

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)
) Docket No. R-2001-1
POSTAL RATE AND FEE CHANGES)

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VOLUME #12

Date: February 14, 2002
Place: Washington, D.C.
Pages: 4834 through 4949

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POSTAL RATE COMMISSION

In the Matter of:)
) Docket No. R-2001-1
 POSTAL RATE AND FEE CHANGES)

Room 300
 Postal Rate Commission
 1333 H Street, N.W.
 Washington, D.C.

Volume 12
 Thursday, February 14, 2002

The above-entitled matter came on for hearing,
 pursuant to notice, at 1:03 p.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
 HON. RUTH Y. GOLDWAY, VICE-CHAIRMAN
 HON. DANA B. "DANNY" COVINGTON, COMMISSIONER

APPEARANCES:

On behalf of the United Parcel Service:

LAURA A. BIANCKE, Esquire
 Piper, Marbury, Rudnick & Wolfe, L.L.P.
 3400 Two Logan Square
 18th & Arch Streets
 Philadelphia, Pennsylvania 19103
 (205) 656-3300

Heritage Reporting Corporation
 (202) 628-4888

APPEARANCES: (cont'd.)

On behalf of the United States Postal Service:

MICHAEL T. TIDWELL, Esquire
United States Postal Service
475 L'Enfant Plaza, S.W.
Washington, D.C. 20260-1137
(202) 268-2998

On behalf of KeySpan Energy and Major Mailers Association:

MICHAEL HALL, Esquire
34693 Bloomfield Road
Roundhill, Virginia 20141
(540) 554-8880

On behalf of American Postal Workers Union AFL-CIO:

SUSAN L. CATLER, Esquire
O'Donnell, Schwartz & Anderson, P.C.
1300 L Street, N.W., Suite 1200
Washington, D.C. 20005

On behalf of the National Association of Pre-Sort Mailers:

HENRY HART, Esquire
Reed Smith
1301 K Street, N.W.
East Tower, Suite 1100
Washington, D.C. 20005
(202) 414-9225

C O N T E N T S

WITNESS APPEARING:
MICHAEL J. RILEY

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
Michael J. Riley					
by Ms. Carter	4838	--			
by Mr. Hart	--	4897			
by Mr. Hall	--	4919			
by Mr. Tidwell	--	4928			

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P R O C E E D I N G S

(1:03 p.m.)

CHAIRMAN OMAS: Just to make a brief announcement, we are trying a new mike with me today. I know my voice is overwhelming to you all, so we're going to try and see if this will make it a little bit better.

Good afternoon. Today's hearing has been scheduled to receive the testimony of the American Postal Workers Union Witness Riley in opposition to the stipulation and agreement of Docket R-2001-1, Request for Rate and Fee Changes. If necessary, the hearing can continue tomorrow, but with any luck we hope to complete his testimony today. We will certainly try.

I want to remind parties that they must file notice of any intention to file surrebuttal testimony by the close of business tomorrow. Also, transcript corrections for today's hearing and any corrections related to the hearings to refute the Postal Service's direct case must be filed by February 21.

Does anyone have any procedural matters to raise at this point?

(No response.)

CHAIRMAN OMAS: Ms. Catler, will you please introduce your witness?

MS. CATLER: I would be glad to introduce my

1 witness.

2 CHAIRMAN OMAS: Turn your mike on.

3 MS. CATLER: That would be helpful.

4 CHAIRMAN OMAS: We'll get it adjusted.

5 MS. CATLER: The American Postal Workers Union

6 AFL-CIO calls Michael J. Riley as its witness.

7 CHAIRMAN OMAS: Mr. Riley, please remain standing.

8 Would you raise your right hand?

9 Whereupon,

10 MICHAEL J. RILEY

11 having been duly sworn, was called as a witness

12 and was examined and testified as follows:

13 CHAIRMAN OMAS: Please be seated.

14 THE WITNESS: Thank you.

15 (The document referred to was

16 marked for identification as

17 Exhibit No. APWU-T-1.)

18 DIRECT EXAMINATION

19 BY MS. CATLER:

20 Q Mr. Riley, have you reviewed two copies of a
21 document designated APWU-T-1 entitled Direct Testimony of
22 Michael J. Riley on behalf of the American Postal Workers
23 Union AFL-CIO?

24 A I have.

25 Q Was this testimony prepared by you or under your

1 supervision?

2 A Yes, it was.

3 Q If you were to testify orally here today, would
4 this be your testimony?

5 A It would be my testimony.

6 MS. CATLER: I am now providing two copies of the
7 direct testimony of Michael J. Riley on behalf of the
8 American Postal Workers Union AFL-CIO to the reporter, and I
9 ask that this testimony be entered into evidence in this
10 docket.

11 CHAIRMAN OMAS: Are there any objections?

12 (No response.)

13 CHAIRMAN OMAS: There being no objection, I will
14 direct counsel to provide the reporter with two copies --
15 this is not working very well today. Please bear with us.

16 I will direct counsel to provide the reporter with
17 two copies of the corrected direct testimony of Michael J.
18 Riley. That testimony is received into evidence and will be
19 transcribed into the record at this point.

20 (The document referred to,
21 previously identified as
22 Exhibit No. APWU-T-1, was
23 received in evidence.)

24 //

25 //

APWU-T-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

RECEIVED
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OFFICE OF THE
SECRETARY

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

DIRECT TESTIMONY
OF
MICHAEL J. RILEY
ON BEHALF OF
THE AMERICAN POSTAL WORKERS UNION, AFL-CIO
January 30, 2002

1

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- 22 should result in lower discounts.
- 23 6. Each piece of First-Class discounted mail
- 24 should contribute at least as much absolute
- 25

dollar contribution as each piece of comparable non-discounted mail.

7. By avoiding excessive discounts, a lower First-Class Stamp of 36 cents might be possible.

8. Prior to the establishment of discounts for First-Class mail, many large mailers voluntarily presorted mail.

9. Discounts should be set at 80 to 100 percent of cost avoided.

IV. POSTAL ARGUMENTS FOR DISCOUNTS GREATER THAN AVOIDED COSTS ARE MISTAKEN, UNSUPPORTED AND HAVE NO LOGICAL BASIS

1. In the past, the Postal Rate Commission has advocated discounts at 80 to 100 percent of estimated cost avoided.

2. The primary focus should be on the absolute contribution per piece, not the percentage markup.

3. The costs avoided by pre-barcoding and pre-sorting mail are declining over time; the Postal Service's automation is successful.

4. A large shift from discounted First-Class to single piece is unlikely.

- 1 5. The Postal Service should send correct price
- 2 signals to mailers by lowering discounts.
- 3 6. Any discount on the additional ounce rate is
- 4 unjustified.
- 5 7. The discount for QBRM should be cut
- 6 dramatically.

7

8 V. CONCLUSION

9 I recommend that discounts be set at 80 to 100

10 percent of avoided costs.

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I. AUTOBIOGRAPHICAL SKETCH

1. Work Experience:

My name is Michael J. Riley. I am President of Riley Associates LLC, a consulting firm that I started in 2001 to provide financial consulting services to business, government agencies and non-profits. Harold Orenstein and Richard Yessian are Principals of Riley Associates LLC and work with me on major assignments.

From August 1993 to July 1998, I held the position of Senior Vice President and Chief Financial Officer of the U. S. Postal Service. Prior to that time, I served as CFO of Lee Enterprises, a newspaper and television station company and United Airlines, a subsidiary of UAL, Inc. Previously, I served as Treasurer of Michigan Bell Telephone Company and Assistant Controller of Northeast Utilities. I began my business career as an accountant at Teradyne, Inc.

2. Education:

My educational background includes a Bachelor of Science degree from the U. S. Naval Academy in 1965, a Master of Business Administration degree from the University of Southern California in 1972, and a Doctor of Business Administration degree from Harvard University in 1977. My work at Harvard required successful completion of all of the required course work for a PHD In Economics. My "Special Field of Study" was

1 Financial Institutions and Markets and my sub-field was
2 Corporate Finance.

3

4 **3. University Affiliations:**

5 I currently hold the position of Adjunct Professor at
6 George Mason University where I teach MBAs and Undergraduates
7 courses in Finance. Previously, I held positions on the faculty
8 of Harvard Business School, Boston University, University of
9 Connecticut, and University of Michigan.

