of the Postal Service to provide DDU-entry times that would facilitate faster delivery. Witness Clark testifies that, even when “parcels entered at a DDU do receive next day service, that transit time is only one element of the total time in transit, and those delivery times certainly have not been comparable to Priority Mail.” AMZ-RT-2, pp. 15-16, Tr. 41/18139-40.

In summary, witness Luciani's proposal that the Commission set the implicit cost coverage for DDU-entry Parcel Post presents a backdoor means of superseding the

Commission's distinct treatment of subclasses and rate categories — a distinction which was fundamental to the Commission's Opinion and Recommended Decision in Docket No. MC95-1. Amazon.com urges the Commission to maintain this distinction, and reject witness Luciani's proposed implicit cost coverage for DDU-entry Parcel Post.

6. Witness Luciani Fails to Incorporate Updated Test Year Advertising Cost Estimates in His Proposed Parcel Post Rates.

Witness Luciani states that \$20 million in base year advertising costs should have been attributed to Parcel Post, as well as \$18.5 million in test year advertising costs. He cites errata to Postal Service witness Kay's testimony which identified these amounts as product specific costs. UPS-T-5, pp. 3-4, Tr. 25/11776-77.

However, witness Luciani's supplemental testimony (UPS-ST-2), while acknowledging a drop in advertising expenses from \$20 million in FY 1998⁴ to \$0.8 million in FY 1999 (with estimated Test Year advertising expenditures expected to drop from \$18.5 million to \$0.6 million), refuses to adjust his estimation of Parcel Post's allocable costs accordingly. UPS-ST-2, p. 3, Tr. 38/17243. (Actually, the amount is \$0.555 million. AMZ-RT-2, pp. 12-13, Tr. 41/18136-37.) Thus, on this question alone, witness Luciani's calculation of Parcel Post's allocable costs are overstated by nearly \$18 million.

⁴ Witness Clark testified regarding his understanding that actual FY 1998 Parcel Post advertising expenditures were under \$1 million. (AMZ-RT-2, p. 12, ll. 17-20, Tr. 41/18136.)

7. Witness Luciani's Assertion that the Postal Service Double Counted Transportation Cost Savings in its Calculation of Destination Entry Rates Lacks Merit.

Witness Luciani accuses the Postal Service of double counting transportation cost savings from the dropshipment of Parcel Post. He states that Postal Service witness Sharon Daniel's (USPS-T-28) calculation of transportation cost savings included the assumption that Parcel Post's base year transportation costs do not reflect any cost savings from entering parcels at the DSCF or at the DDU. He also states, however, that Postal Service witness Eggleston's Test Year transportation costs for DBMC-entry Parcel Post had already been reduced (from what they otherwise would have been) because 7.11 percent of DBMC-entry pieces were entered at a DSCF, thereby already saving a leg of intermediate transportation from the DBMC to the DSCF. Because of this alleged "double counting" of transportation cost savings, witness Luciani proposes that estimated Test Year cost savings be reduced by \$6.6 million (32 percent). UPS-T-5, pp. 4-7, Tr. 25/11777-80.

However, witness Eggleston observes that witness Luciani's claim of double-counting only makes sense if 7.11 percent of DBMC is dropped at the destination SCF in the pre-mix volume, and not in the post-mix volume. She notes that it is rational to assume that, if 7.11 percent of DBMC is dropped at the destination SCF in the pre-mix volume, 7.11 percent of DBMC volume would be dropped at the destination SCF in the post-mix volume — in which instance no double counting occurs. Witness Eggleston cites witness Luciani's acknowledgment (Tr. 25/11927) that DBMC parcels would not be dropped at the destination SCF because, if they were not sorted to 5-digits, they

would need to be sent back to the destination BMC and would not qualify for the DBMC rate. By this analysis, the percentage of DBMC parcels dropped at the destination SCF should be zero for both the pre-mix and post-mix volumes. USPS-RT-20, p. 2, Tr. 41/18161.

