

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**REPLY BRIEF
OF THE
SATURATION MAIL COALITION**

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September 22, 2000

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

OVERVIEW

The issues involving the proposed postal rates for Enhanced Carrier Route mail, among the most hotly contested issues in this proceeding, present the Commission with fundamental choices that have significant implications for mailers, their customers, the Postal Service, consumers, and the appropriateness of Postal Service competition in the distribution of print advertising.

Cost-Based Rates. The first issue concerns the Postal Service's proposed pound rate. As a matter of economic efficiency, the pound rate, like other rates, should reflect underlying cost behavior. The current high pound rate does not. Although in prior cases the Commission has had questions about the cost justification, the record here fully addresses those concerns. The numerous cost analyses presented by the Postal Service and intervenors all point unequivocally to the same conclusion. The pound rate is too high, and the proposed reduction -- smaller than proposed in prior cases -- is only a modest move in the right direction. By contrast, the three parties opposing a reduction in the pound rate do not seriously contend that the current rate is cost-justified.

Impact on Mailers, Customers, and Competition. The second issue, also relating to the pound rate, is its impact. The record in this proceeding establishes that advertisers, consumers, mailers of all classes, the Postal Service, and competition in

the marketplace would benefit from the proposed pound rate, and there is no evidence of significant harm to newspapers or private delivery companies that would outweigh these benefits.

NAA, representing the large daily newspapers that dominate the advertising distribution market, has not even attempted to present evidence that the pound rate will harm newspapers. Instead, it claims that there is something invidious about the Postal Service competing in the marketplace, and it asserts incorrectly that newspapers are entitled to constitutional protection against proposals that would "drive revenue out of the pages of newspapers." NAA Brief at 4. The only evidence NAA and AAPS cite concerning private delivery relates to a specialized segment of that industry, selective delivery of magazines and newspaper TMC programs. They presented no evidence showing harm to *saturation* private delivery. The record indicates that saturation private delivery is growing and is an increasingly attractive alternative for mailers because of the high pound rate.

What the competitors are really seeking is continuation of an excessively high, non-cost-based pound rate that shelters them from competition.

NAA's ECR Rate Proposal. The third issue relates to overall ECR rates. NAA's *rate proposal submitted on brief would hammer ECR saturation mail with a staggering 15% increase in the piece rate and, predictably, even larger increases for pound-rated mail. It would shift additional institutional costs onto ECR, particularly saturation mail, the most competitive and price sensitive segment of the mailstream, contrary to sound principles of economically-efficient, market-based pricing. Its proposal would free newspapers from the market disciplines of competition. It is a punitive proposal, especially with respect to the pound rate, that goes in the wrong direction and should be rejected for what it is: an economically unsound proposal designed to eliminate competition in the marketplace.*

I. THE PROPOSED POUND RATE IS UNQUESTIONABLY COST JUSTIFIED.

The compelling evidence and justification for reducing the ECR pound rate are laid out at length in the SMC's initial brief, as well as the briefs of the Postal Service, AISOP, and the joint brief of MOAA, DMA, and PostCom. The opponents of the lower pound rate, NAA, AAPS, and Val-Pak, have presented nothing to undermine the unavoidable conclusion that the proposed pound rate is cost justified and conservative.

Val-Pak's brief claims that there are "too many" different estimates of the ECR weight-cost relationship presented by witnesses Daniel, Crowder, and Prescott, and that this "smorgasbord" of different estimates creates "confusion." These witnesses have, indeed, employed a wide variety of different analyses that, naturally, produce somewhat differing cost results. *But there is no confusion about the fact that all relevant cost estimates are substantially less than the current pound rate. No matter how looked at, the current and even the proposed pound rates are too high. This is a strength, not a weakness.*

The only "confusion" on this record concerning the cost justification for the pound rate has been concocted by Val-Pak and NAA, who duck the core evidence justifying a lower pound rate, and instead nit-pik at the fringes. They claim IOCS tally "thinness" produces unreliable results, even though the data show a clear and consistent pattern of cost behavior that belies any thinness problem. They cite a few "anomalous" or "counter-intuitive" results for some small sub-categories of Standard A mail with tiny volumes, even though the results for the major category of ECR mail affected by the pound rate -- ECR flats -- show nothing of the sort.

Because Val-Pak initial brief raises a host of new arguments, and attempts to sow the most confusion, our reply comments focus on its claims.

A. What Val-Pak Has Not Addressed On Brief.

1. Haldi and Val-Pak Have Both Forgotten His Correct Demonstration In Docket R97-1 That The Pound Rate Is Too High.

Noticeably absent from the myriad of new arguments Val-Pak raises on brief is any discussion of Crowder's testimony concerning the interrelationship between shape-related and weight-related costs, which Crowder described as "[o]ne of the most critical factors bearing on the weight-cost relationship." ADVO-RT-1 at 14, Tr. 19379. In particular, Crowder highlighted the flagrant inconsistency between Haldi's testimony here and in Docket R97-1. In R97-1, Haldi demonstrated both conceptually and mathematically that, because of the interrelationship between the letter-nonletter cost differences and weight-related differences, the even lower pound rate proposed there was "conservative." *Id.* at 14-16, Tr. 19379-81. Haldi in this proceeding has not even acknowledged his R97-1 analysis. Using a methodology comparable to Haldi's R97-1 analysis, Crowder then computed the implicit weight-related costs under the extreme assumption that the entirety of the letter-nonletter cost differential is due to weight rather than shape. The resulting per pound costs (even if marked up) are far below the proposed pound rate. *Id.* at 16-17, Tr. 19381-82.

This points are addressed in detail in our initial brief at 17-20. However, Crowder's exposé of Haldi's silent abandonment of his R97-1 testimony is *not* addressed in Val-Pak's initial brief. Given the "kitchen sink" nature of its arguments on brief -- addressing in some fashion almost every other one of Crowder's topics -- Val-Pak's oversight on this telling point of Crowder's testimony is most curious. It may be that Val-Pak simply does not have an answer to explain away Haldi's unexplained departure from his R97-1 analysis (there is no explanation on this record). Or perhaps Val-Pak, as a tactical move, is holding back until reply brief to "explain" Haldi's unexplainable departures from his R97 testimony and analyses, in order to evade critical comment. Whatever the case, Haldi's R97-1 analyses and statements remain

true today -- particularly since the pound rate reduction proposed here is much smaller than the one he demonstrated to be "conservative" in R97-1.

2. **Val-Pak Ignores Haldi's Concession That The ECR Mail Most Prejudiced By The Excessive Pound Rate Is Saturation Flats.**

Haldi emphasized in his testimony that within ECR mail there were actually a number of different weight-cost relationships. Because weight-related costs avoided due to presorting are not reflected in the ECR saturation discount, heavier weight saturation pieces pay too much in weight-related charges (or in Haldi's words are "disadvantaged") compared to lighter weight pieces. Haldi at Tr. 32/15917-18; 15923-24. For the same reason, saturation pieces pay too much in weight-related charges compared to non-saturation pieces. He also acknowledged that if the letter-flat cost differential includes not just shape-related but also weight-related cost differences (as it does), passing through the entire letter-flat cost differential over-charges flats with weight-related cost differences that are already charged to flats through the (itself excessive) pound rate. Tr. 15980-82. Conversely, letters are under-charged. As Crowder noted:

"ECR saturation flats get the worst of all worlds in every respect -- they pay a too-high pound rate to begin with, but then get double-charged for weight with an excessive letter-nonletter rate surcharge, and yet do not get full credit for the weight-related costs avoided due to their finer level of presortation." Tr. 44/19373.

On brief, Val-Pak seems to find comfort in the fact that Crowder's own analyses support Haldi's conclusion that there are different weight-cost relationships within ECR. Val-Pak Brief at 27-28. What Val-Pak carefully ignores is the direction of the bias: both Haldi and Crowder agree that the mail most prejudiced by the current single "averaged" ECR pound rate is heavier-weight saturation flats. Instead, Val-Pak attempts to twist this bias into an affirmative reason for *not* reducing the pound rate now, claiming that *nothing* should be done until the Postal Service presents a comprehensive study that

profits." NAA Brief at 22. It suggests that mailers will simply pocket the reduction to increase their profits, and that advertisers would not see "even a penny of this reduction." *Id.*

The contention that advertisers will not benefit from a lower pound rate is hopelessly inconsistent with NAA's argument that the lower pound rate will result in massive diversion of advertising from private delivery. Obviously, if saturation mailers were to simply "pocket" the pound rate reduction and not pass it through in the form of reduced prices to advertisers, then there would be no diversion of advertising from competitors!