10

11 **4. Prior Testimony:**

12 I have testified before Committees of the U. S. Congress
13 and in labor arbitration while at the Postal Service.

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II. PURPOSE OF MY TESTIMONY:

The purpose of my testimony is to propose that the Postal Rate Commission adopt discounts for First-Class automated and presort mail of 80 percent to 100 percent of the estimated costs avoided by the U. S. Postal Service. I also refute the Postal Service's proposal to offer discounts for pre-barcoded and pre-sort mail in excess of the avoided costs. The Postal Service is in financial jeopardy and cannot afford to price this mail incorrectly. It is my opinion that such discounts violate good management practice and are disruptive to the long-term financial interests of the Postal Service.

The level of discounts in the proposed settlement is even higher than that proposed by the Postal Service in its original request. This makes the problem worse. The Postal Service cannot afford to give away this revenue.

I propose alternative rate schedules, Table I and Table II. Table I shows discounts based on 80 and Table II is based on 100 percent of avoided cost. Table III shows both sets of rates. I suggest that the Postal Rate Commission set rates closer to those in Table I. I used the estimated avoided costs sponsored by USPS Witness Miller. Adopting rates within the range that I recommend is in the public interest and is in accordance with the policies of the Postal Reorganization Act as amended. This is in the long-term best interest of the Postal Service, its employees and the American public.

III. GENERAL POLICY OBSERVATIONS

1. Good business management requires discounts be less than avoided costs:

As a practical matter the U. S. Postal Service operates a huge business as an independent agency of the U. S. Government. As such, I would be concerned when any business proposes to offer price discounts to its customers for work-sharing activities that are equal to the costs avoided by those activities. In a typical for-profit organization, I would expect there to be a monetary incentive to those customers who are capable of saving costs for the organization. The organization, however, would offer a price concession somewhat smaller than the costs that would be avoided by the efforts of its customers.

2. The Postal Service is in dire financial straits.

In the case of the Postal Service, rates must be set to cover all costs, including amortization of debt and a reasonable contingency. Most people interpret this to mean "break-even" over time. In fact the Postal Service has failed to meet this standard during most of the years of its existence. Since its inception, the Postal Service has never achieved a cumulative breakeven. The rate making process has consistently resulted in

1 worse financial results than what I believe that the law and
2 good management require.

3 While the Postal Reorganization Act does not allow for
4 profit maximizing behavior typical for a business, the Postal
5 Service needs to have more profits to ensure its viability. In
6 the past, net income resulting from rate cases and other effects
7 showed a shortfall once the new rates were implemented. The
8 Postal Service can no longer afford such a shortfall. In light
9 of the current circumstances, I would consider a pass through of
10 80 percent to 100 percent of costs avoided to be appropriate
11 pricing policy.

12 Looking at the Postal Service from a policy viewpoint, the
13 Postal Service cannot afford to err on the side of giving away
14 too much in discounts. The Postal Service is in dire financial
15 straits and it needs to follow sound financial policies to
16 remain a viable enterprise. Therefore, the Postal Rate
17 Commission should reduce the discounts to a number ranging from
18 80 percent to 100 percent of avoided costs. The only change I
19 recommend to the proposed settlement is to reduce the discounts
20 for First-Class mail. This should help the Postal Service
21 recover from its current predicament.

22 Updated financial information has not been added to the
23 record in this case because of the proposed settlement.
24 However, no reasonable person can ignore the effects on the
25 Postal Service of the terrorist attacks on September 11, 2001

1 and the anthrax attack that followed. The practical results of
2 these events will be revenues for the Postal Service below those
3 that it requested. I urge the Rate Commission, whenever it has
4 a range of choices, to pick the one that will generate the most
5 revenue for the Postal Service.

6

7 **3. Revenue assurance shows that actual cost avoided is**
8 **less than estimated cost avoided.**

9 During my time as CFO of the USPS, I instituted a revenue
10 assurance unit to focus on mailers who received unearned
11 discounts or otherwise failed to pay all the postage that was
12 due. To address part of this problem, the Postal Service has
13 purchased machines and software to check on the readability of
14 bar codes. This oft delayed project is named Merlin and it has
15 consistently shown that the quality and accuracy of some mailer
16 applied barcodes is less than that required by the USPS.

17 The Postal Service has disclosed information at the August
18 2, 2001 Mailers' Technical Advisory Committee meeting that shows
19 a significant percentage of mailings with less than 90 percent
20 barcode readability. There has been continuing controversy
21 about how large a portion of the mail qualifies for discounts.
22 Based on my general knowledge of the Postal Service and my
23 overall direction of the group that performed cost studies, I
24 believe that if the Postal Service were able to measure the
25 "actual" cost avoided, it would find that the "actual" cost

1 avoided by work-share are less than its "should cost" estimates
2 which are provided to the Postal Rate Commission in rate cases.

3 Since the Postal Service's proposed discounts are based
4 upon special studies which develop "should cost" estimates of
5 cost avoided by pre-barcoding and pre-sorting, in those cases
6 where the mail is not presented in the prescribed manner but is
7 granted the discount anyway, the result certainly will be the
8 Postal Service experiencing higher costs than had been
9 estimated. In this case, the CRA cost system will properly
10 register the "actual" costs of the mail with the resulting
11 contribution from such mail being less than had been
12 anticipated. This means that any error is likely to be against
13 the Postal Service. Therefore, discounts should be set at less
14 than estimated cost avoided.

15

16 **4. The Postal Service needs a return on its investment**
17 **in automation equipment.**

18 In the early years of its automation program, the Postal
19 Service needed more ZIP + 4 and later pre-barcoded mail to
20 improve its service and allow more efficient use of its
21 automation equipment. Today, that program is essentially
22 complete and it has received numerous upgrades. For example,
23 the ability of optical character reading technology to
24 accurately read handwritten addresses has improved dramatically
25 in the last few years. Thus, the Postal Service should be more

concerned with getting a continuing return on the billions of dollars it has spent on its automation equipment in contrast to granting excessive discounts to entice mailers to enter mail that could be processed by the Postal Service at lower cost.

If the Postal Service suffers a large decline in total volume, it becomes more important to maintain its expected return on its existing investment in automation equipment. This means that there is a reduction in the benefits to the Postal Service of mailer prepared automated mail. To be specific, if the larger discounts drive greater volume into pre-barcoded and pre-sorted mail, then the Postal Service will realize a smaller return on its investment in automation equipment. With an 80 to 100 percent pass through of estimated cost avoided, the Postal Service will have more mail to process and more revenue with which to do it.

5. The success of the Postal Service's automation lowers the cost avoided for presorted and barcoded mail and should result in lower discounts.

The Postal Service's automation is a success. It has lowered the Postal Service expenses for its own mail sorting activities. Therefore the savings to the Postal Service from mailer prepared, presorted and barcoded mail has declined and will continue to decline (USPS-T-22 rev. 11/29/01 pg.7).

1 6. Each piece of First-Class discounted mail should
2 contribute at least as much absolute dollar
3 contribution as each piece of comparable non-discounted
4 mail.

5 Each piece of First-Class discounted mail should contribute
6 at least as much absolute dollar contribution as each piece of
7 comparable non-discounted mail. This is especially true for
8 discounts offered within a subclass once the target coverage has
9 been established. Technically speaking, if the target coverage
10 implies a fixed contribution per piece for all pieces in the
11 subclass, then the discount must equal the "actual" avoided cost
12 realized by the Postal Service, so that the contribution of any
13 piece will be the same regardless of in which rate category in
14 the subclass that piece enters the mail stream. Said
15 differently, in the worst case the Postal Service should have
16 the exact same absolute contribution from the mailing of one
17 First-Class letter, regardless of how it is presented. If the
18 price reduction exceeds the cost avoided, then the remainder of
19 the category is required to pay a price higher than the price
20 that would otherwise have had to be paid. I believe that a
21 price reduction higher than cost avoided is inherently unfair.

22 To be conservative and thus reflect the current possibility
23 that some mail is entering the mail-stream at discounts for
24 which it does not properly qualify, the Commission should not
25 allow for further increases in discounts. Instead, the Rate

Commission should set discounts for these rates between 80 percent and 100 percent of avoided costs.

7. By avoiding excessive discounts, a lower First-Class Stamp of 36 cents might be possible.

It is very important to realize that the effect of overly generous discounts can be significant to all First-Class mailers. Since the volume of single piece is roughly equal to that of discounted mail, an unjustifiably high discount could make the single piece rate higher than it would otherwise need to be. If this discount reaches two cents per piece above an appropriate level then the single piece rate possibly could be reduced for everyone by a full cent.

