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POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

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

**POSTAL RATE AND FEE CHANGES, 2000**

**Docket No. R2000-1**

**REPLY BRIEF OF RECORDING INDUSTRY  
ASSOCIATION OF AMERICA, INC.**

In its Initial Brief, the Recording Industry Association of America, Inc. ("RIAA") has shown that there is neither analytic or record justification for the Postal Service's proposal to increase the residual shape surcharge for the Standard (A) Commercial regular rate subclass by 18 cents per piece. We have further shown that, by the Postal Service's own admission, it has very considerably and erroneously overstated the FY1999 attributable costs of the Special Standard (B) subclass and has provided an inadequate remedy to this problem. There is much in the Postal Service's Brief that simply ignores the record, Commission precedent and policy on these two issues. There is little in the Postal Service's Brief that is responsive to the arguments RIAA has made. There is nothing in that Brief and this record that should cause the Commission to accept either the proposed increase for the Commercial Standard (A) class or the Postal Service's insufficient remediation of its own errors in estimating Special Standard (B) FY1999 costs.

**I. The Application of an 18-Cent Surcharge to the Standard (A) Commercial Subclass is a Step in the Wrong Direction**

The Postal Service pays heed to the Commission's decision in Docket R97-1 with respect to the residual shape surcharge in only one -- purely superficial -- respect: The Commission recognized that the surcharge it recommended in that case was a "beginning step" (*PRC Op. 97-1* at 427, ¶ 5488); it further held that several key issues, including the need for subclass-specific surcharges which reflect differences in revenues and costs by subclasses required "further . . . exploration." *Id.* at ¶ 5489. The Postal Service made no attempt to deal with these issues. It blithely asserts that its proposal for uniform, one-size fits all surcharge and an 8-cent increase in that surcharge constitutes "the next step" in the process of refining the Standard (A) rate design to reflect shape as a cost causative factor. Postal Service Brief at VII-185. The Postal Service's claim completely ignores the issues in this case and utterly fails to support the results for which it contends.

The issue in this case is not whether there should be a residual shape surcharge. Despite the utter inadequacy of the Postal Service's data purporting to correlate cost with shape, RIAA does not contend that the residual shape surcharge should be repealed. Rather, the issues in this case are (i) whether the Postal Service's proposal to maintain a single surcharge across all Standard (A) subclasses is indefensible and (ii) if so, what, ultimately, is the fair and equitable surcharge applicable to residual shape pieces that are entered at the Standard

(A) Regular Commercial subclass. To the extent that the Postal Service deals with these issues at all on brief, its arguments are without merit:

First, the Postal Service relies entirely on the proposition that "*in ECR* where the weight is nearly identical between parcels and flats, there is still a large cost difference" to justify its one-size fits all approach. Postal Service Brief at VII-192. This proves much too little. The only thing the Postal Service's demonstration proves is that shape may be a primary factor in cost differences between flats and parcels in ECR. It proves nothing about the effect of shape on cost differentials in the Regular Commercial subclass.

The record shows that the weight of parcels and flats is decidedly not "nearly identical" in the Standard (A) Regular Commercial subclass or, even, in the Standard (A) Commercial subclasses combined: Witness Glick's testimony shows that, when the two subclasses are combined, parcels weigh 2.5 times more, on average, than the comparable flat; if the calculations were to be performed for the Standard (A) Regular Commercial subclass alone, the differential in weight is more than 3 times. See RIAA Brief at 7; Tr. 23/10393. Moreover, the parcel flat cost differential in the Regular Commercial subclass is less than the ECR cost differential despite the fact that the weight differential is much greater than in ECR. USPS-T-27 at Attachment F, Table 6.1. This argues for -- not against -- a separate surcharge for each of the subclasses. RIAA Brief at 4-5.