NAA tries to fabricate support for its contention that a reduced pound rate will not result in reduced prices to advertisers from a misreading of SMC witness Giuliano's testimony concerning Advo's private delivery experience. Giuliano stated that:

"No longer constrained by the high postal pound rate, Advo has been able to compete successfully in [its private delivery] markets for a share of the mid-to-heavier weight multi-page preprints that had been priced out of the mail. Our privately delivered volumes average 40% more preprint inserts per package than our mailed volumes, and those privately delivered preprints have a higher average weight than those in the mail." SMC-RT-2 at 16, Tr. 19002.

Although not *explicitly* stated, the only way to "compete successfully" for preprints that had been priced out of mail was by offering *lower prices*, made possible by the lower costs of private delivery. Giuliano further explained:

"These markets have become more profitable to Advo as a result of their conversion to private delivery, due to the *combination* of the lower distribution cost of private delivery *and the enhanced ability to compete for heavier traditional preprint volumes*. Overall, these conversions to private delivery have saved Advo millions of dollars annually in distribution costs, all of which has gone directly to Advo's bottom line, substantially enhancing our company's profitability." *Id.* at 17, Tr. 19003 (emphasis added).

Like counsel for AAPS at the hearing, NAA focuses on just the last sentence, out of context, to imply that the lower costs of private delivery did not result in any lower rates to advertisers, but were simply “pocketed” by Advo. NAA Brief at 22-23.

NAA’s related claim that “Advo’s prices appear nowhere in the record” is disingenuous. Witness Giuliano was eager to discuss Advo’s pricing in the Miami market in response to the pricing claims of NAA witness Wilson, but the Presiding Officer ruled that he could not address the issue unless raised by other counsel during cross-examination. Tr. 19006-07. The closest that opposing counsel got to this subject was AAPS counsel’s humorous opening question, “Mr. Giuliano, about pricing in the Miami - - oh, never mind. [Laughter.]” Tr. 19007. Counsel for NAA did not even bother to cross examine. Thus, the absence of information about Advo’s pricing is not due to any reluctance on Giuliano’s part, but the failure of NAA and AAPS to ask.

In sum, a lower pound rate will unquestionably result in lower costs and more choices for advertisers. This is corroborated by PostCom witness Harding who, based on his experience representing advertisers in the marketplace, emphasized the important benefits of a lower pound rate that would flow to advertisers and consumers. Postcom-RT-1. NAA knows this is true, and that is *why* they oppose the pound rate.

B. ECR Volume Trends Show The Opposite Of What NAA Claims: Heavier Weight Volumes Are At Risk.

The testimony of SMC witnesses, as discussed in our initial brief at 36-40, described the history of saturation mail’s lessened competitiveness and declining share of heavier weight advertising preprints, due to the excessive pound rate. In its brief, NAA claims that the most recent billing determinants for the “hybrid” base year show that “the mix of ECR mail has already shifted to a greater proportion of pound-rated pieces, suggesting that ECR mailers are not having trouble competing at heavier weight

mailings.” NAA Brief at 23. This conclusion -- based on a simplistic comparison of *total* ECR piece- and pound-rated volumes -- is distorted and wrong.²

NAA compares the wrong thing. The reason the proportion of *total* ECR pound-rated pieces *appears* to have increased is because of the huge migration of ECR Basic Letters into the Standard A Regular 5-Digit Automation category. From FY 1998 to the Hybrid Year, ECR Basic Letters declined by more than 3 billion pieces, corresponding to a 4 billion piece growth in Standard A Regular 5-Digit Automation volumes. That volume hasn't disappeared, it has just moved to another subclass. It is this migration of light-weight letters to Standard A Regular -- not an increase in heavy weight mailings as NAA suggests -- that has caused the *proportion* of pound-rated pieces in ECR to increase.

What NAA should have looked at is the volumes of saturation nonletter mail, the category of ECR that competes with newspapers. There, the picture is just the opposite of what NAA contends. While the total volume of saturation nonletters has declined by 1.5%, the volume of *pound-rated* nonletters has *declined by 10.1%*.³

	<u>BY 1998</u>	<u>Hybrid BY</u>	<u>Change</u>
Total Saturation Nonletters	8,940,756	8,804,918	-1.5%
Pound-Rate Saturation Nonletters	2,756,726	2,479,384	-10.1%

This is in sharp contrast to the volumes of ECR high-density mail used by newspaper TMC programs. While saturation nonletter volumes have declined, high-density

² The reason that the proportion of total ECR pound-rated pieces *appears* to have increased is because of the huge migration of ECR Basic Letters into the Standard A Regular 5-Digit Automation category. From FY 1998 to the Hybrid Year, ECR Basic Letters declined by more than 3 billion pieces, corresponding to a 4 billion growth in Standard A Regular 5-Digit Automation volumes. That migration of letters mathematically causes the *proportions* of all other mail in ECR (including pound-rated mail) to increase, regardless of changes in their volumes.

³ These are based on the same sources cited by NAA: BY 1998 billing determinants from LR-I-166; and Hybrid BY billing determinants from USPS-LR-I-436, wp1_hybv.xls, Worksheet "bd".

nonletter volumes have grown by 9.5%, with an even larger 15.7% increase for pound-rated nonletters. Newspaper TMC programs are not nearly as sensitive to the high pound rate because they are able to blend their rates to advertisers with their lower newspaper insert distribution costs.

C. Impact On Newspapers.

1. There Is Nothing "Unconstitutional" About Cost-Based Postal Rates And Competition.

Reaching new heights of hubris, NAA makes the breathtaking claim that the Postal Service's proposal to moderate the high ECR pound rate violates the Constitution of the United States because it might have the effect of diverting advertising revenue from newspapers! According to NAA:

"[Newspapers are] protected from deliberate attempts by the federal government to impair or reduce [their] advertising revenue under the First Amendment to the Constitution.

"This means, *ipso facto*, that under the Constitution, the federal government (which here is the Postal Service) cannot try to drive revenue out of the pages of newspapers." NAA Brief at 4.

NAA traces this alleged "principle" to the Supreme Court's decision in *Grosjean v. American Press Co.*, 297 U.S. 233 (1936). *Grosjean* involved an attempt in the 1930s by Louisiana's colorful Governor Huey "Kingfish" Long to punish larger-circulation newspapers that had been critical of his administration by imposing a "suspicious" selective tax on their gross receipts, "with the plain purpose of penalizing the publishers and curtailing the circulation of a selected group of newspapers." 297 U.S. at 251. As the Court said:

"[The tax] is bad because, in the light of its history and its present setting, it is seen to be a deliberate and calculated device in the guise of a tax to limit the circulation of information....

"The form in which the tax is imposed is in itself suspicious. It is not measured or limited by the volume of advertisements. It is measured alone by the extent of circulation of the publication in which the advertisements are carried, with the plain purpose of penalizing the

publishers and curtailing the circulation of a selected group of newspapers." *Id.* at 250, 251.

Thus, the constitutional danger the Court sought to avoid was the misuse of governmental taxing power as a bludgeon *to punish the press for its exercise of First Amendment rights*.

Carried to its "logical" conclusion, NAA's constitutional argument would force the Postal Service out of the business of delivering any kinds of advertising carried by newspapers -- notwithstanding the fact that the Postal Service traditionally and legitimately has been delivering print advertising for more than a century. As the mailer witnesses testified, the high pound rate caused them to become non-competitive for all but lightweight advertising, and the modest proposed reduction would simply allow them an opportunity to compete once again for a portion of this lost advertising. Under NAA's argument, however, any share of advertising, once lost to newspapers due to non-competitive postal rates (or perhaps even before it is lost), would thereby become constitutionally immune to recapture. Cost-justified rate adjustments would be barred because they might "drive revenue out of the pages of newspapers." Eliminating effective competition, would, indeed, make newspapers fatter (both literally and figuratively), but to the detriment of the Postal Service, mailers, advertisers, competition, and in the end, consumers.

NAA's attempt to characterize the Postal Service's proposed cost-based pound rate as an "unconstitutional tax" on newspapers reveals that NAA's real interest in this proceeding is not protection of First Amendment rights, but protection of newspapers from competition. Its assertion of constitutional principles, for the sake of protecting

newspapers from legitimate and beneficial competition, cheapens the legitimate First Amendment interests of the press.⁴

2. **NAA Has Presented No Evidence Of Harm To Newspapers.**

Except for its bluster about the impropriety of the Postal Service competing for advertising, NAA makes no claim on brief that the proposed pound rate would harm newspapers. Its only allegations of harm relate to private delivery. NAA Brief at 7-11.