8. Prior to the establishment of discounts for First-Class mail, many large mailers voluntarily presorted mail.

Entering First-Class mail prepared in SCF and five digit ZIP codes was not uncommon prior to the institution of discounts. Without a rate incentive, prior to the establishment of discounts, many large mailers presorted mail for practical business reasons. In my experience at Northeast Utilities, Michigan Bell Telephone Company and United Airlines, the focus was on speeding cash flow, more certain dates of delivery for advertising inside the bill, and convenience in dealing with

Postal officials. The discounts were peripheral to our
analysis. As any good economist or marketing expert knows there
is far more to a decision than just the price. Economic
benefits were being achieved with little additional cost.

**9. Discounts should be set at 80 to 100 percent of
avoided cost.**

For the reasons detailed above, I conclude that the
discounts for First-Class mail should not exceed 100 percent of
estimated avoided cost. Typically, they should be set in the
range of 80 to 100 percent of estimated avoided cost.

The proposed settlement increases some discounts above the
levels that are in the original request of the Postal Service.
There is no justification offered for this additional discount
and this level of discount is even more detrimental to the
financial health of the Postal Service. It is a mistake in the
short run and makes the long run problem worse.

1 IV. POSTAL ARGUMENTS FOR DISCOUNTS GREATER THAN AVOIDED
2 COST ARE MISTAKEN, UNSUPPORTED, AND HAVE NO LOGICAL
3 BASIS

4 1. In the past, the Postal Rate Commission has
5 advocated discounts at 80 to 100 percent of estimated
6 cost avoided.

7 In MC95-1 the Postal Rate Commission held that discounts
8 should be based on the cost that the work-sharing activity
9 avoids. Ms. Robinson acknowledges this point (USPS-T-29 pp
10 9,10) in her testimony. Also, she acknowledges the Commission's
11 belief that setting discounts to compensate mailers only for the
12 cost avoided by the Postal Service provides mailers an incentive
13 to presort or apply a bar code only if they can do so at lower
14 cost than the Postal Service. Good economics and good public
15 policy require a limit of discounts to a maximum of cost
16 avoided. The Postal Rate Commission has said as much in its
17 past orders and this is correct.

18
19 2. The primary focus should be on the absolute
20 contribution per piece, not the percent markup.

21 Once attributable costs are covered, the only thing that
22 should matter to the Postal Service in its efforts to generate
23 revenues to cover all its costs plus contingency is the per
24 piece contribution to institutional costs. Ms. Robinson's
25 testimony mistakenly implies that failure to focus on implicit

1 markups resulting from discounted mail ignores the value of this
2 mail to the Postal Service. This illogical statement is a
3 classic mistake of businesses that get into financial trouble.
4 What matters is not the percentage markup; what matters is the
5 total contribution or operating profit.

6 If discounts are given equal to cost avoided then the
7 calculated markup will increase. Technically speaking, if any
8 subclass of mail has a markup greater than zero, the implicit
9 markup of a portion (e.g. rate category) of that mail -- which
10 has been granted a discount for its cost avoidance -- will be
11 higher than the subclass average and certainly higher than the
12 other pieces in that subclass with lower absolute pass throughs.
13 The portion with the higher implicit markup has that markup from
14 simple arithmetic and is no more valuable based upon that
15 calculation.

16 One might go so far as to suggest that when the pass
17 through is set at 100 percent, each group in the sub-class is of
18 equal value to the Postal Service. Each comparable piece in the
19 subclass contributes the same contribution per piece. Ms.
20 Robinson's testimony proposes a pass through of more than 100
21 percent; in this case, the discounted mail is less valuable than
22 comparable single piece mail. It is only when the pass through
23 is less than 100 percent that the discounted category becomes
24 more valuable to the Postal Service. In short, value is
25

1 determined by the amount, not the percentage, of the
2 contribution.

3 The Postal Rate Commission has consistently encouraged
4 rates that pass through no more than the calculated savings
5 within a sub-class. It has correctly stated that this policy
6 allows mailers to make sound choices as to whether they could
7 save more by presorting or using a non-presort rate. This
8 choice leads to the lowest cost producer providing the service
9 (bar-coding, sorting etc), which, in turn, minimizes the cost of
10 the activity to society as a whole. [See MC95-1 §3074] Thus,
11 the opposite of what Ms. Robinson believes is true. When
12 discounts are set greater than cost avoided, the absolute value
13 to the Postal Service of those discounted letters is less than
14 the single piece letters in the subclass. The single piece
15 mailers are required to contribute above and beyond their fair
16 share to the resulting shortfall.

17 This is unfair. The focus of a successful enterprise needs
18 to be on the amount of contribution, not the percentage markup.

19
20 **3. The cost avoided by discounted mail is declining**
21 **over time because the Postal Service's automation is**
22 **successful.**

23 Ms. Robinson's statements express concern about the
24 apparent trend over time of declining cost avoidance amounts and
25 the impact such decreasing savings will have on the automation

program. This concern is misplaced. This is the planned result
2 from the long-term strategic plan of the Postal Service.

3 The declining cost avoided is to be expected and is a
4 result of the continuing investment made by the Postal Service
5 in improving its automation (USPS-T-22 rev. 11/16/01 pg27). The
6 continuing investment in automation equipment and upgraded
7 software by the Postal Service has achieved its goal of reducing
8 the cost of sorting the mail. USPS Witness Miller confirms the
9 decline in the cost avoided by the Postal Service (USPS-T-22
10 rev. 11/29/01 pg.5).

11 USPS Witness Tolley observes the same thing for the cost of
12 the mailers. He testifies that the cost of presorting and
13 barcoding to the mailer is declining and is the result of
14 "improvements in automation equipment and software, which serve
15 to lower automation costs per piece" (USPS-T-7 pp 41-42).

16 I conclude that the mailers and the Postal Service are both
17 experiencing a decline in the cost of the sorting and barcoding.
18 This means that the discounts should be declining.
19

20 **4. A large shift from discounted First-Class to single**
21 **piece is unlikely.**

22 USPS Witness Robinson's testimony expresses the concern
23 that "...the Postal Service could experience operational
24 difficulties if a large portion of the workshared First-Class
25

Mail pieces reverted to the Postal Service for sorting and bar-coding". (USPS-T-29 pg.21)

While there could be a cause for concern if lowered discounts were to cause a dramatic switch from discounted to single piece letters that would depend on whether the Postal Service could handle the volume efficiently. The added single piece volume from any decrease in discounts is likely to be extremely small. USPS Witnesses Thress states that "In the aggregate, workshared First-Class letters volume is virtually unaffected by Postal rates, ...". (USPS-T-8 pg. 22) He states that the elasticity of work-share mail is very low. This is economist language that means the Witness Robinson's fears are baseless.

Any reversal is highly unlikely and Ms. Robinson has not demonstrated that the mailers would benefit by switching to single piece even with dramatically lower discounts offered by the Postal Service. Further, Ms. Robinson acknowledged, upon cross examination, that mailers are slow to adjust to price change signals and suggests that it could take many quarters for the increase in volume to occur. (Tr.Vol.7 pg.1602) She has certainly not established that the cost of qualifying for the discounts has remained the same or increased. To the contrary, USPS Witness Tolley describes declining user costs. (USPS-T-7 pg. 41) Finally, since the cost that the Postal Service is avoiding by not having to sort the mail is declining, the higher

cost to handle this new non-presorted or non-barcoded mail will
be covered by the appropriate rate.

**5. The Postal Service should send correct price signals
to the mailers by lowering discounts.**

Ms. Robinson expresses a concern, at page 21 of her
testimony, that a change in direction of discounts would be
unfair to the mailers who have invested significantly and
changed their way of generating or processing mail in response
to the past expansion in these incentives. (USPS-T-29 pg 21)

One feature of capital investment in high tech equipment is
that these machines are expected to recover their costs in the
first year or two. Wise investors accept that rapidly evolving
technology can make this equipment outdated quickly. Therefore
the speed of recovery of costs becomes more important than the
percentage return on investment.

Further, she does not address the issue of fairness to the
Postal Service and particularly to the other mailers in the
First-Class Letters and Sealed Parcels Subclass, since these
other mailers are in fact going to pay higher rates to offset
the excessive discounts that she is proposing. The Postal
Service must focus its energy on improving the usefulness of its
capital to increase its chances of survival and recovery.

It is wrong to maintain erroneous cost avoidance signals
that overstate the true cost avoided. This works against

achieving economic efficiency for all portions of the subclass.
In fact economic efficiency is achieved by reducing discounts to levels at or below actual cost avoided. "Lowering the implicit cost coverage for the worksharing categories could result in discounts which exceed the cost avoided by the Postal Service... This results in productive inefficiencies. It sends signals to mailers to engage in inefficient worksharing activities." (PRC Decision MC-95-1 § 3075) This is especially true because I expect the Postal Service to continue to have declining cost avoided.

