

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

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POSTAL RATE COMMISSION
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POSTAL RATE AND FEE CHANGES, 2000)

Docket No. R2000-1

REPLY BRIEF

OF

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

William J. Olson
John S. Miles
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070

Counsel for
Val-Pak Direct Marketing Systems, Inc.,
Val-Pak Dealers' Association, Inc., and
Carol Wright Promotions, Inc.

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ARGUMENT

I. THE POSTAL SERVICE'S PROPOSED STANDARD A ECR POUND RATE SHOULD NOT BE ADOPTED.

A. The Postal Service Proposes an Arbitrary Cut to the Standard A Pound Rate Because It Has No Supporting Study That Credibly Identifies the Causal Relationship Between Weight and Cost.

Initial briefs of the Postal Service, MOAA/DMA/APC, and the Saturation Mail Coalition focus their efforts (with respect to Standard A Mail) almost exclusively on the justification for a reduction in the Standard A ECR pound rate. This focus on a pre-determined goal limits their ability to address the larger picture which the Commission must confront. Simply stated, the proper recognition of the causal relationship between weight and cost is a fundamental element in the rate design for every subclass of mail. Currently, the change in rate as weight increases varies widely between subclasses. There has been little attempt by the Postal Service to explain such variation or justify

the changes on the basis of costs driven by weight. Consider the following rates proposed by the Postal Service in this docket:

	Current Rate (per lb.)	Proposed Rate (per lb.)	Percent Change
First-Class Mail (up to 13 oz.)	\$3.52	\$3.68	+4.5%
Priority Mail (2 to 5 lbs.)	1.10	1.25	+13.6%
Standard A Mail:			
Regular	0.677	0.661	-2.4%
ECR	0.663	0.584	-11.9%

The record evidence in this docket neither explains nor supports the Postal Service's passion to cut the pound rate for Standard A Mail (especially ECR) while simultaneously seeking to increase the pound rate for other classes. Moreover, an arbitrary cut in the pound rate for Standard A mail necessarily results in an equally arbitrary increase in the piece rate, severely penalizing other mailers — especially those who mail ECR letters.

The Postal Service has not demonstrated in this docket that it knows how changes in cost are driven by changes in weight, as shown by the table below.

	Cost Estimate -----	Source -----
First-Class Mail:		
10-oz piece	\$0.798	USPS-T-28, p. 11
11-oz piece	0.777	USPS-T-28, p. 11
Priority Mail:		
Less than 1 lb.*	1.83 - 2.13	USPS-T-34, Attach. H, p. 1
Standard A Mail:		
Regular	0.3409 -1.1378	VP/CW Init. Br., Table 1, p. 24
ECR	0.2517 - 0.4447	VP/CW Init. Br., Table 2, p. 26

* The average weight of a piece of Priority Mail under 1 pound is 10.3 ounces, and the average cost (weighted by zone) is \$1.91. The Postal Service makes no effort to explain the difference in average cost between a 10-11 ounce piece of First-Class Mail and a 10.3 ounce piece of Priority Mail.

This lack of understanding makes it difficult to rely on the Postal Service's testimony to conclude that a major drop in the Standard A pound rate would move the Commission towards more cost-based rates.

This brief survey of different subclasses, which the Postal Service, MOAA/DMA/APC, and the Saturation Mail Coalition all ignore, demonstrates why the Commission needs credible studies of the weight-cost relationship. The record in this docket only offers what Postal Service witness Sharon Daniel (USPS-T-28) characterizes as a "distribution key analysis" (USPS-LR-I-92). Many of the arguments raised in the initial briefs of the Postal Service and other intervenors have already been addressed fully in VP/CW's Initial Brief. Certain arguments, addressed below, deserve additional comment.

1. The Postal Service and its Supporters Must Justify a Substantial Cut in the Pound Rate, as it Necessarily Increases the Piece Rates.

The burden of proof is on the Postal Service to present credible evidence that the current pound rates are less reflective of cost than its proposed rates. As explained in VP/CW's Initial Brief, and elaborated on herein, the Postal Service's evidence and the manipulations of Postal Service data by intervenors in this docket fall woefully short of meeting this burden of proof.

Perhaps recognizing that the IOCS data and the distribution exercise presented by the Postal Service fall so far short of meeting a reasonable burden of proof, the Saturation Mail Coalition tries to shift the burden of proof to those intervenors who find the justification wanting for a low pound rate.

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... 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. [SMC Initial Brief, pp. 10-11, emphasis added.]

This effort to shift the burden of proof is misplaced for two reasons. First, it is not up to intervenors who oppose a Postal Service proposal to present a comprehensive study of cost-causing factors; that burden is on the proponents of the change. Second, the data submitted by witness Daniel, which are the only data available in this case, are fatally flawed. As explained in VP/CW's Initial Brief, and discussed in section 4 *infra*, the data can be used to prove virtually anything. Witness Daniel says that her results provide only "a general indication of the effect weight has on total volume variable

costs.” USPS-T-28, p. 3, ll. 22-23; emphasis original. And witness Antoinette Crowder (MPA-T-5), supporting the cut in the pound rate, presents a wide array of results from the same flawed data, with no indication as to what is “the” weight-cost relationship.¹ Mail Order Association of America (“MOAA”) witness Roger C. Prescott (MOAA-T-1) offers yet another analysis of the same flawed data, obtaining yet different results.

**2. Proponents of a Lower Standard A ECR Pound Rate
Erroneously Assert That Some Unattainable Standard of
Perfection Has Become the Enemy of the Good.**

In its Initial Brief, the Saturation Mail Coalition states that:

Haldi and Tye urge that the pound rate remain unchanged until the Postal Service produces a “**definitive study**” on the weight-cost relationship. [*Id.*, pp. 12-13, emphasis added.]

The MOAA/DMA/APC Initial Brief echoes the refrain:

Witness Haldi insists that the status quo should be maintained until the USPS has undertaken studies that would **precisely** measure the cost behavior of Standard Mail A separately on the basis of various methods of entry and other variables. [*Id.*, p. 14, emphasis added]

This brief even quotes approvingly Postal Service witness Bozzo’s statement that:

it is true, but irrelevant, that witness Daniel’s data **do not clearly identify the precise effect** of mail piece weight on cost in isolation from other factors.... the cost data needed to support the ... pound rates need not satisfy the **excessively stringent requirements** suggested by witness Haldi. [*Id.*, p. 15, citing Tr. 44/19481-82, emphasis added.]