D. **Impact On Private Delivery.**

As noted in our initial brief, the only witnesses in this proceeding from companies that *actually use or provide regular weekly saturation private delivery* are the Saturation Mail Coalition witnesses: Buckel, Bradpiece, and Giuliano. AAPS witness White and NAA witness Wilson are both affiliated with newspaper TMC programs that engage in non-saturation selective delivery to newspaper nonsubscriber households -- a type of private delivery that is distinctly different from saturation private delivery in purpose, focus, design, and economics.

1. **AAPS's Claim That Private Delivery Is "The Only Effective Competition For The Postal Service" Is Nonsense: Newspapers Are The Dominant Competitors In The Market.**

AAPS makes the astonishing claim that the lower pound rate would "wipe out the only effective competition for the Postal Service in much of the advertising delivery market." AAPS Brief at 2. This is nonsense on two scores. First, the dominant competitor in the market for distribution of print advertising is not the Postal Service nor mailers, and certainly not private delivery, but the *newspaper* industry. This has always been the case, even as far back as 1984 when similar claims of competitive harm by

⁴ Newspapers, if fact, have many legislatively-granted exemptions that favor them compared to competitors, such as exemptions from sales tax on advertising carried in the newspaper. Newspapers, however, have not been exempted from competition.

AAPS's predecessor, CNPM, were rejected by the Court of Appeals in *Direct Marketing Association v. United States Postal Service*, 778 F.2d 96 (2nd Cir. 1985). There, referring to NAA's predecessor ANPA, the court noted that with respect to the advertising distribution market, "ANPA's members in fact are the strongest competitors of the Postal Service." *Id.* at 106. And newspapers will continue to be the dominant competitors even with the proposed pound rate. Second, and in any event, the moderation in the pound rate will not "wipe out" private delivery.

2. The Claims Of Harm To The Private Delivery Industry Are Exaggerated And Do Not Relate To Saturation Delivery.

The claims of NAA and AAPS that the private delivery industry is on the verge of collapse and the lower pound rate will cause its destruction are hyperbole. Cutting through the histrionics, there is next to nothing in the way of reliable evidence supporting their wild claims, particularly with respect to the saturation private delivery industry. In fact, they make no claims and present no evidence that there has been, or is likely to be, any decline in saturation private delivery.

The "evidence of harm" they cite boils down to just two phenomena: the brief rise and demise of selective delivery of magazines and catalogs in the early-to-mid 1990s; and the recent shift of some newspaper TMC programs from selective delivery to ECR mail. Their two witnesses, both affiliated with large daily newspapers, focused their testimony on this "selective delivery" segment of the private delivery industry.

The MC95-1 Reclassification Argument. Both AAPS and NAA place heavy emphasis on the alleged "devastating" impact that the MC95-1 Reclassification decision supposedly had on private delivery -- claiming that postal rates were the reason for the demise of the magazine industry's selective delivery initiative. That experience, however, is in no way indicative of the health of *saturation* private delivery. It involved the commingling and collation of *selectively-addressed* magazines and catalogs for selective *nonsaturation* delivery to households.

Selective delivery of commingled address-specific magazines and catalogs is far more complex and costly than saturation delivery.

- First, because each magazine and catalog has its own unique list of address-specific recipients, each publication must be separately sorted by address, piece by piece, and then commingled with other publications going to the same address -- a complex "in-office" sorting task functionally identical to the Postal Service's in-office casing of mail.
- Second, the unique sets of household-specific packages must be maintained in the carrier's walk-sequence order to ensure delivery to the correct address.
- Third, because the resulting household coverage is less than saturation, the fixed route and overhead costs of selective delivery are spread over fewer deliveries than with a saturation program, resulting in a higher cost-per-delivery. Tr. 44/19021 (Giuliano).
- Fourth, because the addresses served by this selective-address delivery change from week to week due to subscriber changes and different mixes of publications and catalogs, the planning, logistics, and operational demands of this kind of delivery are far more complex than with regular weekly saturation private delivery.

Saturation private delivery, by contrast, avoids all of these complexities and extra costs. Every house on a route receives the identical package of materials, with a high degree of predictability and consistency from week to week. Tr. 19021

The fact that the magazine selective delivery initiative failed -- whether because of postal rates or, more likely, the inherent difficulty of generating a sufficient critical mass of volumes to offset the high costs of commingling and selectively delivering a number of different publications -- says nothing about the health and competitiveness of the saturation private delivery industry.

The same is true of NAA witness Wilson's claim that newspaper nonsubscriber TMC programs have recently switched from selective private delivery to the mail. For the reasons pointed out in our initial brief, based on the evidence presented, this is no more probative of the impact on saturation private delivery than is the magazine selective delivery experience. They are distinctly different forms of private delivery. SMC Initial Brief at 48-52.

NAA grossly exaggerates the decline in the number of private delivery companies. NAA witness Wilson, for example, claimed (without citation) that:

"AAPS estimates that in 1995 they had over 300 distributing companies as members of their association. This year they have 100 members directly involved in hand delivery. That is a loss of 66%." Tr. 19146.

His claim is flatly contradicted by AAPS's testimony in this and prior cases. The following table lists AAPS's membership numbers, as supplied by AAPS:

<u>Year</u>	<u>AAPS Members</u>	<u>Source</u>
1986	44	R90-1, AAPS-T-1 at 19, Tr. 18478
1990	50	R90-1, AAPS-T-1 at 20, Tr. 18479
1995	125	MC95-1, AAPS-T-1 at 3 (filed 12/___/95)
1997	100	R97-1, AAPS-T-1 at 5, Tr. 11981
2000	110	R2000-1, AAPS-T-1 at 7, Tr. 9942

Thus, AAPS's own testimony indicates a membership decline of only 15 companies since 1995 -- a decline of only 12% (not 66% as Wilson claimed).

Far more relevant is the fact that AAPS membership has *more than doubled* since 1990. The decline since 1995 is not a sign of long-term deterioration in the industry. Rather, it is simply a reflection of the large and sudden rise and demise of *selective* delivery of addressed magazines and catalogs between 1990 to 1995, and the more recent shift of selectively delivered TMCs to the mail. The fact is that, despite these two selective delivery phenomenon, the saturation private delivery segment of the industry appears to have grown. As discussed in our confidential reply brief being filed under seal, the SAI Report, although it appears to be a highly unreliable and incomplete analysis of the industry, confirms this conclusion. Advo's entry into saturation private delivery and its continuing expansion of those operations, shifting previously mailed volumes into private delivery, is further evidence that saturation private delivery is healthy and an increasingly attractive alternative to saturation mail.

III. VAL PAK'S PROPOSED INCREASE IN THE EXCESSIVE LETTER-FLAT RATE DIFFERENTIAL SHOULD BE REJECTED.

The ECR letter-nonletter rate differential is intended to reflect the *shape-related* cost differences between letters and nonletters. In her rebuttal testimony, Advo witness Crowder demonstrated both the mathematical and conceptual errors in Val-Pak witness Haldi's proposal to increase the letter-nonletter cost and rate differentials, and explained why the Postal Service's rate differential should be adopted (although even it overstated true shape-related cost differences). The fundamental problem with increasing the rate differential, she explained, is that the cost differential upon which it is based includes not just shape-related cost differences but also *weight-related* cost differences which are already *over-recovered* through the high pound rate. Thus, even under the Postal Service's proposed rates, the letter-nonletter rate differential results in double-recovery of weight-related cost differences. ADVO-RT-1 at 38-43, Tr. 44/19403-08.

On brief, Val-Pak's only mention of the serious conceptual problem with double-recovery of weight-related costs is one sentence: "[Crowder] does not identify or quantify such costs." Val-Pak Brief at 18. It is true, as Crowder noted, that "as a practical matter, it is likely impossible to truly isolate and segregate these two related cost factors." Tr. 44/19379-80. But as she explained (*id.*) and as Daniel confirmed:

- The letter-nonletter cost differential includes the costs for all flats, both above and below the 3.3-ounce breakpoint;
- Nonletters have an average piece weight three-times greater than letters (2.9 ounces or more for nonletters, compared to less than 1 ounce for letters); and

The unit cost differences between letters and nonletters "include not only the effects of shape-related cost differences, *but also* the effects of weight-related cost differences." Tr. 4/1221 (emphasis added).

These facts prove that the letter-nonletter cost differential includes weight-related cost differences -- a fact which Val-Pak does not dispute. This, in turn, necessarily means that a passthrough anywhere near 100% results in a double-charging of nonletters for

weight-related costs through the combination of (1) the high pound rate (which over-recovers those costs) and (2) the letter-nonletter differential (which recovers them once again in the guise of a "shape" surcharge).