When mailers invest in computer programs and machines to take advantage of work-share discounts, this becomes a fixed cost that is irrelevant to any future decision to switch to single piece. The decision to begin to qualify for discounts is different from the decision to discontinue and switch back. Knowledgeable mailers are well aware of the Postal Service's investment in automation and the trend of cost avoided. They made the decision to incur the investment to qualify for discounts because their incremental cost is sufficiently less than the discounts or postage saved.

6. Any discount on the additional ounce rate is unjustified.

For the first time, Witness Robinson recommends a discount on the additional ounce rate for automation mail. Ms. Robinson

cites an additional ounce cost study to support her

2 recommendation. (USPS-T-29 pg 25) She cites a difference of
3 only 0.15 cents for the average piece. I would suspect that the
4 proportion of extra ounces in the heavier weight categories of
5 single piece as compared to presorted letters might well explain
6 this minor difference. I should note that this estimate has
7 changed twice in the errata to the library reference indicating
8 some uncertainty about the estimate. (USPS LRJ-58) Even if
9 this difference of 0.15 cents were correct, it does not justify
10 the extra 0.50 cent discount proposed. Good economic policy
11 requires that the second ounce rate be the same for work-share
12 and single piece mail absent any meaningful showing of a true
3 cost difference. The difference of 0.15 cents is not
14 meaningful. This is not the time to add a new discount.

15
16 **7. The discount for Qualified Business Reply Mail**
17 **(QBRM) should be cut dramatically.**

18 Ms. Robinson recommends a discount for Qualified Business
19 Reply Mail of 2.5 cents in her testimony. (USPS-T-29 pg 15)
20 She argues that in light of the current 3.0 cent discount a
21 further reduction below the 2.5 cents would be unwarranted. She
22 takes this position despite a cost avoidance of 0.846 cents. I
23 should note that the errata have shown at least two changes in
24 this estimate. The last number that I found was approximately
5 1.6 cents as opposed to 0.846. (USPS LRJ-60 rev. Nov. 15, 2001

QBRM Summary Table) The settlement further exacerbates this problem by keeping the QBRM discounts at 3.0 cents.

This excess pass through violates sound business practice regardless of which cost figure is correct. I recommend that the discount should be equal to or less than the initial estimate of cost avoided. This means a discount of 0.6 to 0.8 cents at her initial cited cost avoidance of 0.846 cents. When there is uncertainty, the choice should be the conservative or lower number.

2

3 VI. CONCLUSION:

4 I recommend that discounts be set at 80 to 100 percent
5 of avoided cost.

6 In summary, I recommend that the Postal Rate
7 Commission set discounts for First-Class mail at levels between
8 80 percent and 100 percent of the estimated cost avoided by the
9 Postal Service. These rates are shown in my Exhibits I, II and
10 III and assume that the cost avoided are as reported by witness
11 Miller in his testimony. I suggest that the Postal Rate
12 Commission set rates close to those on my Exhibit I, which
13 reflects an 80 percent pass through. Further, I suggest that
14 the best interests of the Postal Service and the nation are
15 served by higher total revenues that will mitigate the dire
16 financial straits of the Postal Service. Any added revenue
17 generated would serve to lower the risk of financial disaster to
18 the Postal Service while these rates are in effect. My
19 testimony shows that Postal Service arguments for discounts
20 greater than avoided costs are mistaken unsupported and have no
21 logical basis.

22

23

24

25

Table I: APWU Proposed First-Class Mail Rates Based On 80 Percent Pass Through of USPS-Calculated Avoided Costs, in Cents

	Current Rate (1)	USPS Proposed Rate in USPS-T-29 (2)	USPS Proposed Discount from Single Piece Rate (Calculated from T-29, Table I)	USPS Proposed Discount from Single Piece Rate, Settlement Agreement (3)	80 Percent of USPS Avoided Cost (4)	APWU Proposed Discounts (5)	APWU Proposed Rates
Letters and Sealed Parcels							
Regular							
Single-Piece First Ounce	34.0	37.0	0.0				37.0
QBRM	31.0	34.5	2.5	3.0	1.318	0.6	36.4
Nonautomation Presort	32.2	35.2	1.8		0.643	0.6	36.4
Additional Ounce							
Single Piece	23.0	23.0	0.0				23.0
Presort	23.0	22.5	0.5		0.112	0.0	23.0
Automation Presort							
Letters							
Mixed AADC Presort	28.0	30.9	6.1		4.073	4.0	33.0
AADC Presort	28.0	30.1	6.9		4.773	4.7	32.3
3-Digit Presort	26.9	29.4	7.6	7.8	5.026	5.0	32.0
5-Digit Presort	25.5	28.0	9.0	9.2	5.935	5.9	31.1
Carrier-Route Presort	24.5	27.5	9.5				31.1
Flats							
Mixed ADC Presort	31.2	34.1	2.9				37.0
ADC Presort	31.2	33.3	3.7				37.0
3-Digit Presort	29.7	32.2	4.8				37.0
5-Digit Presort	27.7	30.2	6.8				31.1
Additional Ounce	23.0	22.5	0.5		0.112	0.0	23.0
Cards							
Regular							
Single-Piece	21.0	23.0	0.0				23.0
Nonautomation Presort	19.0	21.2	1.8		0.643	0.6	22.4
QBRM	18.0	20.5	2.5	3.0	1.318	0.6	22.4
Automation-Presort							
Mixed AADC Presort	17.4	19.4	3.6		1.089	1.0	22.0
AADC Presort	17.4	18.7	4.3		1.453	1.4	21.6

Table I: APWU Proposed First-Class Mail Rates Based On 80 Percent Pass Through of USPS-Calculated Avoided Costs, in Cents							
	Current Rate (1)	USPS Proposed Rate in USPS-T-29 (2)	USPS Proposed Discount from Single Piece Rate (Calculated from T-29, Table I)	USPS Proposed Discount from Single Piece Rate, Settlement Agreement (3)	80 Percent of USPS Avoided Cost (4)	APWU Proposed Discounts (5)	APWU Proposed Rates
3-Digit Presort	16.8	18.3	4.7		1.582	1.5	21.5
5-Digit Presort	16.1	17.6	5.4		2.053	2.0	21.0
Carrier-Route Presort	15.0	17.0	6.0				21.0

(1) From Table 1, Testimony of Witness Robinson T-29

(2) From Table 1, Testimony of Witness Robinson T-29

(3) First-class mail Schedules 221 and 222, USPS Settlement Proposal (Revised 12/13/2001)

(4) Letter and card cost avoided numbers are from summary letter and card tables, Library Reference J-60 (Revised 11-15-2001), Witness Miller.

Witness Miller calculates the card cost avoided numbers using the nonautomated presort card as a benchmark. Consequently, his cost avoided numbers have been added to the estimate of cost avoided used for nonautomated presort cards to show an estimated cost avoided from the single-piece rate for cards.

QBRM cost avoided numbers are also from Library Reference J-60 (Revised 11/15/2001). The QBRM numbers have been changed twice since they were originally filed. The original number was 0.846 cents (submitted 9/24/01), the second number was 1.248 cents (submitted 11/5/2001) and the current number is 1.647 cents (submitted 11/15/2001).

Additional ounce cost differences are from Witness Schenk's Library Reference J-58. Those numbers have been revised three times. The original difference between first class single piece and first class presort was 13.90 cents - 13.75 cents or 0.15 cents (submitted 9/24/2001), a revised set of numbers showed a cost of 13.58 cents for single piece and 13.75 cents for presort (submitted 12/17/2001) and the final set of numbers, from which the cost number on the table is generated, show costs of 13.88 cents for single piece and 13.74 cents for presort (submitted 1/22/2002).

Witness Miller's Carrier Route Presort avoided costs for letters and cards are calculated from different benchmarks than the other avoided cost numbers and are not shown here. This proposal is for the Carrier Route Presort rates to equal the rate charged to 5-digit automated mail. Witness Miller does not provide a complete cost avoided analysis for flats, nor is cost avoided a part of the Postal Service's rate design for automated flat rates. Given the high cost of flats relative to the first-class single piece rate, this proposal is that the first ounce rate for automated flats should be the single-piece rate except for the 5-digit automated flats, which LR J-61 indicates provides some benefits to the Postal Service from mailer automation presort.

(5) Discounts are the avoided cost from the column to the left, truncated at the first decimal place except for the QBRM rate and the additional ounce rates. Those exceptions are explained in the text of APWU-T-1 at IV 6 and 7.