¹ Witness Crowder does demonstrate what appear to be different weight-cost relationships for the Basic category and the High-Density/Saturation category. However, no tests of statistical significance accompany her results, and she does not argue that the Commission should adopt or use these results to set different pound rates for the Basic and High-Density/Saturation rate categories.

Such statements are mere straw men. As explained at length in VP/CW's Initial Brief, the Commission has not been provided on the record any reasonable or credible explanation of, or a credible estimate for, the weight-cost relationship for the Standard A subclasses.²

Moreover, and totally contrary to the above-cited assertions by MOAA/DMA/APC (Initial Brief, pp. 14-15) and SMC (Initial Brief, pp. 12-13), witness John Haldi has not crafted this standard. Rather, he has pointed with approval to the Destination Entry Model developed and used by the Postal Service to estimate the weight-cost relationship for destination entry Standard A Mail. Tr. 32/15826. That cost avoidance model has been adopted and used by the Commission in several dockets. The model estimates **average** savings; *e.g.*, it reflects the average cost (or cost avoided) from Origin to DBMC, or to DSCF, or to DDU.³ A model that determines the entire weight-cost relationship need be no more precise than the Destination Entry Model. At no time has witness Haldi proposed any additional requirements of any kind with respect to the Destination Entry Model, much less "excessively stringent requirements," as MOAA/DMA/APC and the Postal Service erroneously represent.

² Although the Postal Service, MOAA/DMA/APC and SMC state their demands with gusto, they have been utterly unable to support their demands with record evidence.

³ Clearly the savings are not "precise" for every mailing that receives a destination entry discount, because the distance between originating facilities and BMCs varies significantly, and the distance between BMC pairs encompasses an enormous span. Some BMCs are within a few hundred miles of one another, whereas thousands of miles separate other BMC pairs. Obviously, therefore, this model is an average over all distances, and is not necessarily "precise" for any pair of BMCs. Nevertheless, the Destination Entry Model has proven eminently workable.

Witness Haldi has consistently urged that the Commission request, and the Postal Service conduct, a reliable cost-weight study. As the Commission noted in its *Opinion and Recommended Decision* in Docket No. R97-1 (para. 5394), “Haldi contends that the Service did not provide a reliable cost-weight study, causing him to make assumptions about the effect of weight on cost. Tr. 27/15875-76.” The recommendation for a “**reliable study**” is a far cry from a “definitive study” that would impose “excessively stringent requirements” in order to “identify the precise effect of mail piece weight on cost.”⁴

Finally, and interestingly, even witness Daniel’s defenders cannot bring themselves to say that she has provided the Commission with a “good” and reliable analysis. Rather, they quote Postal Service witness A. Thomas Bozzo to the effect that the method used “by witness Daniel constitutes a significant advance over Postal Service witness McGrane’s analysis from Docket No. R97-1.” MOAA/DMA/APC Initial Brief, p. 10, citing Tr. 44/19470; also quoted in USPS Initial Brief, p. VII-175. Stated otherwise, witness Bozzo accurately concludes that witness Daniel’s distribution key analysis is simply “less flawed” than witness McGrane’s highly flawed distribution analysis, which the Commission soundly and rightly rejected despite the then-enthusiastic support of the Postal Service, Advo and MOAA. In no way, however, does the mere reduction of the number of flaws make a study “good,” “reliable,” or even “useful.” One cannot craft a silk purse from a sow’s ear.

⁴ Witness Haldi analyzed the ECR weight-cost relationship in Docket No. R97-1, demonstrating how many types of processing costs were clearly weight related.

3. Proponents of a Lower Pound Rate for Standard A ECR Mail Pretend That No Other Practical Way Exists to Study the Weight-Cost Relationship.

The MOAA/DMA/APC Initial Brief approvingly quotes witness Crowder's hyperbolic statement that:

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. [*Id.*, p. 14, citing Tr. 44/19393, emphasis added.]

This statement is totally without foundation, and is false. The fact is that the Postal Service has **never** submitted any analysis of the weight-cost relationship that was not based on IOCS data, despite (i) repeated requests by the Commission and (ii) a recommendation by the Data Quality Study that it do so.⁵ Both the Commission, and experts selected by the Postal Service-Commission-General Accounting Office who authored the Data Quality Study, appear to believe that witness Crowder is wrong, and that such a study is eminently doable. Moreover, not even the Postal Service has made such an outrageous assertion concerning the "impossibility" of any other type of analysis. Until an earnest attempt is made to conduct such a study, self-serving assertions such as the above should be disregarded.

As discussed *supra*, the Postal Service has successfully modeled the (weight-related) savings from destination entry. The Postal Service has developed highly detailed and sophisticated models designed to determine (i) the cost of piece handling

⁵ USPS Data Quality Study, Contract No. 10290-97-B-1972, Summary Report, p. 94 (dated April 6, 1999).

and (ii) the cost of bundle handling. For First-Class Mail the Postal Service has identified MODS activities that are alleged to be worksharing-related, and others which are not worksharing-related, and it has used this classification to estimate the costs avoided by worksharing activities within First-Class Mail. The Postal Service has modeled flat-handling costs in detail. In light of these many efforts at modeling and estimating the cost of various activities, it is a wonderment that the Postal Service cannot provide the Commission with better, more credible studies of the weight-cost relationship than those proffered in this docket (as well as prior dockets).⁶ Witness Crowder attempts to excuse the Postal Service for not doing a proper study by calling it nearly impossible. Nevertheless, whether by neglect or by design, the dearth of data is of the Postal Service's doing and must not be rewarded.