8. Witness Luciani's Distribution of City Carrier Elemental Load Costs Is Not Supported by the Record and Should Not Be Adopted by the Commission.

Witness Luciani observes that Postal Service witness Daniel distributed city carrier elemental load costs (which includes the time spent handling mail pieces at the point of delivery) by weight within First-Class Mail, Periodicals, and Standard A Mail. However, the Postal Service's base year cost rate design witness, Karen Meehan (USPS-T-11), distributed these costs between classes and subclasses by volume, rather than weight. Witness Luciani now proposes that these costs be attributed by weight, rather than by volume, which would more than triple the amount of such costs attributed to Parcel Post (from \$26.4 million to \$80.6 million). He further proposes that city carrier street support costs be attributed by weight rather than by volume, adding another \$11.7 million to Parcel Post's attributable costs. UPS-T-5, pp. 7-10, Exhibit USPS-T-5B, p. 2, Tr. 25/11780-83, 11810.

Witness Haldi observes that witness Daniel's methodology reflected a mere assumption — unsupported by any study, empirical data, or any other evidence — under which elemental load costs are distributed by weight. Further, there is no indication either that witness Daniel intended for her methodology to be used as the basis for allocating costs, or that the Postal Service allocated costs in any class or

subclass based upon her methodology. Also, witness Daniel did not even address Standard B mail. AMZ-RT-1, p.18, Tr. 44/19539.

Witness Haldi also observes that witness Luciani's adoption of witness Daniel's assumption regarding the distribution of costs by weight was entirely on faith. Witness Luciani had conducted no study of the issue, and he had no evidence in support of this theory. In fact, witness Luciani even resists attesting to the accuracy of witness Daniel's methodology as applied to any of the classes of mail which she had studied. *Id.*, p. 19, Tr. 44/19540, ll. 17-19.

Witness Kay (USPS-RT-13) reiterates that witness Daniel's distribution of elemental load costs on the basis of weight incorporated assumptions which were not supported by studies or evidence. The purpose of witness Daniel's assumption was to set an upper bound on the impact of weight on costs. USPS-RT-13, pp. 3-4, Tr. 39/17759-60.

Witness Kay observes that witness Daniel also performed a delivery cost study to distribute costs between rate categories, which distributes such costs by volume. Witness Kay testifies that witness Daniel "is clearly not recommending that the Postal Service distribute elemental load costs on weight **between** subclasses in the CRA, as Mr. Luciani contends." *Id.*, pp. 4-5, Tr. 39/17760-61. She concludes that "[b]ecause weight is not a proven factor in city carrier load costs, Mr. Luciani's proposal to distribute elemental load costs across subclasses by weight is clearly inappropriate and should not be implemented." *Id.*, p. 7, Tr. 39/17763, ll. 1-3.

Witness Glick observes that the Commission's method for estimating elemental load costs is to perform a regression, with average load time per stop as the dependent variable and mail pieces by shape among the independent variables. PSA-RT-1, p. 12, Tr. 41/18071, ll. 5-8, citing *Op. & Rec. Dec.*, Docket No. R97-1, para. 3258. He states that, without a new study regarding the effect of weight on elemental load costs, this regression analysis remains the best evidence regarding the drivers of elemental load costs, and that, to be consistent with this attribution method, elemental load costs should be distributed between subclasses using parcel volume. PSA-RT-1, p. 12, Tr. 41/18071, ll. 8-12.

Given the state of the record, the purpose behind witness Daniel's study, and the limitations of that study, the Postal Service's proposed distribution of elemental load costs between classes and subclasses, including Parcel Post, should be retained.

9. The Assumptions Underlying Witness Luciani's Proposal that Parcel Sequencing Costs be Allocated Between Subclasses Are Not Based on Facts, and the Proposal Should Be Rejected.