Table II: APWU Proposed First-Class Mail Rates Based On 100 Percent Pass Through of USPS-Calculated Avoided Costs, in Cents							
	Current Rate (1)	USPS Proposed Rate in USPS-T-29 (2)	USPS Proposed Discount from Single Piece Rate (Calculated from T-29, Table I)	USPS Proposed Discount from Single Piece Rate, Settlement Agreement (3)	USPS Avoided Cost (4)	APWU Proposed Discounts (5)	APWU Proposed Rates
Letters and Sealed Parcels							
Regular							37.0
Single-Piece First Ounce	34.0	37.0	0.0				36.2
QBRM	31.0	34.5	2.5	3.0	1.647	0.8	36.2
Nonautomation Presort	32.2	35.2	1.8		0.804	0.8	
Additional Ounce							23.0
Single Piece	23.0	23.0	0.0		0.14	0.0	23.0
Presort	23.0	22.5	0.5				
Automation Presort							
Letters					5.091	5.0	32.0
Mixed AADC Presort	28.0	30.9	6.1		5.966	5.9	31.1
AADC Presort	28.0	30.1	6.9		6.282	6.2	30.8
3-Digit Presort	26.9	29.4	7.6	7.8	7.419	7.4	29.6
5-Digit Presort	25.5	28.0	9.0	9.2			29.6
Carrier-Route Presort	24.5	27.5	9.5				
Flats							37.0
Mixed ADC Presort	31.2	34.1	2.9				37.0
ADC Presort	31.2	33.3	3.7				37.0
3-Digit Presort	29.7	32.2	4.8				30.2
5-Digit Presort	27.7	30.2	6.8				23.0
Additional Ounce	23.0	22.5	0.5		0.14	0.0	
Cards							
Regular							23.0
Single-Piece	21.0	23.0	0.0				22.2
Nonautomation Presort	19.0	21.2	1.8		0.804	0.8	22.2
QBRM	18.0	20.5	2.5	3.0	1.647	0.8	
Automation-Presort							21.7
Mixed AADC Presort	17.4	19.4	3.6		1.361	1.3	21.2
AADC Presort	17.4	18.7	4.3		1.816	1.8	21.1
3-Digit Presort	16.8	18.3	4.7		1.977	1.9	

Table II: APWU Proposed First-Class Mail Rates Based On 100 Percent Pass Through of USPS-Calculated Avoided Costs, in Cents							
	Current Rate (1)	USPS Proposed Rate in USPS-T-29 (2)	USPS Proposed Discount from Single Piece Rate (Calculated from T-29, Table I)	USPS Proposed Discount from Single Piece Rate, Settlement Agreement (3)	USPS Avoided Cost (4)	APWU Proposed Discounts (5)	APWU Proposed Rates
5-Digit Presort	16.1	17.6	5.4		2.566	2.5	20.5
Carrier-Route Presort	15.0	17.0	6.0				20.5

(1) From Table 1, Testimony of Witness Robinson T-29

(2) From Table 1, Testimony of Witness Robinson T-29

(3) First-class mail Schedules 221 and 222, USPS Settlement Proposal (Revised 12/13/2001)

(4) Letter and card cost avoided numbers are from summary letter and card tables, Library Reference J-60 (Revised 11-15-2001), Witness Miller.

Witness Miller calculates the card cost avoided numbers using the nonautomated presort card as a benchmark. Consequently, his cost avoided numbers have been added to the estimate of cost avoided used for nonautomated presort cards to show an estimated cost avoided from the single-piece rate for cards.

QBRM cost avoided numbers are also from Library Reference J-60 (Revised 11/15/2001). The QBRM numbers have been changed twice since they were originally filed. The original number was 0.846 cents (submitted 9/24/01), the second number was 1.248 cents (submitted 11/5/2001) and the current number is 1.647 cents (submitted 11/15/2001).

Additional ounce cost differences are from Witness Schenk's Library Reference J-58. Those numbers have been revised three times. The original difference between first class single piece and first class presort was 13.90 cents - 13.75 cents or 0.15 cents (submitted 9/24/2001), a revised set of numbers showed a cost of 13.58 cents for single piece and 13.75 cents for presort (submitted 12/17/2001) and the final set of numbers, from which the cost number on the table is generated, show costs of 13.88 cents for single piece and 13.74 cents for presort (submitted 1/22/2002).

Witness Miller's Carrier Route Presort avoided costs for letters and cards are calculated from different benchmarks than the other avoided cost numbers and are not shown here. This proposal is for the Carrier Route Presort rate to equal the rate charged to 5-digit automated mail. Witness Miller does not provide a complete cost avoided analysis for flats, nor is cost avoided a part of the Postal Service's rate design for automated flat rates. Given the high cost of flats relative to the first-class single piece rate, this proposal is that the first ounce rate for automated flats should be the single-piece rate except for the 5-digit automated flats, which LR J-61 indicates provides some benefits to the Postal Service from mailer automation presort.

(5) Discounts are the avoided cost from the column to the left, truncated at the first decimal place except for the QBRM rate and the additional ounce rates. Those exceptions are explained in the text of APWU-T-1 at IV 6 and 7.

Table III: Summary of Proposed APWU First-Class Mail Rates		
	APWU Proposed Rates Based on 80 Percent Pass Through (1)	APWU Proposed Rates Based on 100 Percent Pass Through (2)
Letters and Sealed Parcels		
Regular		
Single-Piece First Ounce	37.0	37.0
QBRM	36.4	36.2
Nonautomation Presort	36.4	36.2
Additional Ounce		
Single Piece	23.0	23.0
Presort	23.0	23.0
Automation Presort		
Letters		
Mixed AADC Presort	33.0	32.0
AADC Presort	32.3	31.1
3-Digit Presort	32.0	30.8
5-Digit Presort	31.1	29.6
Carrier-Route Presort	31.1	29.6
Flats		
Mixed ADC Presort	37.0	37.0
ADC Presort	37.0	37.0
3-Digit Presort	37.0	37.0
5-Digit Presort	31.1	30.2
Additional Ounce	23.0	23.0
Cards		
Regular		
Single-Piece	23.0	23.0
Nonautomation Presort	22.4	22.2
QBRM	22.4	22.2
Automation-Presort		
Mixed AADC Presort	22.0	21.7
AADC Presort	21.6	21.2
3-Digit Presort	21.5	21.1

Table III: Summary of Proposed APWU First-Class Mail Rates

	APWU Proposed Rates Based on 80 Percent Pass Through (1)	APWU Proposed Rates Based on 100 Percent Pass Through (2)
5-Digit Presort	21.0	20.5
Carrier-Route Presort	21.0	20.5

(1) From Table I, APWU-T-1, Testimony of Michael Riley

(2) From Table II, APWU-T-1, Testimony of Michael Riley

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Direct Testimony of Michael J. Riley on Behalf of the American Postal Workers Union, AFL-CIO, APWU-T-1, upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

Date: January 30, 2002


Susan L. Catler

1 CHAIRMAN OMAS: Mr. Riley, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was made available to you in the
4 hearing room today?

5 THE WITNESS: Yes.

6 CHAIRMAN OMAS: If the questions contained in that
7 packet were posed to you orally today, would your answers be
8 the same as those you previously provided in writing?

9 THE WITNESS: Yes, they would.

10 CHAIRMAN OMAS: Are there any corrections or
11 additions you would like to make to those answers?

12 THE WITNESS: I have no corrections or additions.

13 CHAIRMAN OMAS: Counsel, would you please provide
14 two copies of the corrected designated written cross-
15 examination of Witness Riley to the reporter? The material
16 is received into evidence, and it is to be transcribed into
17 the record.

18 (The document referred to was
19 marked for identification as
20 Exhibit No. APWU-T-1 and was
21 received in evidence.)

22 //

23 //

24 //

25 //

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes

Docket No. R2001-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS MICHAEL J. RILEY
(APWU-T-1)

Party

KeySpan Energy

Major Mailers Association

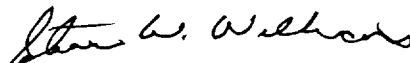
Interrogatories

KE/APWU-T1-1

MMA/APWU-T1-1-2, 4-6

USPS/APWU-T1-1, 3, 6

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS MICHAEL J. RILEY (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

KE/APWU-T1-1

MMA/APWU-T1-1

MMA/APWU-T1-2

MMA/APWU-T1-4

MMA/APWU-T1-5

MMA/APWU-T1-6

USPS/APWU-T1-1

USPS/APWU-T1-3

USPS/APWU-T1-6

Designating Parties

KeySpan

MMA

MMA

MMA

MMA

MMA

MMA

MMA

MMA

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO INTERROGATORY OF KEYSpan ENERGY

KeySpan/APWU-T1-1 Are you aware that USPS witness Miller changed the methodology for estimating QBRM cost savings from the methodology employed by the Commission in Docket No. R2000-1 less than one year prior to the time Mr. Miller filed his direct testimony in this case? If yes, please explain all of those changes, as you understand them, provide the separate impact of each such change upon measured QBRM cost savings, and provide copies of all work papers or other documents prepared by you or under your direction and supervision prior to the date your Direct Testimony was filed that set forth or discuss an analysis of Mr. Miller's changes in the methodology for estimating QBRM cost savings. If no, please explain the extent to which you studied USPS witness Miller's derivation of QBRM cost savings.