Second, the Postal Service abjectly fails to explain its refusal to take revenue effects into account in measuring the appropriate level of the surcharge

in application to the Standard (A) Regular Commercial subclass. The Postal Service does not, because it cannot, quarrel with witness Glick's demonstration that there is a compelling theoretic basis for including weight-related cost effects in measuring the surcharge for each subclass separately and that the failure to do so results in double charging of parcels. Instead, it claims that witness Glick failed to provide an exact-piece comparison. Postal Service Brief at VII-191. In this, the Postal Service is disingenuous: Indeed, witness Glick did not perform an exact piece analysis under the Commission's classic methodology; but that is because the Postal Service does not have the data that would permit such an analysis. As Mr. Glick explained, lacking the requisite cost data, it is proper to use weight-related revenue differences as a proxy for the weight-related cost difference. RIAA Brief at 6-7. The Postal Service does not respond to this unimpeachable conclusion at all. It simply invokes its comparison of ECR parcels and flats as the basis for failing to consider revenue effects in the Standard (A) Regular Commercial subclass. Postal Service Brief at VII-192. Once again, this proves nothing concerning the proper measurement of the surcharge for the Standard (A) Regular Commercial subclass in which the failure to use weight-related revenues overcharges residual shaped pieces.

Third, the Postal Service's claimed justification for a lower surcharge in the ECR subclasses perverts the Commission analysis in Docket R97-1. The Postal Service is correct in its claim that the Commission "expressed receptiveness to subclass-specific surcharges" in that docket and is even more correct that the Commission expected those subclass-specific surcharges to be based on

"different cost levels" among the difference subclasses. Postal Service Brief at VII-189. However, the lower ECR surcharges it has proposed are not based upon the cost differentials between parcels and flats; they are based upon "rate comparisons" between the Regular and ECR subclasses. Postal Service Brief at VII-189. Essentially, the Postal Service's argument is that, after application of the pre-barcode discount in Standard (A) Regular, the surcharge in the Standard (A) Regular Commercial subclass should be the same as in the ECR subclasses. This argument entirely lacks explanatory force: Standard (A) Regular Commercial mailers who cannot qualify for the barcode discount will pay 18 cents not 15 cents; in any event, the barcode discount -- which certainly should be adopted -- is based on avoided cost, not shape-related cost drivers. The rate levels that the Postal Service has proposed, therefore, do not come remotely close to satisfying the Commission's concern that a uniform surcharge does not properly reflect "the variation in the average cost or the cost differential between flats and parcels by subclass." *PRC Op. 97-1* at 427, ¶5488. By proposing what it perceives to be a uniform single-piece surcharge across all four subclasses, the Postal Service has acknowledged the legitimacy of the issues identified in the Commission's decision and then has simply ignored them. See RIAA Initial Brief at 8.

Fourth, the Postal Service ignores entirely its witness' own admission that there is a mismatch between the measurement of parcel costs and the measurement of revenues and that there simply is no way to accurately compute the cost differential between parcels and flats for any period after implementation

of the 10-cent surcharge in January, 1999. RIAA Brief at 11-12; see *also* Brief of District Photo, et al. at 25. The contrast between the Postal Service's treatment of this costing problem and its treatment of a very similar costing problem in the context of the non-standard First-Class surcharge is striking: In the latter case, recognizing the costing problem, the Postal Service proposes to retain the surcharge at its current level, a result essentially compelled by the Commission's decision in Docket R97-1. *PRC Op. 97-1* at V-337. In Standard (A), however, the Postal Service purports to justify a 180% increase in the surcharge on the basis of cost data which predates the implementation of the existing surcharge and in which any cost study based upon post-surge costs would, by its own assessment, "cause uncertainty" in the results. Tr. 8/3433. This disparate approach to surcharge cost analysis may not rise to the level of discrimination under 39 U.S.C. § 403(c). It certainly raises a fundamental issue of fairness and equity.

For these reasons, the Commission must reject the Postal Service's surcharge proposal. In Docket R97-1, the Commission said that the surcharge was needed to resolve an intra-class "equity problem" by reflecting shape-based costs in rates. *PRC Op. 97-1* at IV-426, ¶ 5485. The Postal Service's across-the-board surcharge rate increase is not grounded in an accurate measurement of costs or any assessment of cost or revenue differentials by subclass. It is purely and simply a revenue raising measure. In application to the Standard (A) Regular Commercial subclass, the results are arbitrary because unsupported and unfair because excessive. That is certainly not the "next step" the Commission

contemplated in its R97-1 decision. It is not the right step. The Commission should not take it.