Witness Luciani proposes that the cost of sequencing parcels into delivery order be backed out of City Carrier Street Support costs and allocated to Parcel Post (and the other Standard B subclasses, as well as Priority Mail). He uses the Postal Service's (confidential) Engineered Standards study to identify how much time was spent sequencing parcels (which he asserted was performed during the loading of the postal vehicle, or while en route). He then calculates a cost per piece for sequencing parcels, multiplying the time spent by the city carrier wage rate. He next multiplies the cost per piece by the volume of parcels delivered in each affected subclass (as estimated by

Postal Service witness Thomas W. Harahush (USPS-T-3). These totals were then backed out of city carrier street support costs, and reattributed. The resulting increase in costs attributed to Parcel Post under witness Luciani's proposal was filed under seal, as were the supporting calculations. UPS-T-5, pp. 10-12, Tr. 25/11783-85.

Witness Kay (USPS-RT-13) observes that witness Luciani's calculation is a misapplication of Engineered Standards study data, which provide an average — not marginal — cost per piece. USPS-RT-13, p. 9, Tr. 39/17765. Witness Kay also testifies that “[t]here is no sound reason to assume that the activity of loading parcels measured by the time standard is the same as the activity of casing letters and flats.” She adds that there are extensive procedures governing the casing of letters and flats, but no corresponding procedures governing the casing or sequencing of parcels. *Id.*, pp. 9-10, Tr. 39/17765-66.

Witness Kay notes that “[t]ime standards cannot substitute for engineering studies involving actual observations.” She challenges witness Luciani's effort to simplify carrier costing by multiplying a single time standard by a carrier wage rate and mail volume, concluding:

Vehicle loading supports all carrier delivery activities, so the application of the aggregate city carrier variability and distribution is correct, and applies to all vehicle loading costs. It is unnecessary to separate vehicle load costs for parcels from other street support costs. The current, accepted treatment properly treats all street support costs. [USPS-RT-13, pp. 9, 11, Tr. 39/17765, ll. 5-6, and 17767, ll. 13-17.]

Witness Raymond (USPS-RT-11), who prepared the engineering standards study, observes that the time standards in his study have not been implemented by the Postal Service, and that “it would be incorrect to assume, as witness Luciani does, that carriers currently are not meeting or beating particular time standards included in the Standard Operating Procedures documents.” USPS-RT-11, p. 19, Tr. 39/17924, ll. 9-11. Witness Raymond observes that the actual practice of placing parcels on delivery vehicles typically does not involve placement in actual delivery order, and “is a very casual process.” Since parcels are not “sequenced” in delivery order, their placement on delivery vehicles cannot be equated to in-office sequencing. *Id.*, pp. 18-19, Tr. 39/17923-24.

Therefore, witness Luciani’s assumptions — that the Engineered Standards reflect current practice, that “city carriers are likely not yet meeting those time standards,” and that “the cost per piece for sequencing parcels obtained using the results of the time standards is a conservatively low estimate” — are not valid. *Id.*, pp. 18-19, Tr. 39/17923-24.

10. Witness Luciani’s Proposed Treatment of “Exclusive Parcel Post Route” Costs Embraces an Oversimplified Understanding of Such Routes and Should Be Rejected.

Witness Luciani also states that the Postal Service misattributed costs related to “Exclusive Parcel Post Routes,” one of several categories of “City Carrier Special Purpose Routes.” He identifies total base year costs of the Exclusive Parcel Post Routes as \$37.4 million. However, the total attribution of special purpose route costs to Parcel Post was \$11.0 million. Witness Luciani proposes, at minimum, that \$26.4

million in attributable costs be added to Parcel Post. UPS-T-5, pp. 12-14, Tr. 25/11785-87.

Witness Kay notes witness Luciani's testimony that his proposal is based solely on the (perhaps inappropriate) title of such routes, and a description of the routes found in Library Reference USPS-LR-I-14. In response, witness Kay demonstrates that the Postal Service sometimes uses "Parcel Post" to refer to all parcels. USPS-RT-13, pp. 12-13, Tr. 39/17768-69, 1. 22 through 17769, 1. 2. Exhibit USPS-RT-13D provides examples of this usage of the term "Parcel Post." Witness Kay documents that the parcels handled on such routes are not all (or even mostly) Standard B, let alone Parcel Post. She concludes with the observation that the Postal Service is applying the methodology which had been accepted by the Commission in Docket No. R97-1. *Id.*, pp. 13-14, Tr. 39/17769-70.