RESPONSE

I am aware that at pages 26 – 27 of USPS witness Miller's testimony he explains changes he made to the methodology used by USPS witness Campbell to estimate QBRM cost savings in Docket No. R2000-1. Any more specific questions concerning the methodology changes in witness Miller's testimony and the impact of those changes should be directed to USPS witness Miller.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO INTERROGATORIES OF THE MAJOR MAILERS
ASSOCIATION

MMA/APWU-T1-1 Please refer to page 6 of your Direct Testimony where you state that you "used the estimated avoided costs sponsored by USPS Witness Miller."

- A. Did you independently verify the estimated cost savings derived and presented by USPS witness Miller? If yes, please explain exactly how you did so and provide copies of all studies, workpapers, and any other documents you prepared or reviewed in connection with that effort. If you did not prepare any of these documents, for each such document please identify the person that did so.
- B. Were you aware that Mr. Miller changed the methodology for estimating workshare cost savings from the methodology employed by the Commission in Docket No. R2000-1, less than one year prior to Mr. Miller's filing of his direct testimony in this case? If yes, please list and explain each of those changes, as you understand them, provide the separate impact of each such change upon measured workshare cost savings, and provide copies of all workpapers or other documents prepared by you or under your direction and supervision prior to the date your Direct Testimony was filed that set forth or discuss an analysis of Mr. Miller's changes in the methodology for estimating workshare cost savings. If no, please explain the extent to which you have studied USPS witness Miller's derivation of workshare cost savings.
- C. If the Commission's exact methodology for measuring workshare cost savings had been proposed by the Postal Service in this case, would the First-Class workshare discounts proposed in the settlement be greater or less than the cost savings? Please explain your answer and provide citations to all sources and set forth clearly the formulae and computations used to support your answer.

RESPONSE

- A. No.
- B. No. USPS witness Miller states at page 17, lines 15 – 17 of his testimony: "In Docket No. R2000-1, I used an improved worksharing related savings calculation that was subsequently relied upon by the Commission. I again use that methodology in this docket." (Footnote omitted). Any more specific questions concerning the methodology changes in witness Miller's testimony and the impact of those changes should be directed to USPS witness Miller.
- C. This is beyond the scope of my testimony. Any questions concerning the methodology in witness Miller's testimony compared or contrasted with an alternate methodology should be directed to USPS witness Miller.

**RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO INTERROGATORIES OF THE MAJOR MAILERS
ASSOCIATION**

MMA/APWU-T1-2 Please refer to page 8 of your Direct Testimony where you recommend changes only to the proposed settlement rates for First-Class letters. Please also refer to the Direct Testimony of Joseph D. Moeller (USPS-T-32), page 23, lines 15 – 18, where Mr. Moeller recommends a 150% passthrough of the cost difference for 5-digit automated Standard letters. Please explain why you are proposing to establish First-Class discounts that are less than the alleged cost savings, but have ignored Standard rate discounts that are greater than the alleged cost savings.

RESPONSE

The American Postal Workers Union, AFL-CIO opposed the rate design proposed for First-Class Mail. It did not file an opposition to the rate design for Standard Mail.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO INTERROGATORIES OF THE MAJOR MAILERS
ASSOCIATION

MMA/APWU-T1-4 On page 11 of your Direct Testimony you propose lower workshare discounts to attract more First-Class single piece letters and higher revenues. Please confirm that First-Class single piece volumes have remained fairly stagnant over the past 30 years. See USPS-T-7, page 34. If you cannot confirm, please explain.

RESPONSE

I do not propose lower workshare discounts to attract more First-Class single piece letters and higher revenues on page 11 of my testimony. I am proposing lower workshare discounts to stop giving mailers more in discounts than the Postal Service is saving by their mail preparation.

I cannot confirm that First-Class single piece volumes have remained fairly stagnant over the past 30 years. There was no such rate category in 1970. With respect to First-Class letter mail volume, it is important to note that in 1970 all letters in First-Class Mail were what is now called single piece First-Class letters. Since then other rate categories for First-Class letters have been created. Those other rate categories for First-Class letters now have a total volume approximately equal to the current single piece First-Class letter volume. In addition, in 1970, personalized information could not be sent in a Third-Class letter. Now personalized information can be sent in a Standard Mail letter. For the single piece First-Class letter rate category to maintain the volume it had in 1970 while there has been a huge migration of business mail to other First-Class letter rate categories and to Standard Mail letters does not represent stagnation of single piece First-Class letters.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO INTERROGATORIES OF THE MAJOR MAILERS
ASSOCIATION

MMA/APWU-T1-5 On page 12 of your Direct Testimony you suggest that the unit contribution to institutional costs for First-Class discounted workshare letters be at least as great as the contribution for "comparable" non-discounted single piece letters.

- A. Please explain exactly how you would measure the unit contributions for First-Class workshare letters and single piece letters. Should the distance traveled be the same? Should the weight be the same? Would you compare the workshare unit contribution to that of an average single piece letter, an average clean letter, an average metered letter, an average bulk metered letter, or something else?
- B. Please provide the unit contributions for First-Class workshare letters and comparable single piece letters that would result if your proposed workshare rates, as shown in your Table 1, were adopted by the Commission. Please provide citations to all sources and set forth all formulae and computations used to support your answer.

RESPONSE

- A. On page 12 of my testimony at lines 12 through 14 I explain how the contribution for a piece should be measured, I explain, "so that the contribution of any piece will be the same regardless of in which rate category in the subclass that piece enters the mail stream."
- B. I have not calculated the specific numbers. In the case of an 80 percent pass-through, the contribution of a comparable single piece letter would be lower and thus the comparable workshare letter would have a higher value to the Postal Service. In the case of a 100 percent pass-through the same piece would make the same contribution regardless of the rate category the mailer chose.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO INTERROGATORIES OF THE MAJOR MAILERS
ASSOCIATION

MMA/APWU-T1-6 On page 24 of your Direct Testimony you recommend that the First-Class work-share discounts be set at 80% of the costs avoided, as determined by USPS witness Miller. Please provide for the test year in this case, a table of postal finances that includes First-Class workshare mail, First-Class single piece mail, and all mail. Please be sure to provide for each category the total revenue, cost, contribution to institutional costs, cost coverage, markup index, and the percent increase that would result from implementation of your proposed rates. Please include as part of your response to this interrogatory clearly labeled keys to all of the source documents, inputs, outputs, and calculations used in your analyses.

RESPONSE

I have not performed the cited calculations.

**RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO WITNESS RILEY
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/APWU-T1-1

Please refer to your testimony at page 4 at (lines 9-11) where you state, "From August 1993 to July 1998, I held the position of Senior Vice President and Chief Financial Officer of the U.S. Postal Service."

- a. Please confirm that the USPS Request in Docket No. R97-1 (an electronic copy of which may be accessed and examined via the PRC website) was filed at the Postal Rate Commission on July 10, 1997. If not confirmed, please explain.
- b. Please confirm that you were the Senior Vice President and Chief Financial Officer of the Postal Service at the time that the Postal Service prepared its Docket No. R97-1 Request, submitted to the USPS Board of Governor for approval, and filed it at the Postal Rate Commission. If not confirmed, please explain.
- c. Please confirm that the Certification found in Attachment D of that Request was signed by John A. Reynolds, Manager, Product Finance, Finance Department, USPS Headquarters. If not confirmed, please explain.
- d. Please confirm that in July, 1997, the Finance Department operated under the direction of the Senior Vice-President and Chief Financial Officer. If not confirmed, please explain.