The Postal Service, MOAA/DMA/APC, and SMC appear to recognize the dearth of data for their initial briefs rely heavily on, and ask the Commission to accept on faith, merely intuitive arguments that the pound rate for Standard A ECR Mail is too high. For instance, "it doesn't require cost analyses or testimony from costing experts to know that this counter-intuitive, purely pound-related structure is non-cost-based and overcharges weight in relation to costs." SMC Initial Brief, p. 11. The result desired by SMC is not nearly so self-evident as this statement infers. If it were, then instead of presenting the Commission with yet another exercise in cost distribution, the Postal

⁶ In addition to the distribution analyses of weight and cost sponsored by witness Daniel in this docket, she was also involved in and is the sponsor of work reported in several other library references (12 library references in total, USPS-LR-I-91 through USPS-LR-I-102). A meaningful study of the causal relationship between weight and cost would probably require somewhat more commitment from the Postal Service than one part-time analyst.

Service presumably could have presented the Commission with a credible study “that track[s] weight in conjunction with other mail cost-causing characteristics through the entire production process,” as called for by both the Commission and the authors of the Data Quality Study.⁷

4. The Record Evidence in this Case Can Support an Extraordinarily Wide Range of Pound Rates, and Just as Easily Could Be Used to Justify a Sharp Increase in the Pound Rate as the Proposed Decrease.

MOAA/DMA/APC and the Postal Service assert that the record evidence in this case only supports a reduction in the pound rate. For instance, the MOAA/DMA/APC Initial Brief states that:

USPS witness Daniel’s cost study provides ample support for the Standard Mail A pound rates proposed by the Postal Service.... There is not only no substantial evidence of record to support the existing pound rates, there is in fact **no** evidence.” [*Id.*, p. 16, emphasis original.]

In a similar vein, the Postal Service states that “an improved analysis presented by witness Daniel reconfirms prior [Commission-rejected and admittedly flawed] studies that costs do not increase with weight as dramatically as implied by the current ECR pound rate.” USPS Initial Brief at p. VII-174, citing USPS-T-28 at pp. 5-19. These statements are empty rhetoric, without foundation.

⁷ 1999 USPS Data Quality Study, Summary Report, p. 94, Recommendation 45.

Witness Daniel's cost distribution analysis consists broadly of two parts:

(i) regression results, and (ii) what witness Bozzo calls an "aggregate analysis." The shortcomings of the "aggregate analysis" are addressed in section 5, *infra*.

As explained in VP/CW's Initial Brief, the regression results of witness Daniel (as well as those of witnesses Crowder and Prescott) provide the Commission with an extraordinary smorgasbord of results that just as easily could be used to justify a sharp increase in the pound rate as the proposed decrease. For Standard A Regular, for instance, four out of seven of witness Daniel's regressions would support a rate for 16-ounce pieces of between \$0.95 and \$1.51, versus the highest proposed rate of \$0.841.⁸ Witness Daniel's raw data thus lend themselves to all kinds of analyses that could obtain almost any result desired. The smorgasbord of "results" presented in this docket illustrates precisely why the Commission cannot rely on USPS-LR-I-92, and why it still needs a credible study of the weight-cost relationship.

5. The Postal Service's Methodology for Assigning Mixed-Mail Tallies Is Nothing More than an Unsupported Assumption, Made to Facilitate the Full Distribution of All Mail Processing Costs to Weight Increments.

The Postal Service states that "the method for distributing costs from **mixed mail and not handling** tallies is vastly improved." USPS Initial Brief at VII-175, emphasis original. MOAA/DMA/APC makes an even stronger assertion:

The Postal Service's methodology for assigning mixed-mail tallies is also correct.... the methodology used by the Postal Service for mixed mail

⁸ See VP/CW Initial Brief, Table 1, p. 24. MOAA witness Prescott's regression results for Standard A Regular also indicate that a pound rate higher than the current rate would be more appropriate. VP/CW Initial Brief, p. 39.

distribution “ensures that the mixed-mail tallies have the same relationship” as the proportion of direct tallies. [*Id.* at 10, citing witness Bozzo at Tr. 44/19468.]

The Postal Service’s claim is less presumptuous, merely stating that witness Daniel’s methodology is better than the approach used by witness McGrane in Docket No. R97-1 (as well as similar studies by other Postal Service witnesses in prior dockets).⁹ In Docket No. R97-1, the Postal Service, SMC, and MOAA/DMA/APC had asked the Commission to rely upon that flawed study and reduce the pound rate.

MOAA fails to realize that witness Daniel’s rote distribution of mixed mail and not handling tallies **in exact proportion** to the distribution of direct tallies is based on nothing more than an unsupported assumption, as explained in VP/CW’s Initial Brief.¹⁰ The record contains no evidence whatsoever to support this heroic assumption. True, witness Daniel did distribute mechanistically to weight increments the costs associated with tallies for which no weight is recorded — which represent over 60 percent of all mail processing tallies.¹¹ However, the assumption is arbitrary and what scarcely could be called a costing methodology is as artificial as the fully-distributed costing system that the old Post Office Department used prior to passage of the Postal Reorganization Act, which was thoroughly discredited by the Kappel Commission.

⁹ The weight-cost distribution analysis by witness McGrane in Docket No. R97-1, which relied on the now-abandoned LIOCATT, also slavishly allocated costs to weight increment in the same manner as had traditionally been used to allocate costs to the classes and subclasses of mail.

¹⁰ See VP/CW Initial Brief, pp. 47-48.

¹¹ See VP/CW Initial Brief, p. 46, citing Tr. 44/19502-04.

Full distribution of all costs always conveys the illusion of completeness and accuracy. Complete does not mean accurate, however. Witness Daniel's proportionality assumption to fully distribute mail processing costs may be convenient, but that does not make it correct. The mere fact that costs can be fully distributed using some convention does not trace causality.

As explained in VP/CW's Initial Brief, the Postal Service has no causal basis for distributing to weight increment those mail processing costs that are associated with tallies where no weight is recorded. If the Postal Service had tried to estimate a weight-cost relationship using only available information for tallies where no weight was recorded, the futility and arbitrariness would be immediately and abundantly transparent. Without the information for direct tallies, it would have to invent an entirely new, equally arbitrary methodology to fully distribute all costs.

Until the Postal Service actually studies the activities and costs represented by the tallies where no weight is recorded, it will never determine how they are causally related to weight. This is precisely why the Commission has said that it needs a study that credibly explains the causal relationship of weight to cost in the various subclasses. Without evidence to support witness Daniel's proportionality assumption, MOAA/DMA/APC's assertion that the methodology correctly assigns costs of tallies to the appropriate weight increments where no weight is indicated on the tally is not credible.