Witness Glick discusses the data collected in a study of "Exclusive Parcel Post Routes" from Docket No. R97-1: only 13.5 percent of the parcels delivered were Parcel Post; on some of the days studied, none of the parcels delivered were Parcel Post; and the percentage of parcels delivered never exceeded 34 percent on the days studied. He concludes that the Commission should reject witness Luciani's proposal. PSA-RT-1, pp. 12-13, Tr. 41/18071-72.

Amazon.com likewise urges the Commission to recognize the actual nature of these routes, by accepting in this docket the established procedure for the allocation of costs to these routes, rejecting witness Luciani's proposals.

B. UPS's Proposed Parcel Post Rates Are Not Supported in the Record and Should Not Be Recommended.

Witness Sappington (UPS-T-6), in his direct testimony, proposes a **24.9 percent** increase⁵ in Parcel Post, which he states would result in a cost coverage of **111 percent**. UPS-T-6, p. 39, Tr. 31/15260, ll. 4-6. Witness Luciani (UPS-ST-2), recalculating Parcel Post rates using FY 1999 as the Base Year, proposes a higher increase of **38 percent**, retaining the same cost coverage. UPS-ST-2, pp. 1, 9, Table ST-5, Tr. 38/17241, 17249.

Witness Sappington states that his proposed rate increase and target cost coverage reflect (1) the substantial increase in Parcel Post total attributable costs since Docket No. R97-1, (2) the volume and revenue growth experienced by Parcel Post (suggesting an ability to bear a higher markup), and (3) the higher value of Parcel Post due to delivery confirmation and the new dropship discounts. UPS-T-6, p. 39, Tr. 31/15260, ll. 8-16.

1. Increases to Parcel Post's Total Attributable Costs Do Not Support Rate Increases.

Witness Sappington claims, using calculations from witness Luciani, that Parcel Post TYAR total attributable costs increased 31 percent from Docket No. R97-1 to this docket. He asserts that a 31 percent rate increase would therefore be necessary to ensure that Parcel Post revenues exceed costs. *Id.*, p. 40, Tr. 31/15261, ll. 13-15.

⁵ Revised on June 22, 2000 from 31.1 percent to 24.9 percent.

As witness Haldi observes, however, witness Sappington's analysis focuses on increases to Parcel Post **total** attributable costs, not increases to Parcel Post **unit** attributable costs. Witness Haldi points out the fallacy of the Sappington argument and illustrates it by observing that microchip manufacturer Intel's costs increased by a similar amount (29 percent) over a similar (four-year) time period, yet the unit attributable costs (and consumer costs) for microchips decreased over the four-year period. Thus, much of the increase in subclass-wide attributable costs can be ascribed to the substantial increases in Parcel Post volume since Docket No. R97-1. Witness Haldi concludes that the proper analysis would be to focus on changes in unit attributable costs, not total attributable costs. AMZ-RT-1, pp. 2-4, Tr. 44/19523-25. Clearly, witness Sappington's argument linking increases in rates to increases in total attributable costs has no merit.

2. The Negligible Increase in Parcel Post Volume Following Implementation of Docket No. R97-1 Rates Does Not Support the Imposition of an Increase 2-3 Times Larger.

Witness Sappington states — using Postal Service volume and revenue estimates from its DRPW/BRPW methodology — that Parcel Post volumes and revenues continued to increase in 1999 after implementation of the 12 percent rate increase of Docket No. R97-1. (The volume increase was 0.9 percent in 1999.) He concludes that Parcel Post could therefore sustain an increase several times larger. UPS-T-6, pp. 40-42, Tr. 31/15261-63.