Because it has no real answer to the double-counting problem, Val-Pak's brief focuses instead on Crowder's corrections to the mathematical errors in Haldi's analysis, where he attempted to correct for Daniel's alleged misallocation of the costs of "heavy-weight" letters. Val-Pak's and Haldi's confusion stems from a continuing stubborn misinterpretation of Daniel's analysis. Daniel, in fact, recognized that there was a definitional mismatch between the RPW (which classified pieces by rate category) and the IOCS (which classified pieces by shape). To avoid this mismatch, she did *not* use RPW volumes in her analysis. Instead, she employed shape-based PERMIT volume data corresponding with the shape-based IOCS cost data, which for her purposes was the correct way to analyze costs. Her reasons for using PERMIT rather than RPW volumes were explained fully in the Postal Service's response to VP-CW/USPS-1 and 2, Tr. 21005-08.

Thus, in Daniel's analysis, both the costs *and volumes* of heavy-weight letters were assigned to letter mail.⁵ But when Haldi made his heavy-weight letter adjustment to Daniel's data, he shifted only the costs of those letters to the nonletter category, overlooking the need to also shift the related *volumes* of heavy-weight letters. In discovery, Haldi effectively conceded this point, acknowledging that

"My testimony was based on a misunderstanding of the differences between witnesses Daniel and Moeller. See Postal Service responses to VP-CW/USPS-1...and VP-CW/USPS-2." Tr. 15865.

⁵ In the shape-based PERMIT volume data Daniel used, the volumes of heavy-weight letters are reported as "letter" rather than "nonletter" volumes.

Crowder's rebuttal analysis corrected Haldi's error by shifting both the costs and volumes of heavy-weight letters to the nonletter category.

On brief, Val-Pak simply repeats Haldi's original error. It claims:

"Specifically, in this instance the *RPW data correctly* count heavy-weight letter-shaped pieces as non-letters (or flats), because they pay the non-letter rate. Consequently, not only is there no need to shift volume and make an adjustment to *RPW volume data*, as witness Crowder does, it is also wrong to do so." Val-Pak Brief at 18-19 (emphasis added).

But Daniel *did not use RPW volume data*. And Crowder's correction *did not adjust RPW volume data*. Rather, Crowder correctly adjusted the *shape-based PERMIT volume data* that Daniel used. It is Val-Pak that doesn't understand Haldi's adjustment, and the errors he made.

Moreover, as Crowder and Prescott explained, this was not the only error in Haldi's heavy-weight letter adjustment and his resulting letter-nonletter cost differential. Haldi's analysis improperly included *all* letter-nonletter cost differences, whereas the correct method includes only mail processing and delivery cost differences. See MOAA, et al.-RT-1 at 37-38, Tr. 19305-06; ADVO-RT-1 at 40-41, Tr. 19405-06. In addition, Crowder explained that:

"Further, the USPS LR I-92 costs he uses include (1) a considerable amount of cost allocated on the basis of weight in order to be conservative in estimating the ECR letter and nonletter weight-cost relationships and (2) more than the traditional mail-processing and delivery costs used by witnesses Daniel/Moeller to develop the ECR letter/nonletter rate differentials.

"Effectively, Dr. Haldi's analysis requires both volume and cost corrections. With respect to the cost correction, I adjusted witness Daniel's ECR costs for letter- and flat-shape volume by eliminating all costs but mail processing and delivery (i.e., those in Cost Segments 3, 6, 7, and 10) and re-allocated shape-related elemental load costs using pieces as the distribution key." Tr. 19405.

On brief, Val-Pak does not dispute Crowder's cost-related adjustments to Haldi's letter-nonletter cost differential. After Crowder's corrections for (1) Haldi's failure to shift

heavy-weight letter volumes to nonletters and (2) his inclusion of inappropriate costs, the letter-flat cost differential about which Val-Pak and Haldi are so concerned increases by less than one-tenth of a cent -- a very minor difference that is overwhelmed by the fact that the resulting letter-nonletter cost differential reflects not just shape- but also weight-related costs.

This highlights the extreme overcharging of weight under Val-Pak's rate proposal. Even at the Postal Service's moderated pound rate (higher than the one Haldi found "conservative" in R97-1), nonletter mail will pay not only a pound rate substantially in excess of true weight-related costs, but also a letter-nonletter "shape" surcharge that includes weight-related cost differences. Val-Pak's proposal would compound both problems: maintaining the excessive current pound rate and increasing the double-charging with an even higher letter-nonletter rate differential. As Crowder explained, this is, in fact, another compelling reason why the ECR pound rate must be reduced:

"[B]ecause the letter-flat unit cost differential includes both shape-related *and* weight-related costs -- and because it would charge flat mail, in the guise of a shape-related surcharge, with weight-related costs that are already over-recovered by the pound rate -- even a 94% to 95% passthrough is excessive....

"Moreover, coupling this with a high weight-related (pound) rate compounds the problem by recovering the same letter-flat cost difference in two ways: once from the piece rate and once again from the pound rate. This inequitable and counter-intuitive situation only demonstrates why it is important to start moving the pound rate in the right direction -- downward." ADVO-RT-1 at 42-43. Tr. 44/19407-08.

For these reasons, Val-Pak's proposals to increase the ECR letter-nonletter rate differential and maintain a high pound rate should be rejected.

IV. UPS'S PROPOSAL TO DISTRIBUTE ALL LOAD COSTS TO ALL SUBCLASSES ON THE BASIS OF WEIGHT RATHER THAN SHAPE, PREMISED SOLELY ON THE UNIQUE LOAD CHARACTERISTICS OF HEAVY-WEIGHT PARCELS, SHOULD BE REJECTED.

Elemental load costs are currently distributed among the subclasses on the basis of shape. However, this distribution implicitly reflects the effects of weight (if any) on

load time costs. This is because the Postal Service's load time variability analysis captures the entire cost difference between letters, flats and parcels, whether caused by shape or weight or a combination of the two. This variability analysis indicates that flats incur more load time than letters (1.40 versus 1.08 seconds per piece), while parcels require substantially more time than flats or letters (22.48 seconds for SPRs and 36.50 seconds for parcels). Tr. 18707 (Baron). In distributing these load time differences among the subclasses in proportion to each subclass's mix of shapes, the effects of weight (if any) are reflected in the ultimate subclass attributions.

Citing alleged loading time differences between heavy-weight parcels and Standard A parcels weighing less than 16 ounces, UPS urges that weight rather than shape be used as the distribution key for distributing *all* elemental load costs among *all* subclasses of mail. However, the only evidence on this record concerning the effect of weight on load time relates to parcels, and even more narrowly, to differences between Standard A parcels weighing less than one pound and the much heavier parcels in Parcel Post.⁶ Even then, the only explanation offered for the effect of weight on parcel loading is that heavy parcels, because of their weight and bulk, cannot be cased and delivered with letter and flat mail, and do not fit in mail receptacles, thereby requiring delivery of the parcel directly to the customer. Tr. 18707. By contrast, for First Class and Standard A mail weighing under 16 ounces, there is no record evidence indicating that load costs are a function of weight rather than shape.

⁶ UPS tries to bootstrap witness Daniel's weight-cost analyses into an affirmative justification that weight rather than shape is, in fact, the cost driving factor for elemental load. That misrepresents Daniel's testimony. The purpose of her analysis was to estimate weight-related costs for First Class and Standard A in connection with the Postal Service's proposed pound rates. As she made clear, solely for the purpose of making a conservative estimate of weight-related costs, she simply *assumed* that elemental load costs were purely weight-related (USPS-T-28 at 8-9) -- a "worst case" assumption intended to eliminate this issue as a source of criticism of her analyses (Tr. 39/17759-60, Kay/Bozzo).

Thus, the record indicates that the effect of weight on load time is not a continuous linear function, but kicks in only when the mail piece's weight and bulk make it difficult to deliver into the receptacle along with letters and flats, thus requiring either a separate delivery or a delay while the carrier waits for the customer to accept the bulky item. Whether this circumstance requires some special method for distributing elemental load costs to Parcel Post, it clearly does not support distribution of *all* elemental load costs to *all* subclasses on the basis of weight alone, as UPS advocates.

V. NAA'S PUNITIVE ECR RATE PROPOSAL SHOULD BE REJECTED.

On brief, NAA presents an ECR rate proposal that it claims will more fairly align ECR rates with First Class Mail. Specifically, it proposes that the ECR basic nonletter piece rate be increased from 16.2¢ to 18.6¢, that the pound rate be increased from 66.3¢ to 76.0¢, and that the basic per-piece charge for pound-rated pieces be increased from 2.5¢ to 2.9¢. NAA Brief at 33.