6. The Determination of “Piece and Pound Costs in the Aggregate” Is No Better than the Underlying Data Relied Upon to Determine Aggregate Costs.

The Postal Service states:

Witness Daniel’s study provides, for the first time, the ability to analyze cost estimates for ECR piece- and pound-rated mail. Witness Daniel provides cost estimates for piece- and pound-rated ECR mail using 3.0 and 3.5 ounce proxies for the breakpoint. USPS-T-28 at 17. The use of the data in such an aggregated form dispels past criticisms relating to data thinness and variation among data point estimates. [Initial Brief, p. VII-177.]

MOAA/DMA/APC, quoting witness Bozzo, makes a parallel claim:

As witness Bozzo observes, “it is true but irrelevant, that witness Daniel’s data do not clearly identify the precise effect of mail piece weight on cost in isolation from other factors.” Tr. 44/19481. All that is needed is to determine the cost of mail subject to the “piece and pound rates in the aggregate” and “the available cost data are sufficient for that purpose.” *Id.* at 19481. [Initial Brief, p. 15]

Aggregating cost data where costs have been fully distributed to weight increments may help to reduce the problems that arise from the thinness of tallies in individual weight increments. As explained above, however, witness Daniel’s methodology incorporates an arbitrary proportionality assumption, which lacks any evidentiary support, to distribute over 60 percent of all mail processing costs to individual weight increments, which are then aggregated. If her assumption is wrong, then the cost data for each weight increment are wrong, and the aggregate data will also be wrong. Aggregating flawed data creates aggregated data which are also flawed. The magic wand of “aggregation” cannot turn bad data into good. The entire structure

is built on a foundation of sand. The only way to make it right is to build on the proper foundation (*i.e.*, a study of cost causality), which has not been done.

The Commission should also take note of the fact that the Postal Service chose not to apply this highly-touted “aggregation technique” to support its proposal for a slight reduction in the pound rate for Standard A Regular Mail. If this aggregation technique were so highly indicative of the proper relationship, as the Postal Service would want the Commission to believe, clearly it should have been used consistently to support its position on both Standard A subclasses.

7. The IOCS Was Not Designed to Explain Underlying Causal Relationships, and IOCS Data Can Explain Little or Nothing.

Initial briefs of the Postal Service, MOAA/DMA/APC, and SMC all defend the IOCS-based studies by witness Daniel. Yet by witness Daniel’s own admission, the IOCS was “not specifically designed for the purpose of measuring the impact of weight on costs.” Tr. 32/15824, ll. 4-5. If the IOCS database did not exist, and the Postal Service had to start from scratch to study the weight-cost relationship, it is almost unthinkable that one would undertake such a study by designing and implementing a work sampling system, even if the budget available for such studies were very high. The Commission has repeatedly rejected IOCS-based studies of the weight-cost relationships, and called for a more credible study using some more appropriate methodology. The Data Quality Study did likewise.¹² Appropriately, these requests have left it to the Postal Service to determine the most preferable **alternative**

¹² 1999 USPS Data Quality Study, Summary Report, p. 94.

methodology. Yet, inexplicably, the Postal Service persists in limiting itself to use of IOCS data for a purpose for which they are not suited, and it knows were never intended. Not surprisingly, in each case the results are unreliable, disappointing, and do not provide the Commission with a credible basis for establishing cost-based pound rates. This is yet another reason why the Commission needs a credible study of the weight-cost relationship.

The “explanatory” power of the IOCS is of course extremely low. The IOCS was designed simply to ascertain the costs of the various subclasses of mail, but not to explain why those costs are what they are. On more than one occasion this “impartiality” has been the asserted strength of the IOCS. Time and again, the Commission and intervenors are confronted with cost behavior that is seemingly anomalous and confusing, only to be told that costs are what they are because that is the way that the IOCS tallies were recorded. Efforts to use IOCS data for a purpose for which they were never designed facilitates manipulation and, as has been shown in this case, can cater a smorgasbord of results that would support a wide range of recommendations. This kind of uncertainty illustrates well why the Commission needs a credible study, and must again send the Postal Service back to the drawing board.

B. The Postal Service Proposes an Immodest Range of Rate Changes Within Standard A ECR.

The Postal Service Initial Brief presents a table showing the percentage changes by ounce increment for Saturation pound-rated ECR mail. With respect to the

percentages shown in that table, the Postal Service states that “the decreases in the lower pound-rated ounce increments, which contain most of the ECR saturation pound rated nonletters, Tr. 4/1358-59, **will be quite modest.**” USPS Initial Brief, p. VII-171, emphasis added. For the 5 to 7 ounce weight increments, the “modest” **decreases** range up to 5.5 percent. For the 8 to 16 ounce increments, the (presumably less) “modest” **decreases** range up to 11.5 percent.

In its zeal to promote the proposed reduction in the pound rate for Standard A ECR, the Postal Service chooses to present only a partial picture of percentage changes in rates proposed for ECR Mail. The flip side of the **decreases** for ECR nonletters is that for **ECR letters** the Postal Service proposes percentage **increases** that range from 3.8 to 11.0 percent, as shown below.

	----- Destination Entry -----			
	None	DBMC	DSCF	DDU
Basic	8.0%	8.2%	8.5%	8.1%
Basic Automated Letter	4.5%	4.3%	4.4%	3.8%
High-Density	9.4%	9.8%	10.2%	9.7%
Saturation	10.0%	10.5%	11.0%	10.6%

The average rate increase proposed by the Postal Service for Standard A ECR is 4.9 percent. For all Standard A ECR Mail, the range of proposed rate changes thus goes from an **increase** of **11.0** percent to a **decrease** of **11.5** percent. Such a wide range can hardly be described as “quite modest.”¹³ In addition to all other factors,

¹³ Omnibus rate cases are usually characterized by rate increases. A rate increase of 10-11 percent for some rate categories, while other rate categories receive a decrease of 10-11.5 percent, is a wide range indeed. The breadth of the range is seen more clearly when one realizes it is equivalent to proposing no change for some rate categories and increases of 20 to

consideration of the 39 U.S.C. Section 3622(b)(4) criterion — the impact upon mailers — should moderate considerably the extent of proposed rate increases and decreases.