Witness Haldi, citing witness Sappington's testimony and witness Luciani's workpapers, observes that UPS had roughly estimated that its proposed 24.9 percent

rate increase would reduce Parcel Post volumes by 14.7 percent from TYBR to TYAR; Parcel Post volumes would fall below 1998 levels (to 266 million). AMZ-RT-1, pp. 5-6, Tr. 44/19526-27. Witness Luciani's rebuttal testimony, proposing a 38 percent rate increase, would reduce Parcel Post volumes even more — by 24.5 percent from TYBR to TYAR; Parcel Post volumes would fall below 1997 levels (to less than 235 million). UPS-ST-2, p. 10, Table ST-6, Tr. 38/17250.

Witness Haldi concludes that even UPS' proposed 24.9 percent rate increase “would reduce Parcel Post volumes and market share by an unacceptably large amount, to an unacceptably low level.” AMZ-RT-1, p. 5, Tr. 44/19526, ll. 4-5. Since that is true of the original UPS proposal — a 24.9 percent rate increase, reducing Parcel Post volume to 266 million — how much stronger is the argument when the proposed rate increase is 38 percent, and the volume drops below 235 million — nearly **140 million** less than the Postal Service's estimated TYAR Parcel Post volume. *See* UPS-ST-2, p. 10, Table ST-6, Tr. 38/17250.

Witness Clark identifies three likely consequences if UPS's proposed rate increase is recommended by the Commission:

The rate for an individual shipment will increase sufficiently relative to the next alternative carrier to cause a dramatic shift to that carrier. Alternatively, the rate will rise to a level which will cause shippers to reduce, or eliminate completely, the sale of lower priced merchandise which cannot bear the increased cost of shipping. The third possibility is that the alternative delivery company will simply raise its prices, using the postal rate as an umbrella under which it operates. [AMZ-RT-2, p. 7, Tr. 41/18131, ll. 4.-11.]

Witness Clark observes that mostly low-value merchandise is carried by Parcel Post. He asks whether a \$10.95 purchase can stand a delivery charge of \$7.00. *Id.*, pp. 6-7, Tr. 41/18130-31.

3. UPS's Arguments for a Higher Parcel Post Cost Coverage Lack Merit.

a. Parcel Post Covers Attributable Costs.

Witness Sappington calls for Parcel Post to receive a higher cost coverage than that recommended by the Commission in Docket No. R97-1. One reason he gives for the higher cost coverage is his assertion that Parcel Post revenues failed to cover attributable costs in 1989-91, 1993-94, and 1996-98 (1998 data reflecting traditional Postal Service calculations of revenue and volume). UPS-T-6, pp. 42-43, Tr. 31/15263-64.

Witness Haldi notes witness Sappington's admission that his calculations do not reflect the Commission's Alaska Air adjustment to Parcel Post's attributable costs, and that, as a result, witness Sappington actually does not know whether Parcel Post revenues have in fact covered attributable costs. AMZ-RT-1, pp. 8-9, Tr. 44/19529, l. 32, through 19530, l. 5.

b. Parcel Post Is Not a Higher Value Service.

Witness Sappington comments on utilization of DSCF- and DDU-entry Parcel Post for "more expedited parcel services" as a reflection that Parcel Post has become a higher value service. He cites utilization of DDU-entry Parcel Post by *Airborne@Home*, which he called "a service that provides high value to both the

senders and the recipients of parcels.” He also states that the availability of delivery confirmation “further increases the value of service that Parcel Post now delivers to its users.” Witness Sappington concludes that this increase in value of service supports an increase in the markup (compared with Docket No. R97-1). UPS-T-6, pp. 44-45, Tr. 31/15265-66.

Witness Haldi notes the several flaws in witness Sappington’s argument. According to witness Haldi, whether the DDU-entry mail is entered by the parcel shipper itself, by a ground-transportation consolidator, or by an air-transportation consolidator, the Postal Service’s delivery of the parcel will be viewed as only one element of transporting the parcel to the customer. Thus, the DDU-entry Parcel Post element should be examined in context, rather than as an artificially distinct service. AMZ-RT-1, pp. 10-11, Tr. 44/19531-32.