RESPONSE

- a. Confirmed.
 - b. Confirmed.
 - c. Confirmed.
 - d. Confirmed.
-

**RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO WITNESS RILEY
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/APWU-T1-3

- a. Please refer to your testimony on page 10 at 9-11 where you state, "In this case, the CRA cost system will properly register the 'actual' costs of the mail with the resulting contribution from such mail being less than had been anticipated." Please confirm that the CRA is designed to capture costs related to all mail. If not confirmed, please explain.
- b. Please refer to witness Miller's testimony (USPS-T-22) on page 8 at 15-16. Please confirm that witness Miller's analysis relied upon CRA mail processing unit cost estimates. If not confirmed, please explain.
- c. Please refer to witness Miller's testimony (USPS-T-22) on page 17 at 1-9. Please confirm that CRA adjustment factors were applied to witness Miller's test year model cost estimates. If not confirmed, please explain.
- d. Please refer to USPS LR-J-60, page 51. Please confirm that witness Miller's cost models rely upon actual accept rates for all mail processed on letter sorting equipment. If not confirmed, please explain.
- e. Please refer to your testimony on page 10 at 3-9 where you state, "Since the Postal Service's proposed discounts are based upon special studies which develop "should cost" estimates of cost avoided by pre-barcoding and pre-sorting, in those cases where the mail is not presented in the prescribed manner but is granted the discount anyway, the result certainly will be the Postal Service experiencing higher costs than had been estimated." Please explain how the Postal Service will experience higher costs than it has estimated, if its costs estimates are based on data representing actual mail pieces, including mail pieces accepted and processed despite not being presented in the prescribed manner.

RESPONSE

- a. I agree that the CRA cost system is designed to take the total costs incurred by the Postal Service and to identify them, to the extent possible, by class.
- b. Mr. Miller states that his analysis "relies upon shape-specific CRA mail processing unit costs, which are reported by cost pool in the In-Office Cost System (IOCS)". This does not mean that his cost estimates by rate category are reported in the CRA system.
- c. I can confirm that the heading at line 1 is "CRA Adjustments". Witness Miller needs to make adjustments because the CRA does not report unit costs by rate category.
- d. Not confirmed. Page 51 indicates that the source of some of the data is "Engineering" and Docket No. R97-1. I also note that this table does not show accept rates for all rate categories.
- e. As I have explained, the "should cost" estimates by First-Class rate category do not account for the added costs of mail presented at a category for which it does not qualify.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO WITNESS RILEY
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE

USPS/APWU-T1-6

Please refer to your Table I and Table II, Column (4) of your testimony.

- a. Please confirm that cost methodology changes will affect the costs in Table II, Column (4). If not confirmed, please explain.
- b. Please confirm that the results in Column (4) would change if the Postal Service, in support of its Docket No. R2001-1 cost presentations, had adopted the Postal Rate Commission's approach to volume variability, as reflected in PRC Op. R2000-1, Appendix F.
- c. Please confirm that Docket No. R2001-1 witness Miller (USPS-T-22) has made cost pool classification adjustments that differ from those relied upon by the Commission in Docket No. R2000-1. (See USPS-T-22, pages 9 (line 23) - 10 (line 4). If not confirmed, please explain.
- d. Please confirm that Docket No. R2001-1 witness Miller (USPS-T-22) has adopted a delivery unit cost estimate proxy for Bulk Metered Mail (BMM) letters that differs from that relied upon by the Commission in Docket No. R2000-1. (See USPS-T-22, page 20 (lines 19-24). If not confirmed, please explain.

RESPONSE

- a. If the Postal Service changes the methodology it uses to calculate avoided costs, the cost avoided calculated using the new Postal Service methodology could differ from the cost avoided calculated using the Postal Service methodology used in this case.
 - b. I have not attempted to trace the impact of changes in methodology. I have simply objected to the Postal Service passing on savings greater than it has estimated it will save. Witness Miller has reported estimated savings, the Postal Service used his figures to develop its rate proposal and so have I.
 - c. See my response to (b) above.
 - d. See my response to (b) above.
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1 CHAIRMAN OMAS: Is there any additional cross-
2 examination?

3 MR. HART: Mr. Chairman, Henry Hart representing
4 the National Association of Pre-Sort Mailers. I apologize
5 for a little delay here.

6 We wish to designate some of Mr. Riley's responses
7 to our interrogatories. They were not due until yesterday
8 and today. They were kind enough to answer both sets
9 yesterday afternoon. This morning I prepared designations.
10 I have just given Ms. Catler a copy of them.

11 I tried to file them in the docket room, I
12 understand, where they said you ought to do it here. I am
13 not sure. If you could give me a minute? Some of them may
14 have already been designated.

15 Ms. Catler, do you have a sheet?

16 (Pause.)

17 MR. HART: Mr. Tidwell, did you designate No. 10?

18 MR. TIDWELL: I am after you. I will after you.

19 MR. HART: Well, I think I will just put my whole
20 set in then if I may, which are the ones that I gave you
21 copies of. I have two sets that I was going to file with
22 the dockets room. Should I just file them here?

23 MALE VOICE: Counsel, for the record you might
24 want to state which ones.

25 MR. HART: Which ones? Yes. They are Mr. Riley's

1 responses to ABA and NAPM/APWU-T-1 Nos. 1, 2, 3, 4, 6, 7, 10
2 and 12. I will give, with the Chair's permission, two
3 copies to the reporter.

4 CHAIRMAN OMAS: Without objection, yes.

5 (The document referred to was
6 marked for identification as
7 Exhibit No. ABA and NAPM/APWU-
8 T-1 Nos. 1, 2, 3, 4, 6, 7, 10
9 and 12 and was received in
10 evidence.)

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RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

4886

ABA & NAPM/APWU-T1-1

You argue that USPS should receive a return on its investment in automation equipment.

- a. Are you saying that ONLY USPS should receive such a return on investment in automation equipment, and that private mailers who have also invested hundreds of millions of dollars in automation equipment should receive no return?
- b. If automation investment by the USPS enables the USPS to process mail in a less costly manner than it would be able to without automation investment, is this a return on investment?
- c. Is it your position that when the USPS invests in automation equipment, it should price its mail services so as to return a profit to the USPS on such investment?

RESPONSE

- a. No. Please refer to my testimony on pages 20 and 21.
- b. No, but the lowered cost of processing the mail enters into the calculation of the return on the investment.
- c. I believe it is required by the Postal Reorganization Act that the Postal Service only invest in capital equipment if its expected return on investment exceeds its weighted average cost of capital and that the Postal Service should price its products recognizing this objective.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-2

Please confirm that your discount proposals, in light of the other test year financial evidence entered into this case by the Postal Service, would produce a profit to the USPS of several hundred million dollars well beyond the break even requirement of CFR Title 39.

RESPONSE

I am not certain that your amount is correct, but I also believe that a "surplus" after the satisfaction of the "revenue requirement" using the data in the current case is not in conflict with the Postal Reorganization Act, especially in light of the problems the Postal Service is facing after September 11th and anthrax.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-3

Please confirm that one way to address the Postal Service's "dire financial straights" is to cut postal costs, including labor costs.

RESPONSE

Drastic cost cuts forced by severe financial trauma do more harm than good. Organizations struggling for survival often harm their long-term prospects for success by excessive cost cutting.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-4

You argue a large shift from workshared mail to single piece mail is unlikely as a result of your slashing discounts by 3 or more cents per piece. Have you done any studies of the breakpoint beyond which it would pay business mailers to simply abandon USPS entirely in favor of accelerating the existing trend toward more and more bill presentment and payment by electronic commerce?

RESPONSE

No.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-6

On page 10 of your testimony, you argue that the CRA with its "actual" costs should pick up higher costs from poor barcode readability. Please confirm that the cost difference between FCM single piece letters and presort letters has since 1990 consistently grown right through to the latest CRA, that for PFY 2000.

RESPONSE

I cannot confirm or deny your assertion. To my knowledge, data to answer this question are not in the record.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-7

At page 15, lines 14 and 15 of your testimony you state that it is "good economics and good public policy" to limit discounts to the maximum of cost avoided. Are you purporting to provide advice to the Commission on allocatively efficient pricing? Are you qualified as an expert to provide advice on allocatively efficient pricing, and if your answer is yes, please provide your qualifications to provide such advice as an expert

RESPONSE

The purpose of my testimony is to recommend discounts at or preferably below avoided costs of First Class Mail to the Commission. This is a policy recommendation. I am an expert on Postal Policy and its effects. My qualifications are shown in my testimony on pages 4 and 5.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-10

- a. Please confirm that Title 39, section 3621, of the U.S.C. states: "Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service."
- b. As a not for profit organization subject to a "break-even" legal mandate, and in light of the fact that worksharing arrangements apply to well over two thirds of the entire mail volume of the Service please confirm that there is no justification whatsoever for the Postal Service to earn a profit on its worksharing arrangements, i.e. by setting discounts at anything less than correctly estimated avoided costs.