C. The Postal Service Proposes a New Criterion for Judging Fairness and Equity of Rate Categories Within Subclasses.

The Postal Service states that “[m]ultiple factors underlie the ECR proposed reduction in the pound rate. First, the proposal promotes equity by **equalizing the implicit, intra-subclass costs coverages** within ECR.” USPS Initial Brief, p. VII-171, emphasis added.

Pound-rated ECR mail can be viewed as the equivalent of a rate category within Standard A ECR. The essence of the Postal Service’s argument is that implicit cost coverages of rate categories should be computed, compared, and for the sake of equity, should be equalized to the maximum extent practical. In other words, according to the Postal Service’s new “principle,” pound-related costs should receive the same coverage as per-piece costs — no more, and no less. This new “principle” is, of course, no more than a feeble justification for a desired result, rather than a rate design “principle” which the Postal Service embraces consistently. If this new principle were applied broadly across the various subclasses of mail, it would have a dramatic impact. For example, consider the effect on the rate design for First-Class Mail and Priority Mail, where under the Postal Service’s proposal, revenue from the pound rate has a higher-

22.5 percent for other rate categories. Such rate increases are anything but “quite modest” when viewed against an average rate increase for the subclass of 4.9 percent.

than-average implicit markup and makes a disproportionately high contribution to institutional costs.¹⁴ For First-Class Mail, the effect would be an increase in the first-ounce rate, and a lower rate for additional ounces. Within Priority Mail the effect would be similar; *i.e.*, higher rates for the lighter pieces, and lower rates for heavier pieces.

More generally, applying the principle advocated here by the Postal Service to presort and destination entry rate categories would have even more wide-ranging implications. Specifically, it would mean that (i) the average cost of each rate category should be determined, then (ii) the implicit coverage of each rate category should be computed, and (iii) equity should be promoted by equalizing the coverage on the rate categories. In Docket No. R97-1, Dr. Haldi's direct testimony for VP/CW developed bottom-up costs for each rate cell and proposed a similar proposition, which was opposed by the Postal Service and MOAA, and rejected by the Commission.¹⁵

The fact that the Postal Service only would apply this principle opportunistically, and not generally, raises serious questions about the principle. Even if such a proposal were adopted across the board, in this instance the Postal Service's proposal to compare the implicit coverages of rate categories is rendered impossible by the fact that the implicit cost coverages are computed using witness Daniel's fully

¹⁴ The MOAA/DMA/APC Initial Brief states at page 14 that "[t]he issue is ... whether there is a reliable relationship between increases in weight and increases in cost, and a pound rate that will recover all pound-related costs." Of course, this statement is clearly wrong. The issue is whether there is a pound rate that will recover all pound-related costs **plus**, at a minimum, the subclass markup.

¹⁵ See *Op. & Rec. Dec.*, Docket No. R97-1, para. 5374.

distributed, but flawed, cost data. For all these reasons, it must be concluded that the record contains no reliable evidence whatsoever that “the pound-rated ECR implicit cost coverage exceeds that for piece-rated ECR by approximately 15 percent,” as the Postal Service’s initial brief asserts. USPS Initial Brief, p. VII-171.

D. Conclusion.

The Commission should (i) reject the weight-cost analyses as inadequate, (ii) retain the existing pound rates for Standard A Mail, and (iii) more in sorrow than in anger, yet again request the Postal Service to study the causality of weight on costs.

II. CONTRARY TO NAA’S ASSERTIONS, ITS ARGUMENTS SHOW WHY THE COVERAGE ON STANDARD A ECR SHOULD BE REDUCED, NOT INCREASED.

A. NAA’s Argument for a Higher Coverage on Standard A ECR Ignores Virtually All the Non-cost Criteria in the Act.

The Newspaper Association of America’s (“NAA”) Initial Brief, claiming that First-Class Mail pays an excessive share of institutional costs, states that:

This is true whether measured by absolute dollars, cost coverage indices, or unit contributions. Correspondingly, **commercial standard mail, particularly ECR mail**, contributes less revenue and institutional cost contributions than is warranted by its **proportion of volume or weight**. [p. 25, emphasis added.]

The NAA argument pointedly omits any discussion of or reference to the non-cost criteria contained in the Act.¹⁶ Presumably, the above argument is directed at “fairness,” criterion 1 under section 3622(b). However, NAA’s argument adds an amusing twist not in the Act and believed never before to have been argued to the Commission. Namely, a “fair and equitable” contribution should allegedly be determined by comparing the “proportion of volume or weight” in different subclasses. Of course, such an argument is absurd on its face, and NAA obviously does not advocate that its approach be used for any other class or subclass. Reasons why the statutory non-cost criteria indicate a lower coverage for Standard A ECR are discussed in VP/CW’s Initial Brief, at pages 65-67, and need not be repeated here.

Citing witness Clifton, NAA’s Initial Brief goes on to discuss what it describes as “[t]he disproportionate burden on First Class Mail.” NAA Initial Brief, p. 26. Totally disregarded in NAA’s discussion is the fact that First-Class Mail has benefitted disproportionately from the Postal Service’s targeted investment in automation and cost reduction for letter-shaped mail. Of all the subclasses, First-Class letter mail, far more than any other, has seen a reduction in the wage-adjusted unit cost. *See* POIR No. 4, and the Postal Service’s response thereto, Tr. 46D/21807-22. The direct result of this disproportionate focus on letter automation has been to keep the rate increase for all

¹⁶ American Bankers Association and National Association of Presort Mailers (“ABA & NAPM”) witness James A. Clifton likewise compares the coverage of First-Class Mail and Standard A Mail without reference to the statutory non-cost criteria. The Joint Initial Brief of ABA & NAPM (pp. 24-27) is equally deficient. It argues for an increase in the coverage of Standard A Mail without any reference to the non-cost criteria of the Act, and without any other rationale except to serve as an expeditious way to fund its own rate-cutting proposals for First-Class Mail.