Witness Haldi also observes that witness Sappington can only cite anecdotal evidence for his assertion that DDU-entry Parcel Post receives next day delivery 97 percent of the time. Moreover, there is no evidence that either the (1) performance in the delivery of parcels from the DDU, or (2) the value of service given to parcels at the DDU has improved since Docket No. R97-1. *Id.*, p. 12, Tr. 44/19533.

Witness Haldi also rebuts witness Sappington’s claims that the availability of Delivery Confirmation increases Parcel Post’s value of service, observing that Delivery Confirmation for Parcel Post is neither free, nor is it offered “at cost” (*i.e.*, without a markup). Instead, Delivery Confirmation for Parcel Post is separately and fully priced, with its own implicit cost coverages (122 percent for manual, and 147 percent for

electronic). Therefore, those mailers who purchase *Delivery Confirmation* receive additional value in return for additional payment. For those who elect not to purchase *Delivery Confirmation*, any value which they may perceive from the availability of the option clearly is less than the rate charged, and perhaps even zero value. *Id.*, p. 13, Tr. 44/19534.

Witness Clark observes that *Delivery Confirmation* offers very little value to mailers:

It is not a proof of delivery. There is no signature. No information about the shipment is available while in transit, only the delivery time. Consumers and shippers now want to know where their shipment is at all times. They want pipeline visibility.

He concludes that even the suggestion “that the mere existence of this option enhances the value of *Parcel Post*” is not credible. AMZ-RT-2, p. 8, Tr. 41/18132, ll. 2-5, and ll. 12-13.

c. Without Information Regarding the Performance of Competitors, True Value of Service Cannot Be Measured.

Parcel Post is not dominant in its market. See AMZ-RT-1, p. 8, Table 2, Tr. 44/19529. Therefore, representations of *Parcel Post*'s value of service cannot be taken in isolation. Witness Haldi, noting witness Sappington's admission that “[c]hanges in the qualities of competitors' services can affect the incremental value of services” (*id.*, pp. 14-15, Tr. 44/19535, l. 22 through 19536, l. 1, citing response to PSA/UPS-T6-19, Tr. 31/15393), observes that “[i]mprovements in the quality of service provided by competitors, especially by the dominant provider, is thus a critical factor in determining

Parcel Post's incremental value of service." *Id.*, p. 15, Tr. 44/19536, ll. 2-4.

However, such information has not been made available to the Commission by UPS or other service providers. Therefore, representations by UPS witnesses regarding the high value of service by Parcel Post are of extremely limited value in the rate-setting process. Additionally, witness Haldi suggests that the Commission, in its deliberations concerning Parcel Post rates, give weight to the fact such imperfect information and lack of record evidence with respect to competitors' prices and their quality of service is no accident of the marketplace, but is rather the deliberate result of a conscious corporate policy by UPS and others to suppress and withhold such information. *Id.*, pp. 16-17, Tr. 44/19537, l. 21 through 19538, l.1.

Again citing witness Sappington, witness Haldi observes that "the Commission must be careful not to raise Parcel Post rates above the level which would cause the total contribution to institutional costs to decline, and it must do so in the face of highly imperfect information." *Id.*, p. 16, Tr. 44/19537, ll. 3-20. Thus, even in the view of UPS' own witness, the Commission must be cautious in the selection of Parcel Post rates to be recommended to the Board of Governors.

CONCLUSION

Amazon.com respectfully requests that the Commission recommend (i) rates for Parcel Post in general no higher than those proposed by the Postal Service, and (ii) rates for DSCF and DDU entry equal to those proposed by the Postal Service.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'William J. Olson', written over a horizontal line.

William J. Olson

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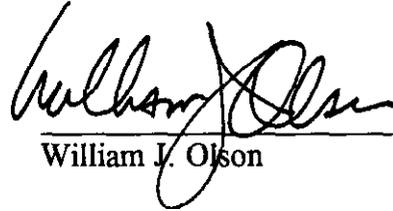
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CERTIFICATE OF SERVICE

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



William J. Olson

September 13, 2000