Although not stated by NAA, the effect of this proposal would be a staggering rate increase targeted at the saturation mailers that compete with NAA-member newspapers. The increases for saturation nonletters entered at the DDU would range from 14.9% to 16.3% -- with the largest increase, naturally, on heavier mail above the breakpoint.

Other ECR mailers, although not NAA's intended targets, would also get hammered by its proposal. Basic rate nonletter mailers such as the catalog mailers who are members of MOAA would get rate increases of 15-16%. The many smaller newspaper members of the National Newspaper Association (not to be confused with NAA) that use saturation mail for their TMCs and free community papers would also be in the blast zone of NAA's proposal. "Saturation mail is very important to NNA members." Tr. 46-B/20562 (NNA witness Max Heath). None of this matters to NAA in its single-minded effort to harm its competitors, regardless of who else is harmed in the process.

Despite its pretext, NAA's interest is not really protecting First Class mailers, but only undermining the ability of ECR mailers to compete with its members. NAA's notion that these excessive ECR rate increases would be "fair" or "beneficial" to First Class mailers was dispelled by SMC witness Giuliano. The ultimate effect, as he explained, would be to drive advertising and saturation mailers out of the mail, to the detriment of First Class mailers and the postal system:

"Ironically, NAA witness Tye argues that ECR mail should be hit with an even higher cost coverage and higher rates in order to 'protect monopoly customers' by 'increasing the contribution from competitive classes such as ECR.' Tr. 14742...."

"Given the fact that saturation mail is price sensitive and faces substantial competition, and because saturation postal rates are near or at the point where a shift to private delivery becomes feasible, Tye's 'solution' for 'protecting monopoly customers' will have the opposite effect. Even higher rates will force that mail out of the system -- either by diverting advertisers to newspapers and private delivery competitors, or by causing mailers themselves to leave the postal system and become competitors of the Postal Service. Neither outcome is in the best interest of 'monopoly customers' or the Postal Service's universal delivery system." SMC-RT-2 at 18, Tr. 19004.

Excessive ECR rates would also undermine the Postal Service's ability to generate new sources of revenue, so critically needed in the face of inevitable non-price-related volume losses to electronic forms of communication. As Giuliano stated:

"What the Postal Service needs -- at a time when it is facing inevitable non-price-related diversion of core mail volumes due to changing technology -- is the opportunity to generate new volumes of profitable mail in all of its product categories, including First Class mail." *Id.* at 18-19, Tr. 19004-05.

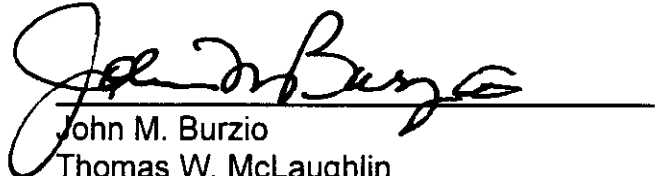
Although punitive ECR rate increases anywhere approaching the magnitude proposed by NAA would, no doubt, be beneficial to some of NAA's members by stifling competition, they would be decidedly harmful not only to saturation mailers and their customers (particularly small businesses and entrepreneurs that depend on affordable advertising), but to all ECR mailers including smaller publishers. As Postcom witness

Harding's testimony demonstrates, it would also harm advertisers by further limiting competition and restricting choices in the marketplace. Moreover, the ripple effect would ultimately harm all mailers including the "monopoly customers" that NAA feigns a desire to protect, to the detriment of the postal system. NAA's over-the-top ECR rate proposal should be rejected.

CONCLUSION

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "John M. Burzio", is written over a horizontal line.

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APPENDIX A: Val-Pak's Pound Rate Arguments**1. Val-Pak's On-Brief Analyses Of Aggregated ECR Regressions Are Incorrect And Contrary To Haldi's Position That ECR Presort Categories Should Be Analyzed Separately.**

In her testimony, USPS witness Daniel presented unit costs by ounce increment for ECR mail that aggregated Basic and High-Density/Saturation mail together. She also presented simple, unweighted regressions based on those unit costs. Subsequently, in response to discovery, she provided separate data that disaggregated the costs for the ECR Basic and High Density/Saturation categories. ADVO/USPS-T28-13, Tr. 1351-59.

On brief, Val-Pak presents a new but inappropriate comparison of the Postal Service's proposed rates with the costs derived from Daniel's *original aggregated* ECR weight-cost regressions. Val-Pak Brief at 21-26. Using these original aggregated regressions, Val-Pak computes the implied cost for a 16-ounce piece, then inflates the cost by the full 208.8% ECR cost coverage proposed by the Postal Service and compares the marked up cost to the proposed rates.⁷

Val-Pak's on-brief analysis is an excellent example of the reason for the "on the record" evidentiary requirement. The data that Val-Pak manipulates all comes from witness Daniel's testimony and library reference LR-I-92. Val-Pak's analysis *should* have been presented in Haldi's direct testimony, in which case the flaws described below would have been exposed on the record.

In any event, Val-Pak's new analysis is flawed in concept and execution, and is directly contrary to its own witness's testimony. Its use of Daniel's *original aggregated* data for its on-brief comparisons is curious. Haldi in his testimony repeatedly

⁷ As discussed below, Val-Pak's application of a full percentage cost coverage to weight-related costs is contrary to Haldi's testimony that all rate cells within ECR should have an equal *unit* contribution.

emphasized the importance of analyzing the effect of weight separately by presort category, to avoid distortions due to differences in presort mix by weight cell and to isolate the effect of weight from presort effects. Tr. 32/15884, 15917-18, 15923-24. Daniel's discovery responses provided the kind of data by presort category that Haldi said is necessary. Yet on brief, Val-Pak ignores these data in favor of an analysis of the aggregated data that Haldi eschewed.

When Val-Pak's on-brief methodology is applied to Daniel's disaggregated costs by presort level, the resulting regression-derived costs for a 16-ounce piece (even after a full markup) are lower than the rates proposed by the Postal Service:⁸

	Val-Pak Methodology Applied To ECR Presort Categories		
	All Hi-Density/ Saturation Flats	Pound-Rated Hi-Density/ Saturation Flats	All Basic Flats
<u>Regression Results</u>			
Intercept Value (cost/piece)	0.0219	0.0168	0.0576
Slope (cost/ounce)	0.0093	0.0098	0.0137
Slope x 16 ounces	0.1488	0.1568	0.2192
Cost of 16-ounce piece (¢)	<u>17.07¢</u>	<u>17.36¢</u>	<u>27.68¢</u>
Cost Coverage	208.8%	208.8%	208.8%
<u>Fully Marked Up Cost</u>	<u>35.6¢</u>	<u>36.2¢</u>	<u>57.8¢</u>
<u>Proposed Rates - 16-oz.</u>			
No Destination Entry	61.8¢	61.8¢	63.9¢
DDU Entry	48.4¢	48.4¢	56.2¢ ⁹

⁸ The regression values shown above are from Daniel's response to ADVO/USPS-T28-13: Tr. 1358 (all High-Density/Saturation flats); Tr. 1359 (pound-rated High-Density/Saturation flats); and Tr. 1356 (all Basic flats).

⁹ These marked-up costs and proposed rates are not precisely comparable, because the costs are an average for *all* levels of drop shipment. For High-Density/Saturation flats, the average marked-up costs are substantially below even the lowest rate for DDU entry. For Basic flats, the average marked-up cost is slightly above the DDU entry rate but well below the "no destination entry" rate, indicating that the marked-up costs, when adjusted for drop ship level, would all be lower than the proposed rates.

Haldi's mark-up methodology also masks the separate effects of the pound-charge versus the piece-charge. For Pound-Rated Saturation Flats in the second column above, the marked-up pound rate (15.68¢ weight-related cost \times 208.8%) is only 32.7¢ , far below the proposed DDU pound rate of 45.0¢ ; whereas the marked-up piece charge (1.68¢ \times 208.8%) is 3.5¢ , higher than the proposed 2.8¢ piece charge. The same is true for Basic Flats in the last column. The marked-up average pound rate (21.92¢ \times 208.8%) is 45.8¢ reflecting an average of all drop ship levels, whereas the proposed pound rates range from 45.0¢ for DDU entry to 58.4¢ for non-destination mail. This again demonstrates that even the proposed rate structure over-recovers weight-related costs and under-recovers piece-related costs.

In light of these factors, perhaps it is not so curious why Val-Pak chose to look only at Daniel's aggregated data.