First-Class Mail among the lowest for any subclass. In Docket No. R97-1, and again (presumably) in this case, the increase for First-Class single piece mail is only 1 cent. On a percentage basis, the increase in the two cases is 3.1 and 3.0 percent, respectively.

B. NAA's Reliance on Unit Contributions from Similar Subclasses Is Misplaced.

The Initial Briefs of NAA and VP/CW both emphasize the need to compare critically unit contributions as well as coverage percentages when determining the appropriate contribution to institutional costs. Citing witness William B. Tye (NAA-T-1), NAA states:

First, they [unit contributions] highlight the actual contribution being made by the average piece. This can facilitate comparisons among **similar** subclasses. [NAA Initial Brief, p. 28, emphasis added.]

NAA's Initial Brief then **assumes** that First-Class Mail and Standard A ECR are sufficiently similar to warrant a direct comparison of unit contributions. What the NAA Initial Brief pointedly omits, however, is that its own expert witness, William Tye (NAA-T-1), absolutely refused to take this position on cross-examination. In fact, witness Tye was not able to state whether he considered Standard A ECR and First-Class Mail to be similar subclasses, or whether he considered Standard A ECR to be more similar to (i) Standard A Regular or (ii) First-Class. Tr. 30/14959-61. As explained in VP/CW's Initial Brief (pp. 70-71), the Standard A Regular and ECR subclasses have many similarities with each other, but comparatively few similarities

with First-Class Mail. Witness Tye did not really disagree with that; he simply tried to avoid it. *See* Tr. 30/14959-81. Hence proper interpretation of witness Tye's testimony would support the conclusion that coverage on ECR Mail should be reduced, not increased.

C. Conclusion.

For the reasons discussed here, as well as in VP/CW's Initial Brief, the coverage and unit contribution on Standard A ECR Mail should be reduced slightly, thereby reducing the amount by which the unit contribution from Standard A ECR exceeds that of Standard A Regular.

III. THE EVIDENCE SHOWING THAT A CONTINGENCY ALLOWANCE OF 1 PERCENT OR LESS SHOULD BE RECOMMENDED WAS NOT OVERCOME BY THE POSTAL SERVICE'S ARGUMENTS ON BRIEF.

A. The Postal Service's Initial Brief Incorrectly Argues that the Meager Evidence It Presented Is Sufficient Because It Was "Reasoned."

The Postal Service's Initial Brief summarizes the testimony supporting its requested contingency allowance, and argues that its request should be recommended by the Commission because its determination was "reasoned." *Id.*, p. II-8. The requirement, however, is that the contingency **amount** be **reasonable**. *See* 39 U.S.C. section 3621. As the Commission pointed out in Docket No. R97-1, the contingency **amount** must be reasoned, and attempts to justify arbitrary amounts will not be accorded much weight. *Op. & Rec. Dec.*, Docket No. R97-1, para. 2031. Obviously,

therefore, the Postal Service's contingency proposal not only must be reasoned to be accorded weight by the Commission, but the amount **must also be demonstrated to be reasonable** on the record to **merit recommendation** by the Commission. The Postal Service seems to think it can avoid the second step — reasonableness — merely by articulating concerns about future uncertainties, so that it can claim its approach was “reasoned.” VP/CW's Initial Brief demonstrated that the Postal Service's testimony does not even begin to approach the showing necessary to demonstrate the need for a \$1.68 billion contingency allowance. VP/CW Initial Brief, pp. 76-80.

Only two Postal Service witnesses, William P. Tayman (USPS-T-9) and Richard J. Strasser, Jr. (USPS-RT-1), testified in support of the requested contingency allowance. The Postal Service now cites the testimony of witness Victor Zarnowitz (USPS-RT-2) as support for its showing of general economic uncertainty. *See* USPS Initial Brief, pp. II-6-7. It is important to note, however, that witness Zarnowitz did not testify in support of the amount of the Postal Service's contingency request. Indeed, he was not involved when the Postal Service decided to request a contingency allowance of \$1.68 billion, nor did he ever express a position on the appropriate level of the contingency. *See* Tr. 41/18264-65.¹⁷ The Postal Service nevertheless argues that its witnesses provided an adequate basis for the requested contingency allowance. But

¹⁷ As the Office of the Consumer Advocate (“OCA”) has pointed out in its initial brief, the testimony of witness Zarnowitz does not even support the Postal Service's reliance on an alleged future unstable economy as a significant factor justifying a high contingency allowance. *See* OCA Initial Brief, pp. 47-51.

the Postal Service exaggerates the substance, as well as the significance, of its witnesses' testimony.

At pages II-1 through II-5 of its initial brief, the Postal Service mentions **general considerations**, including snippets from recent past dockets to the effect that the lower contingency approach it proposed in those dockets did not bind it for all time. It states that "it took very little to convince the Commission" of the reasonableness of the Postal Service's contingency proposals in those dockets. USPS Initial Brief, p. II-5. The Postal Service actually seems to be arguing that the Commission has not required substantial evidence in recommending the contingency allowance proposed by the Postal Service in those dockets, and that therefore no such evidence should be required in the current docket. But the very quotations it relies on seem to contradict the Postal Service's argument. For example, the Commission's *Opinion and Recommended Decision* in Docket No. R94-1 stated that "the reasonableness of a contingency provision can only be judged as a product of a historical record and in the factual and policy context of a particular rate proceeding." *Id.*, para. 2036. The Postal Service's one-paragraph summary of what purportedly was done in the last two omnibus rate dockets is incomplete, ignores the Commission's own words about the importance of the "particular rate proceeding," and appears to be an attempt to distract the Commission from the Postal Service's need to demonstrate reasonableness **in this docket**. Furthermore, any implication in the Postal Service's initial brief that the Commission based its contingency recommendation in Docket No. R94-1 on a single

statement in that case from witness Ward would be decidedly incorrect. *See id.*, paras. 2036-2047.

At pages II-6 through II-8 of its initial brief, the Postal Service summarizes its testimony in support of the requested \$1.68 billion contingency, arguing that such testimony itself constitutes substantial record evidence supporting “Postal management’s judgment” that the huge requested contingency allowance is necessary. In fact, however, the testimonies of witnesses Tayman and Strasser essentially are composites of brief assertions or conclusions, rather than analyses, which generally lack any depth whatsoever, and offer no real explanation of methodology or calculation of amount. The Postal Service exaggerates the importance of such conclusory statements by characterizing them as evidence.