**II. The Postal Service's Remedy to its Special Standard (B) Errors is not Adequate**

RIAA sponsored the testimony of Stuart W. Elliott urging that "... FY1999 mail processing costs should not be used in any way for the determination of Special Standard rates." RIAA-ST-1 at 2, Tr. 41/18029, lines 13-15. Dr. Elliott's testimony was based on a statistical analysis of the BY 1998 and FY1999 Special Standard mail processing costs. He demonstrated that the 1999 numbers fell well outside of the upper bound of the ninety-five percent confidence interval calculated from 1998 mail processing costs. Dr. Elliott concluded that the Postal Service had offered no adequate explanation for the unnaturally large FY 1999 and provided "a unit cost estimate for BY1998 . . . in 1999 dollars using the R2000-1 method." *Id.* at 10, Tr. 41/18037, lines 12-13.

The Postal Service's Brief relies exclusively and without substantive elucidation on testimony of Carl Degen to contest Dr. Elliott's conclusions. Postal Service Brief at VII-134. In his Response of United States Postal Service Witness Degen to Order No. 1300, Mr. Degen concurred that the FY1999 data were suspect:

Q It's your testimony, I take it, Mr. Degen, that there was something wrong with the tallies for Special Standard for 1999, is that right?

A That's probably a little stronger than my testimony. My testimony is that we identified a group

of tallies that bore a Special Standard or Bulk Rate marking, but for which the data collector classified them as Special Standard Subclass.

Tr. 45/20066, lines 2-9.

While lessening the impact of the anomalous FY1999 costs on Special Standard costs, the corrected data provided by witness Degen's analysis in no way contradict the conclusions of Dr. Elliott's supplemental testimony. Tr. 41/18031-18036. It is still the case that IOCS mail processing costs for Special Standard show a cost increase that is too large to be explained by sampling variation and that deviates from the historical trend. It is still the case that the Postal Service has not provided an adequate explanation of the increase in IOCS Special Standard mail processing data that is consistent with the stability of the DRPW Special Standard volume data.

Witness Degen's response suggests that almost half of the original Special Standard mail processing cost increase was erroneous. However, this response provides no reason to believe that the remaining cost increase is correct. Quite the contrary, the fact that such a large error was detected after only a few days of investigation merely reinforces the impression that the entire increase is likely to be erroneous. Whether the unit cost increase is 20% or 37%, it is still the case that the FY1999 mail processing cost data are anomalous for Special Standard and should not be used by the Commission. Tr. 45/20066, lines 2-9. Mr. Degen performed an "adjustment", *id.* at line 14, to the 1999 data that resulted in mail processing cost of \$101,562,000, as compared with the originally reported \$116,164,000 and the \$86,575,000 recommended by Dr.



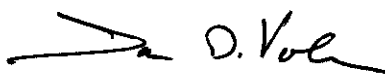
Elliott. The upward bound for the 1999 number calculated by Dr. Elliott is \$90,582,000. RIAA-ST-1 at 4, Tr. 41 /18031, line 15. Mr. Degen's adjusted number is still well outside the statistically predicted limit; there is very good reason to suspect that Mr. Degen's adjustment has not cured all of the flaws in the 1999 data.

Mr. Degen was almost certainly right to eliminate the tallies that he did, on the basis of internal evidence of their likely lack of reliability. See, e.g., Tr. 45/20068, lines 21-25. But what he did was not enough to cure the problems with those data. Dr. Elliott's resolution – using the 1998 data adjusted to 1999 dollars and employing the R2000-1 methodology – is far superior.

## CONCLUSION

For these reasons, as detailed more fully in RIAA's Initial Brief, the Commission should recommend a surcharge for the Standard (A) Regular Commercial subclass that is not more than 13 cents before application of the barcode discount. It should use FY1998 data, not the hopelessly tainted 1999 data, in determining the rates for Special Standard (B).

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ian D. Volner". The signature is stylized with a long horizontal stroke at the beginning and a cursive "Volner" following.


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Dated: September 22, 2000

## **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.

  
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Ian D. Volner