2. Val-Pak's On-Brief Testimony About The "Reasonableness" of Crowder's "Beyond Worst Case" Analysis Is Wrong.

As one of a number tests of the reasonableness of the proposed pound rate, Crowder made the extreme assumption that the costs of all flats were purely weight-related, with zero piece-related costs (which she termed Case 1). She then computed the "implicit" cost per pound, 25.9¢ for DDU Saturation flats.

Characteristically, Val-Pak tries to twist this on brief with the new testimony-like claim that Crowder's "beyond worst case" assumption of zero weight-related costs is "realistic." Val-Pak Brief at 30-31. It hypothesizes -- without citation to the record -- that the costs of saturation mail entered at a destination delivery unit are essentially purely weight related, claiming that "the first and only time such saturation ECR flats receive a piece handling is when they are placed in the recipient's mailbox." VP Brief at 30-31. It then applies a full 208.8% cost coverage to Crowder's extreme implied cost and claims that the marked-up costs are higher than the proposed pound rate. Val-Pak's hypothesis is demonstrably false.

All saturation flats, including those entered at a DDU, incur significant piece-related costs. Rural carrier costs and city delivery access costs are unquestionably piece-related, not weight-related. Tr. 44/19398 (Crowder). In addition, saturation flats incur piece-related carrier in-office costs for casing detached address labels or collating flats. Just these three piece-related cost components constitute 30% of witness Daniel's total attributable costs for saturation flats, producing a piece-related cost of at least 1.36¢ per piece.¹⁰ Moreover, Daniel's assumption (for purposes of conservatism) that elemental load costs are 100% weight-related is, as witnesses Bozzo and Kay demonstrate, an "upper bound" assumption. Tr. 44/19478, 39/17760. If elemental load costs were, for example, only 50% weight-related, the remaining 50% piece-related load cost would add at least another penny -- increasing the total piece-related cost of this mail to substantially more than 2¢ per piece.¹¹

Crowder's "beyond worst case" assumption is, indeed, just that.

3. Val-Pak Misconstrues Crowder's "Case 2" Analysis.

Crowder also presented a "Case 2" analysis which looked only at flats above the breakpoint, but with the same extreme assumption as in Case 1 that the entire costs of all such flats were purely weight-related. The implied cost per pound in this case, 19.9¢ per pound for DDU Saturation flats, was lower than in Case 1.

Here, Val-Pak does not go through the same exercise on brief to "mark-up" this pound cost and compare it to the proposed pound rate. The reason is because this

¹⁰ Tr. 1359. These three piece-related components constitute \$129,507(000) of the total \$433,820(000) cost of ECR saturation nonletters. Dividing this cost by ECR flat volumes (9.501 billion pieces) produces a unit piece-related cost of 1.36¢. *Id.*

¹¹ The average elemental load unit cost for High Density/Saturation flats is 1.70¢ per piece (Tr. 1359), which Daniel distributed to weight increments entirely on the basis of weight. If half of that cost is instead piece-related, the resulting piece-related unit elemental load cost would be 0.85¢. Since elemental is the dominant distribution key affecting distribution of carrier street support time, a 50/50 piece/weight assumption would push the piece-related portion of delivery costs to well over a penny.

extreme per-pound cost, even with a full mark-up, is below the proposed pound rate. Instead, Val-Pak asserts that Crowder's Case 2 should be "disregarded."

First, Val-Pak claims not to understand how Crowder's analysis was conducted and even claims that her workpapers "do not indicate how [the Case 2] results were obtained." It is entirely mistaken on that score.¹²

Second, not understanding Crowder's analysis (or not wanting to understand), Val-Pak claims that her Case 1 and Case 2 results are "counter-intuitive":

"Since the exercise in Case 2 is designed to isolate the cost of heavier-weight flats with (presumably) higher unit cost, one normally would expect the resulting unit cost to be higher than the average for all flats, discussed under 'Case1.' Nevertheless, she obtains just the opposite result. Her unit costs for flats above the breakpoint are 23 to 31 percent lower than the unit costs for all flats." Val-Pak Brief at 32.

Once again, it is Val-Pak that is confused. Specifically, it confuses the difference between a unit *per piece* cost and a unit *per pound* cost. The average unit *per piece* cost of 1-ounce pieces (included in Case 1) is, in fact, lower than the average unit *per piece* cost of 6-ounce pieces (included in both Cases 1 and 2). However, on a *per pound* basis, which is what Crowder's analysis calculates, the average unit *per pound* cost of 1-ounce pieces is *higher* than the average unit *per pound* cost of 6-ounce pieces.¹³

¹² Contrary to its assertions, all of Crowder's estimates are fully explained and supported by her workpapers. Her workpapers are clearly documented and contain Excel spreadsheets with all data and calculations used to develop the estimates. A text accompanies the spreadsheets and identifies the spreadsheet used for each set of figures used in Crowder's testimony. As noted in that text, the files for Section III.A.1 (the flat costs and cost curves) are contained in Unit Costs 1.xls. Within that spreadsheet, the Case 2 per pound estimates are included in the Tab called "Per Pound Costs." Within that Tab, those estimates may be found in Cells J50, J53, and J56 (each of which is surrounded by borders for easy identification). Since all algorithms and data used to develop those estimates are included within that spreadsheet, anyone familiar with Excel may easily identify how those estimates were developed. If Val-Pak were truly confused, it had the opportunity to seek clarification from Crowder in cross-examination. Its cross-examination, however, did not touch upon her Case 2 analysis.

¹³ This can be readily seen from Daniel's response to ADVO/USPS-T28-13, Tr. 1358-59. The unit per piece cost of saturation flats in the 0.5-1.0 increment is 3.2¢, lower than the 7.4¢ per piece cost of flats in the 6-7 ounce increment. However, when these costs are divided by the average piece weights to derive

(footnote continued on next page)

Far from being “counter-intuitive,” the lower *per pound* unit cost of heavier pieces is the expected result, because (1) there *are* economies of scale in bulk handling operations, contrary to Haldi’s testimony; and (2) the piece-related handling costs that *all* ECR mail incurs, when converted to a per pound basis, is spread over a larger weight and produces a lower cost per pound. than for light-weight pieces. As Crowder thoroughly explained, additional weight does not increase per piece cost on a one-for-one basis. As additional weight is added to a piece, the increase in cost is relatively small proportionately. ADVO-RT-1 at 3, Tr. 19368.

This also explains why Crowder’s Case 2 results, although themselves based on an extreme assumption, are more realistic than the Case 1 results. Because they are not biased by inclusion of light-weight mail (with the highest per pound costs), they more accurately reflect the weight-related costs of mail above the breakpoint, where the pound rate applies.

4. Val-Pak Does Not Challenge Crowder’s Regression Analyses.

As yet another demonstration of the low weight-related costs of ECR mail, Crowder presented improved regression analyses for Basic Flats and for High-Density/Saturation Flats. Tr. 19378. Val-Pak’s discussion of her analysis is most peculiar. It concedes that Crowder’s analyses, disaggregated by presort tier, show lower weight-related costs than Daniel’s aggregated analyses (an improvement over Daniel’s analysis both in method and result). Val-Pak Brief at 32-33. It even concedes that Crowder’s results, even after Val-Pak’s application of a full cost coverage, produce marked-up costs lower than the proposed rates. *Id.*

(footnote continued from prior page)
a unit cost *per pound*, the relationship reverses. The unit cost per pound for 0.5-1.0 ounce pieces is 67¢, compared to 18¢ for the 6-7 ounce increment.

Val-Pak's only "criticisms" are the preposterous and meaningless statements that her results (1) "broaden the varied smorgasbord of regression results," (2) "add to the confusion accompanying the interpretation and application of such data," and (3) "widen the range of uncertainty surrounding witness Daniel's results"! *Id.* Val-Pak does not bother to explain how Crowder's analyses "add to confusion." And far from "widening" any alleged uncertainty about Daniel's results, Crowder's various analyses accomplish just the opposite: they serve to *eliminate any uncertainty* about the conclusion from Daniel's analyses that the pound rate is too high in relation to weight-related costs.

5. **Val-Pak And NAA's Attempts To Use Anomalous Weight-Cost Results For Very Small-Volume Nonprofit And Parcels Categories Are Specious.**

Noticeably, neither Val-Pak nor NAA argue that any of Daniel's results for ECR flats (the predominant type of mail to which the pound rate applies) are "counter-intuitive" or "anomalous." Instead, reaching for any straw they can find, they focus on Daniel's unit costs and regression results for extremely small-volume categories within Standard A mail, claiming that "anomalous" results in these tiny categories invalidate her entire analysis.