According to the Postal Service, witness Tayman “discussed” seven separate factors cited as “reasons” for the high contingency request. In actuality, however, witness Tayman did not really discuss those items, he merely listed them, more or less as the Postal Service has listed them in its initial brief. *Compare* USPS-T-9, p. 43, *with* USPS Initial Brief, p. II-6.

And although it is true that rebuttal witness Strasser did add a little more verbiage when repeating witness Tayman’s points (and trying to rehabilitate the Postal Service’s contingency showing), witness Strasser added nothing of substance in his “elaboration.” *See* USPS Initial Brief, pp. II-6 through II-7. In fact, on brief the Postal Service has quoted the very same Postal Service interrogatory response that witness Strasser quoted in his testimony, purporting to “describe” postal management’s

process in evaluating the various factors related to the contingency proposal. *See id.*, p. II-7; USPS-RT-1, pp. 7-8, Tr. 46A/20187-88. This “framework for assessing the reasonableness of the contingency amount” is not evidence of what Postal Service management actually considered or determined in arriving at a proposed contingency in this docket. Even if the procedures set forth in the response were followed, the Postal Service has provided **no facts** demonstrating that the Postal Service management’s consideration of those factors was reasonable, or even whether its resulting conclusions were reasonable.

Aside from an indication that the Postal Service is uncertain about the future, no evidence indicates what role any of the items mentioned by witnesses Tayman and Strasser may have played in rendering any particular decision, including any particular calculation of amount. It is impossible to determine from such testimony how the proposed contingency allowance of \$1.68 billion was arrived at.

In Docket No. R94-1, the Commission recognized that the Postal Service had provided a “better vantage point” for reviewing its contingency request than it had provided in Docket No. R90-1 by “openly and clearly articulating the rationale for its requested contingency allowance.” The Commission then observed that “[w]hat remains to be determined is the reasonableness of that preference, *i.e.*, its congruence with applicable postal policy and relevant facts.” *Op. & Rec. Dec.*, Docket No. R94-1, para. 2037. In this docket, aside from heralding general, future uncertainties, the

Postal Service has simply failed to provide either the rationale for its requested contingency or the facts needed to gauge the reasonableness of its request.¹⁸

Nevertheless, the Postal Service argues that its contingency request should be recommended by the Commission because it is “reasoned.” *See* USPS Initial Brief, p. II-8. Specifically, the Postal Service argues that “[a] test of reasonableness does not require agreement; it requires **only** a finding that the determination was reasoned.” *Id.* (emphasis added). VP/CW respectfully disagree. The statute, 39 U.S.C. section 3621, requires a “reasonable” contingency allowance. A request can be “reasoned,” as the Postal Service uses that term, and still be “unreasonable” in context and amount, exactly like the Postal Service’s current contingency request, which should not be recommended.

¹⁸ United Parcel Service (“UPS”) has argued in its initial brief that the Postal Service’s contingency request should be “approved,” on the theory that the \$1.68 billion requested allowance is “not out of line when compared to contingency provisions previously approved by the Commission.” UPS Initial Brief, p. 92. This “comparison” argument of UPS lacks substance without a comparison of the relevant facts in the various dockets to which UPS cites. UPS also expresses that “services with a low cost coverage ... and ... subject to considerable cost uncertainties ... will fall below attributable costs or will not contribute their fair share to institutional costs.” *Id.* Perhaps, anticipating that the exorbitant rate increases it has proposed in this docket will not be recommended by the Commission, UPS is seeking another way to promote non-cost-based rate increases. Whatever its motive, the possible uncertainties it mentions as being relevant to the contingency in this docket already should have been taken into account by the Postal Service in determining costs and revenues, and should have no bearing on the size of the contingency amount.

B. The Postal Service's Criticisms of the Testimony and Evidence Supporting a Contingency of 1 Percent or Less Are Not Persuasive.

At pages II-9 through II-28 of its initial brief, the Postal Service addresses to a limited degree the substantial record evidence contradicting the purported reasonableness of the Postal Service's requested contingency allowance. The Postal Service touches only briefly upon certain proposals of the OCA and other intervenors for a lesser contingency allowance, without addressing the analysis of witness Haldi (VP/CW-T-1) at all. Admittedly, there was so much testimony opposed to the Postal Service's contingency request that it would have been difficult for any Postal Service brief to cover every point at any length. But the Postal Service's initial brief misses entire arguments lodged in favor of a sharply reduced contingency.

Although the Postal Service grappled with a few points made in the direct testimony of Direct Marketing Association, Inc., *et al.* witness Lawrence G. Buc (DMA-T-1) and OCA witnesses Robert E. Burns (OCA-T-2) and Edwin A. Rosenberg (OCA-T-3), it barely mentioned the substance of their testimony. For the most part, the Postal Service, without analysis, simply referred to attempts by Postal Service witness Strasser to respond to the numerous points made by these witnesses in his rebuttal testimony. *See* USPS Initial Brief, pp. II-9 through II-10. As for the rebuttal testimonies of witness Buc and witness Rosenberg regarding the contingency, the Postal Service's initial brief is silent. The testimony of these witnesses is compelling, and the Postal Service's failure to make an effort to rebut them should be seen as an admission that it was incapable of mounting a credible opposition.

The same principle applies to the Postal Service's failure even to attempt to rebut VP/CW witness Haldi. Although it argued at length about Alliance of Nonprofit Mailers' witness Haldi's proposal to reduce the revenue requirement with respect to acknowledged inefficiency in flats processing (*see* USPS Initial Brief, pp. II-10 - II-26), the Postal Service **never addressed at all** witness Haldi's VP/CW testimony with respect to the contingency. *See* VP/CW-T-1, pp. 30-37, Tr. 32/15784-91. VP/CW witness Haldi explains that the Postal Service's request is inadequately supported and exorbitantly high. He testified that if Postal Service forecasts accurately project a Test Year surplus equal to the amount of the Postal Service's proposed contingency (less the amount budgeted for Recovery of Prior Years' Losses ("RPYL")), a substantially lesser contingency amount should be more than sufficient; thus, the improved accuracy of the Postal Service's own cost-revenue forecasts virtually dispenses with any need for such a large contingency in this docket. *See* VP/CW-T-1, p. 31, Tr. 32/15785.

Witness Haldi also explained at some length why (i) the prospective contingency should not be viewed alone, but rather in conjunction with the RPYL mechanism, and (ii) the Commission's established practice of recommending an amount for RPYL must be incorporated into consideration of the contingency, because the "RPYL mechanism acts as a retrospective contingency mechanism, backstopping and taking over much of the function of the contingency fund." VP/CW-T-1, p. 33, Tr. 32/15787. As a retrospective contingency, it both helps fulfil the Act's contingency requirement and also assures the Postal Service that its actual revenue requirement will be met. This is an important concept that provides a complete answer to the Postal

Service's vague concerns about what the future has in store, but which the Postal Service's initial brief wholly ignores.

Finally, witness Haldi testified that the Postal Service's proposed contingency could drive up postal rates faster than the rate of inflation, stimulating competition and loss of volume, and accelerating the next rate increase. VP/CW-T-1, pp. 30-36, Tr. 32/15784-90. He proposed a \$400-\$500 million contingency allowance, and testified to its reasonableness under the record evidence in this docket. This testimony was not rebutted by any Postal Service witness, was not addressed by the Postal Service at all in its initial brief, and therefore stands unchallenged in this docket.

C. The Postal Service Seeks to Negate the Commission's Authority to Make an Independent Recommendation Regarding the Contingency.

The Postal Service appears to be attempting to finesse its substantial difficulties relative to its exorbitant contingency request by arguing that the "participants' witnesses who testified regarding the contingency would essentially seek to have the Commission substitute their or its judgment for postal management's." USPS Initial Brief, p. II-9. But the Postal Service should not persuade the Commission with that line of argument. All parties offering testimony on the contingency issue — with the possible exception of the Postal Service — have focused on the evidence. The Postal Service has focused on the judgment of postal management, and on what appears to be

a legal position that the Commission has no power to make a recommendation at odds with whatever postal management has decided.¹⁹

Whenever the Postal Service chooses to “argue Newsweek” relative to intervenors’ proposals questioning Postal Service managerial decisions on the contingency, the Postal Service seeks to ward off Commission meddling. However, managerial decisions, insofar as they affect matters within the jurisdiction of the Commission, can be questioned. In Docket No. R80-1, the Commission, *inter alia*, reduced the Postal Service’s requested contingency allowance and disallowed the requested RPYL. *Op. & Rec. Dec.*, Docket No. R80-1, at 15, 18. In Newsweek, Inc. v. U.S. Postal Service, 663 F.2d 1186 (2d Cir. 1981), the Second Circuit set aside the Commission’s Docket No. R80-1 denial of the Postal Service’s RPYL and its adjustments to the contingency allowance, primarily because the Commission’s action was deemed arbitrary, had been taken with the intent to stimulate more frequent filing of rate cases, and had been designed to discipline the Postal Service. The Second Circuit held that those specific actions unlawfully infringed on the discretion of Postal Service management. *See Op. & Rec. Dec.*, Docket No. R84-1, paras. 1019, 1020, 1029-1031. Subsequently, the Commission rejected the Postal Service’s argument — that the Newsweek decision effectively insulated the judgment of the Postal Service

¹⁹ The Postal Service decided not to share with the Commission and the parties in this case its management’s contingency rationale. Not only did it refuse to offer such evidence as an integral part of its rate request, but it also resisted efforts by the participants in this case to discover the factors that postal management may have considered, and how it was determined such factors would bear on a projected contingency amount. *See OCA Initial Brief*, pp. 62-64.

from the Commission's review authority — and clarified the scope of the Newsweek decision as follows:

Accordingly, we have concluded that the Commission has both the authority and the responsibility to make adjustments in the Postal Service's proposed revenue requirement, so long as our adjustments are not arbitrary, our reasoning is fully articulated and based upon substantial evidence in the record, and where our adjustments have neither the intent nor the effect of causing more frequent rate filings nor constitute an intrusion into the policymaking domain of the Board in accordance with the Holding in Newsweek. [*Op. & Rec. Dec.*, Docket No. R84-1, para. 1047.]

That is a correct interpretation of the law regarding the Commission's function and authority. *See, e.g., Mail Order Ass'n v. U.S. Postal Service*, 2 F.3d 408, 422-24 (D.C. Cir. 1993); United Parcel Service v. U.S. Postal Service, 184 F.3d 827, 832-33 (D.C. Cir. 1999), which support the Commission's analysis and conclusion that it has the authority to make its own independent judgment on issues within its jurisdiction.

Witness Haldi testified in this docket that a reasonable contingency would be in the range of \$500 million. That proposal is within the range of reasonableness in light of the evidence, and is consistent with the testimony of other witnesses in this docket. Where, as here, the Postal Service's requested contingency is so far out of bounds, and where a contingency allowance of 1 percent or less of total costs is in accordance with the overwhelming weight of the evidence, the Commission not only may but, it is submitted, should reject the Postal Service's request and recommend an appropriately lower contingency allowance.

CONCLUSION

Val-Pak/Carol Wright submit that the Postal Service's rate and classification proposals, as modified by the direct testimony of witness Haldi (VP/CW-T-1), should be recommended by the Commission.

Respectfully submitted,

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

William J. Olson

John S. Miles

WILLIAM J. OLSON, P.C.

8180 Greensboro Drive, Suite 1070

McLean, Virginia 22102-3860

(703) 356-5070

Counsel for

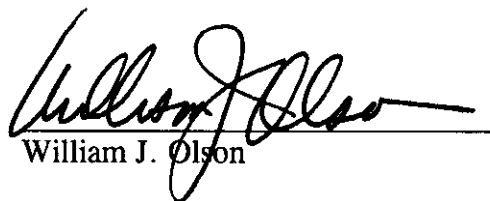
Val-Pak Direct Marketing Systems, Inc.,

Val-Pak Dealers' Association, Inc., and

Carol Wright Promotions, Inc.

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 22, 2000