Val-Pak focuses on Daniel's regression results for the small Standard A Regular *Parcels* and *Nonprofit* ECR flats categories, which have only *one-twentieth* the volume of commercial ECR flats. It claims that Daniel's regressions for these small categories produce counter-intuitive results -- a regression line for *Parcels* that declines with increasing weight, and a regression line for *Nonprofit* ECR that is steeper than that for commercial ECR. VP Brief at 43. On that score, we can agree: her regression results for these two categories are indeed counter-intuitive and should be given no weight. What Val-Pak carefully does not mention is that these weird regressions are the result of just a few wildly anomalous unit costs in the extreme weight increments (0-0.5 ounces for *Nonprofit*, and 13-16 ounces for *Parcels*) that have almost no volume.

The following table, from Daniel's LR-I-92, compares the volumes of these small Nonprofit and Parcel categories by weight increment with the volumes of ECR flats:

**Comparison of ECR Flats Volumes With
Nonprofit ECR Flats and Regular Parcel Volumes. ¹⁴**

Ounce Increment	Commercial ECR Flats (000)	Nonprofit ECR Flats (000)	Std. A Regular Parcels (000)	% of ECR Flats Volume	
				NP ECR Flats	Regular Parcels
0 to .5	564,955	33,189	1,591	5.9%	0.3%
.5 to 1.0	1,538,150	214,920	6,916	14.0%	0.4%
1.0 to 1.5	1,579,231	177,570	16,631	11.2%	1.1%
1.5 to 2	2,251,236	115,867	19,979	5.1%	0.9%
2 to 2.5	2,953,270	82,280	26,592	2.8%	0.9%
2.5 to 3	2,515,987	73,782	17,782	2.9%	0.7%
3 to 3.5	1,711,263	68,938	26,413	4.0%	1.5%
3.5 to 4	1,503,269	53,771	18,307	3.6%	1.2%
4 to 5	2,959,193	59,829	46,402	2.0%	1.6%
5 to 6	1,337,073	24,019	55,542	1.8%	4.2%
6 to 7	696,823	12,428	77,437	1.8%	11.1%
7 to 8	370,601	10,750	88,588	2.9%	23.9%
8 to 9	200,729	2,784	53,254	1.4%	26.5%
9 to 10	78,154	804	77,559	1.0%	99.2%
10 to 11	74,152	290	108,768	0.4%	146.7%
11 to 12	33,649	117	98,542	0.3%	292.9%
12 to 13	31,987	175	128,399	0.5%	401.4%
13 to 14	25,238	105	83,077	0.4%	329.2%
14 to 15	17,122	175	23,691	1.0%	138.4%
15 to 16+	12,998	57	14,157	0.4%	108.9%
Total	20,455,078	931,849	989,626	4.6%	4.8%

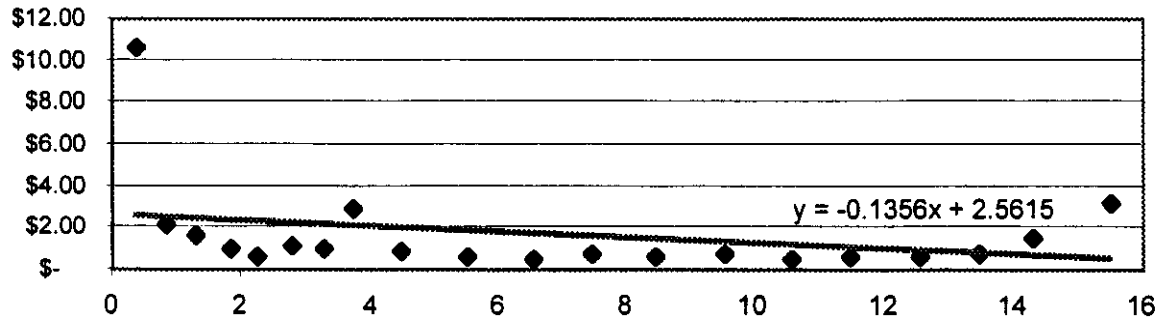
What is immediately obvious is that the total volumes of both Nonprofit ECR and Regular Parcels are quite small, less than one-twentieth the volume of ECR flats. Moreover, their distributions of volumes by ounce increment are markedly different from ECR flats. For Nonprofit ECR flats, there is almost no volume above 10 ounces. For Regular Parcels, there is very little volume under 4 ounces, particularly in the tiny 0-0.5

¹⁴ These volumes come from Daniel's electronic version of LR-I-92. ECR flats volumes are from LR92bECR.xls, Worksheet "ECR Flats (detailed)"; ECR Nonprofit flats volumes are from LR92dNPE.xls, Worksheet "NECR Flats (detailed)"; Regular Parcel volumes are from LR92aREG.xls, Worksheet "3CREG Parcels (detailed)."

ounce increment. As shown below, these tiny fringe-volume increments are precisely where the “anomalous” unit costs appear.

Standard A Regular Parcels. The following chart reproduces Daniel’s unit costs and unweighted regression line for Parcels which Val-Pak characterizes as counter-intuitive.¹⁵

Standard A Parcels -- Unit Cost by Ounce Increment



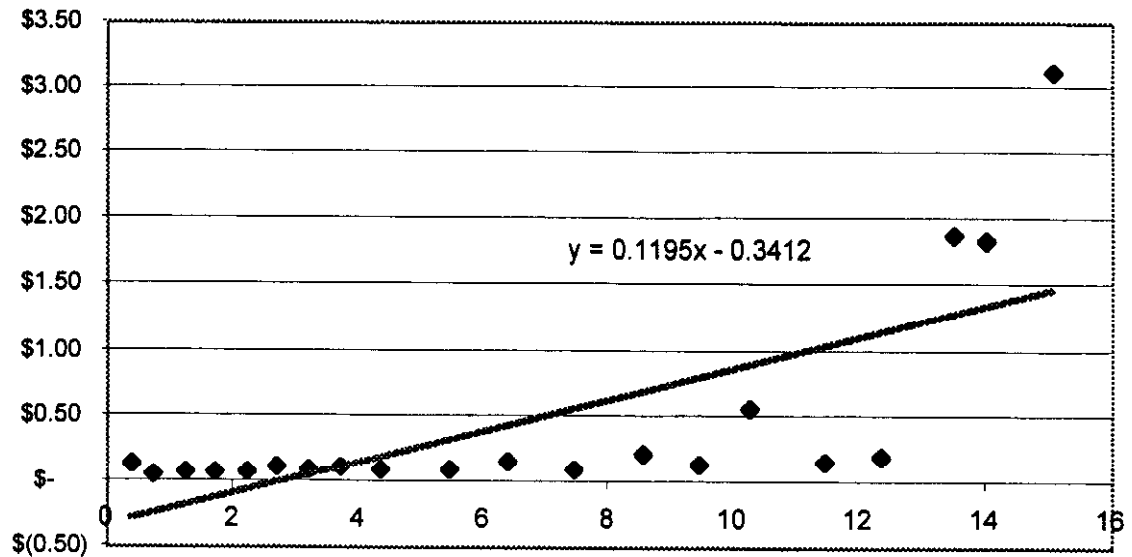
The “negative slope” in Daniel’s unweighted regression line is obviously heavily influenced by the extraordinarily high unit cost in the first 0-0.5 ounce increment (has anyone ever seen a half-ounce parcel?). As shown above, the total volume in this weight increment is only 1.6 million pieces -- less than 0.2% of total Standard A Regular Parcel volumes and less than 0.004% (4 one-hundred-thousandths) of total Regular volumes.

Nonprofit ECR Flats. The following chart reproduces Daniel’s unit costs and unweighted regression line for Parcels which Val-Pak characterizes as counter-intuitive because the slope of the regression line is steeper than for commercial ECR.¹⁶

¹⁵ This chart is resized and copied directly from Daniel’s LR-I-92 spreadsheet: LR92aREG.xls, Worksheet “3CREG Parcels (detailed).”

¹⁶ This chart is resized and copied directly from Daniel’s LR-I-92 spreadsheet: LR92dNPE.xls, Worksheet “NECR Flats (detailed).”

Nonprofit ECR Flats -- Unit Cost by Ounce Increment



What Val-Pak doesn't mention is that, because of the anomalously high unit cost in the last three (13-16) ounce increments, the unweighted regression that it cites produces a steep slope with a negative intercept, implying that pieces under 2 ounces cost less than *zero* to handle. The problem is obviously with the costs in 13-16 ounce range, due to the incredibly small volume in those cells. The total volume in these three increments is just 337,000 pieces -- less than 0.04% of total Nonprofit ECR flats. For commercial ECR flats, by contrast, the volume in just the last 15-16 ounce increment is 13 million pieces, 40 times greater than the combined Nonprofit volume over the last three ounces, and 250 times greater than the Nonprofit volume in the same 15-16 ounce increment.¹⁷ Moreover, contrary to Val-Pak's claim that the unweighted regression line is steeper for Nonprofit than for commercial ECR, the Nonprofit *unit*

¹⁷ Had Val-Pak raised the issue of the pound rate markup in its direct case, all parties would have had an opportunity to explore on the record how cost contribution within a subclass should be handled, and to address the market and demand conditions that would affect the allocation of that contribution among various rate elements -- as Haldi acknowledged is an important factor in deciding whether to depart from his preferred equal unit markup. Haldi has consistently, over the years, supported an equal unit contribution for all subclass pieces. Val-Pak is now apparently rejecting its own witness's statements and beliefs.

costs for increments below 10 ounces (which constitute 99.96% of Nonprofit volume) closely track the unit costs for commercial ECR flats.

NAA takes these comparisons of cost differences between extremely small-volume categories to an even more absurd level than Val-Pak. For example, it compares Daniel's unit costs for Standard A Regular Parcels (which as discussed above is itself a small category) with the costs for *Nonprofit* Parcels. NAA Brief at 16. The *total* volume of Nonprofit Parcels is only 46 million pieces -- less than one-twentieth the volume of Regular Parcels, and less than one-four-hundredth the volume of ECR Flats. Indeed, the volume in the *largest* weight cell of Nonprofit Parcels is far smaller than the volume in the *smallest* weight cell (15-16 ounce) of ECR Flats.

Val-Pak concludes from its discussion of these tiny subcategories of Standard A mail that:

"Good studies do not produce irrational results, and studies which produce or support irrational results are not good studies, even if they can be used to support desired results." Val-Pak Brief at 43.

In truth, Daniel's analyses as supported by the further analyses of Crowder and Prescott are, indeed, "good studies" that produce highly rational, sound, and intuitively expected results. The problem is not with *their* analyses, but with the strained attempts by Val-Pak and NAA to go to the furthest extremes to manufacture "irrational results" out of the thinnest threads. To paraphrase Val-Pak,

Even the best study can be subjected to irrational analyses that look for anomalies at the most minute volumetric levels, but that does not undermine its validity as support for a desired result.

Rather than an indictment of the reliability of Daniel's analysis, Val-Pak and NAA's nit-picks actually illustrate a number of points that reinforce the validity of her analysis for ECR Flats:

- First, for the extremely small-volume categories of Standard A cited by Val-Pak and NAA, the tiny volumes in fringe weight cells *do* produce wild swings in unit costs -- a clear indication that, for these very small categories, "thinness" of IOCS tallies is, indeed, a problem.

- Second, where “thinness” is a problem, it manifests itself in the form of anomalous gyrations in unit costs.
- Third, unlike the wild gyrations of some unit costs in the fringe cells of the small-volume categories cited by Val Pak and NAA, the unit costs for ECR flats show a clear and consistent cost trend, with no apparent unit cost anomalies (except perhaps in the last ounce increment);
- Fourth, the absence of wild, anomalous gyrations in unit costs for ECR Flats clearly indicates that IOCS tally “thinness” is not a problem for this large category of mail.

6. Val-Pak's On-Brief Percentage Markup Approach For Weight Related Costs Is Directly Contrary To Haldi's Testimony.

On brief, Val-Pak for the first time advocates (without explanation) that the pound rate should be analyzed by applying a subclass-average 208% cost coverage markup on weight-related costs. Val-Pak Brief at 25. This argument is directly contrary to the testimony of Val-Pak witness Haldi, both in this case and in Dockets R97-1 and MC95-1. Haldi has consistently supported an equal *unit* contribution for all rate cells within the ECR subclass, in order to “put[] all mailers within a subclass on equal footing as regards unit contribution.” Tr. 15936.¹⁸

Haldi's only exception to his equal unit contribution principle further undercuts Val-Pak's arguments on brief:

“Let me hasten to add the following qualification. Unless and until the Postal Service faces more competition for delivery, I see no good reason for departing from an equal unit contribution within a subclass. Assuming active competition, however, *I could readily imagine circumstances where an equal unit contribution would no longer be appropriate; i.e., the Postal Service would need to adjust rates to protect and preserve the volumes that are most contested.*” Tr. 15936 (emphasis added).

¹⁸ His “bottom-up” ECR rate proposal in R97-1 was based on this principle. See SMC Initial Brief at 18-19 and the cites therein.

In cross-examination, Haldi conceded that the segment of ECR mail that is "most susceptible to competition" is *heavier-weight saturation flats* that pay the pound rate. Tr. 15984. Even in Docket R97-1, where the Postal Service's proposed pound rate was much *lower* than proposed here, Haldi concluded:

"[U]nder the Postal Service's proposal, an unduly high share of the already excessive coverage is being pushed onto saturation mail, the rate category most susceptible to diversion to alternate delivery." Tr. 15074, R97-1.

Like Haldi's turnabout from his testimony and analysis in Docket R97-1 demonstrating that the even lower then-proposed pound rate was "conservative," Val-Pak's position on issues shifts depending on whatever argument is most expedient.¹⁹

7. Val-Pak Misconstrues Crowder's Testimony On Weight-Related Scale Economies.

In his testimony, Haldi contended that the use of IOCS tallies was inappropriate for purposes of a weight cost analysis on the theory that the IOCS does not properly capture bulk handling costs, which he maintained were almost entirely weight related. In rebuttal, Crowder pointed out a number of reasons why Haldi's assumption that bulk handlings varied 100% with weight were incorrect and overstated the effect of weight.

On brief, Val-Pak attempts to mischaracterize Crowder's testimony, implying that Crowder was claiming bulk handling costs had no weight-related element. The point of Crowder's testimony, as she clearly stated, was that while bulk handlings are affected

¹⁹ Had Val-Pak presented this new position on the markup in its direct case instead of on brief -- with an explanation of the reasoning behind this sharp departure from Haldi's and Val-Pak's positions on the record in this and prior proceedings -- the parties would have had the opportunity to explore on the record the most appropriate approach to markups within ECR. The parties also would have had the opportunity to present their own rebuttal evidence on matters such as the implications of demand and competition on the markups, which Haldi acknowledged are important considerations. By changing its position, on brief and without explanation, Val-Pak has effectively precluded the development and litigation of this issue on the evidentiary record.

by weight (and are picked up in the IOCS), the relationship to weight is not one-to-one as Haldi claimed. Among Val-Pak's mischaracterizations on brief are the following:

- Crowder did not admit that mailers fill their trucks to capacity (or any of the other points on page 35 of Val-Pak's brief). She only agreed with a counsel-provided hypothetical that she pointed out was not realistic.
- Crowder never stated that there was zero weight variability (as implied by Val-Pak's discussion on page 35). Rather, she explained that the variability was substantially less than the 100% assumed by witness Haldi. Nor did she said that weight always fills excess capacity but never creates any, but simply that because of the existence of excess capacity, the addition of incremental weight does not always and inevitably cause additional bulk costs as Haldi incorrectly claimed.
- Val-Pak's on-brief testimony regarding truck capacity and FSM tub capacities is disingenuous. Clearly, such capacities are affected by factors other than weight in at least two ways, operationally: (1) dispatch and service requirements and (2) the ability to match (truck and container) capacities to volume requirements. Both factors cause scale economies.


Val-Pak's claim that there is no evidence regarding scale economies is also incorrect and demonstrates its lack of understanding of the data it attempts to criticize. With the data already available, scale economies are clearly evident:

- The U-shape to the flats weight-cost curve is due not only to the "flimsy flats" phenomenon, but also to the fact that light-weight flats are entered in less efficient containers (R97-1, ADVO-RT-1 at 8-9, Tr. 34/18311-12).
- Much of the cost difference between basic-rate and saturation flats is due the fact that there are more pieces/weight in containers holding saturation flats.
- The lower weight-related cost estimated by Crowder in Case 2 (all costs for flats above the breakpoint, on a per pound basis) as opposed to Case 1 (all costs for flats, on a per pound basis) is also the result of more efficient containerization and handling of heavier weight pieces.

In sum, contrary to Haldi's claim and the criticisms and new testimony presented in Val-Pak's brief, there are, in fact, economies of scale in bulk handling operations due to excess capacity that result in a less than one-to-one increase in costs when incremental weight is added.

CERTIFICATE OF SERVICE

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


Thomas W. McLaughlin

September 22, 2000