RESPONSE

- a. Your quote stops short of the most important sentence in Section 3621. It goes on to say, "For purposes of this section, "total estimated costs" shall include (without limitation) operating expenses, depreciation on capital facilities and equipment, debt service (including interest, amortization of debt discount and expense, and provision for sinking funds or other retirements of obligations to the extent that such provision exceeds applicable depreciation charges), and a reasonable provision for contingencies." This sentence and the prior sentence mean that the Postal Service should have annual profits and cumulative positive retained equity (the result of profits exceeding losses since its inception).
- b. The Postal Service is not and never has been a "not for profit" organization in the commonly accepted definition of that term. It does not have a "break-even legal mandate" and even if it did, it would mean to achieve at least "break-even." It has failed to achieve zero retained losses in its 31-year history to the great detriment of the American people.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO
WITNESS RILEY TO JOINT INTERROGATORIES OF THE
AMERICAN BANKERS ASSOCIATION AND THE
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA & NAPM/APWU-T1-12

In the "for profit" environment that underpins much of your testimony, please answer the following questions.

- a. Please cite any economics textbook or academic economic research article which claims efficient pricing across products in a multi-product organization can be achieved by a uniform absolute-dollar mark-up above the direct costs of all such products.
- b. In marginal cost analysis please explain your understanding of how profit maximization could, if at all, be achieved within a multi-product firm using the mark-up principle you advocate in your testimony.

RESPONSE

My testimony is based on the Postal Service being an independent establishment of the executive branch of the Government of the United States governed by the Postal Reorganization Act as amended, not a "for profit" environment.

- a. I do not recommend a uniform absolute dollar mark-up above direct costs.
- b. My testimony advocates not giving discounts larger than cost avoided.

1 MR. HART: I have already given Ms. Catler a copy.

2 Would it be helpful if I also gave the cover

3 motion, or will that just confuse matters?

4 CHAIRMAN OMAS: I think that might confuse things.

5 Just leave it as it is.

6 Is there any additional written cross-examination
7 for Witness Riley?

8 MR. TIDWELL: Yes, Mr. Chairman.

9 CHAIRMAN OMAS: Mr. Tidwell?

10 MR. TIDWELL: Mr. Riley, I have placed before you
11 two copies of your responses to Postal Service
12 Interrogatories Nos. 7 and 9. Those responses were prepared
13 by you?

14 THE WITNESS: Yes.

15 MR. TIDWELL: Mr. Chairman, the Postal Service
16 would then move those two responses into the record as its
17 additional designation of written cross-examination.

18 CHAIRMAN OMAS: Without objection.

19 (The document referred to was
20 marked for identification as
21 Exhibit No. USPS/APWU-T1-7 &
22 USPS/APWU-T1-9 and was
23 received in evidence.)

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RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO WITNESS RILEY
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE

USPS/APWU-T1-9

- (a) Are your rate proposals based on an alternate implementation date to the June 30, 2002, date reflected in the settlement agreement? If so, please indicate that alternate date.
- (b) Please confirm that, all other things equal, a rate implementation date that is later than June 30, 2002, will result in less revenue for the Postal Service in Fiscal Year 2002 than a June 30, 2002 implementation date.

RESPONSE

- (a) No. My testimony contains no recommendation about an implementation date. It is my opinion that the Postal Service should implement the rates as soon as possible after the Commission issues its decision.
- (b) Postal revenue in FY2002 will be a function of the rates implemented for all classes of mail, the timing of the rate increase and mailer behavior.

RESPONSE OF AMERICAN POSTAL WORKERS UNION, AFL-CIO WITNESS RILEY
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE

USPS/APWU-T1-7

Please refer to page 19 of your testimony (line 6) where you state that: "[t]he added single piece volume from any decrease in discounts is likely to be extremely small." You support this claim with a citation to Postal Service witness Thress's testimony (USPS-T-8 at 22) where he states that "[i]n the aggregate, workshared First-Class letters volume is virtually unaffected by Postal rates."

- (a) Please confirm that the aggregate rate elasticity cited by witness Thress (-0.028) refers to the price impact on postal volume assuming all postal rates (including worksharing rates, single-piece rates, and worksharing discounts) are changed equally or approximately equally. If you cannot confirm, please supply your understanding of the interpretation of this elasticity.
- (b) Please confirm that you propose different rate changes for discounted and non-discounted First-Class letters, and worksharing discounts that decrease at the same time that worksharing rates would be increasing. If you cannot confirm, please explain fully.
- (c) Have you or any person working in consultation with you or under your direction in relation to Docket No. R2001-1 made any effort to estimate test year volumes at the rates that you have proposed? If so, please provide the results of such analysis and all underlying workpapers.
- (d) In comparison to current First-Class Mail rates, please state the percentage rate change that you are proposing for each First-Class Mail rate category or rate element.

RESPONSE

- (a) Witnesses Tolley and Thress find very small price elasticities and cross-elasticities. This means that the overall volume change and the volume that will switch from discounted mail to single piece will be very small.
- (b) Confirmed.
- (c) No.
- (d) I am not proposing that the Commission set rates by looking at the percentage change in any rate category. However, over the last ten years, the percentage increase in discounted rates has been significantly less than the percentage increase in single piece rates. If one wants to look at percentage changes in rate categories, the only thing that makes sense is to do so over a long period of time.

1 CHAIRMAN OMAS: Are there any additional written
2 cross-examinations for Witness Riley?

3 (No response.)

4 CHAIRMAN OMAS: There being none, this brings us
5 to oral cross-examination.

6 Four parties have requested oral cross-
7 examination, American Bankers Association and the National
8 Association of Pre-Sort Mailers, KeySpan Energy, Major
9 Mailers Association and the United States Postal Service.

10 Is there any other party that wants to cross-
11 examine Witness Riley?

12 (No response.)

13 CHAIRMAN OMAS: There being none, Mr. Hart, would
14 you like to begin?

15 MR. HART: Thank you, Mr. Chairman. Again, Henry
16 Hart representing the National Association of Pre-Sort
17 Mailers.

18 CROSS-EXAMINATION

19 BY MR. HART:

20 Q Good afternoon, Mr. Riley.

21 A Good afternoon.

22 Q I wonder if you would turn to your response to
23 Interrogatory ABA/NAPM No. 2. Just let me know when you
24 have it in front of you. Do you have that in front of you,
25 sir?

1 A I do.

2 Q In that interrogatory, you were asked to confirm
3 that your discount proposals would produce a profit of
4 several hundred million dollars for the Postal Service. You
5 answered in part that you were not certain that our amount
6 of several hundred million dollars was correct.

7 Do you have any idea whether your proposal would
8 result in a profit to the Postal Service and, if so, how
9 much?

10 A I'd be surprised if the Postal Service were to
11 actually achieve a profit in fiscal 2003 even with the rates
12 that are proposed by me.

13 If the Commission were to adopt what I recommend,
14 an 80 percent pass through of cost, and set discounts
15 appropriately they have a fighting chance, and they would
16 have some momentum of actually getting there.

17 Q Have you made any attempt to quantify the impact
18 on the profit or loss of the Postal Service of your
19 proposals?

20 A Just my general judgement as a former chief
21 financial officer. I have an order of magnitude estimate.

22 Q Sort of a hunch?

23 A It's not a hunch. It's an educated guess that is
24 pretty much always on track.

25 Q Then what is that number?

1 A The number, depending on whether the Commission
2 chooses the Table 1, is a little over \$1 billion added less
3 loss in fiscal 2003 than they otherwise would have had and
4 probably between \$500 million and \$600 million if they were
5 to adopt Table 2 in my testimony, which is a 100 percent
6 pass through.

7 Q And that incorporates the price elasticities and
8 the volume effects of your proposal? That's all in your
9 calculation?

10 A My calculation is my professional judgement. I
11 would normally have people in the Postal Service or experts
12 run through all the elasticities to come up with an exact
13 number. I haven't done that, but, yes, I would be surprised
14 if I were off by much.

15 Q But you've done no calculations on volume effects
16 of what you're proposing?

17 A I've done no work paper calculations on volume
18 effects, --

19 Q Thank you.

20 A -- but I'm used to volume effects affecting what
21 comes out.

22 Q Please turn, if you would, to ABA and NAPM
23 Interrogatory No. 3. In that interrogatory you were asked
24 whether the Postal Service's "dire financial straits", as
25 you characterized it, might be helped by cutting postal

1 costs, including labor costs. Your response was that
2 drastic cost cuts forced by severe financial trauma do more
3 harm than good.

4 Wouldn't that statement that drastic cost cuts
5 forced by severe financial trauma do more harm than good,
6 wouldn't that statement apply and be equally true for any
7 cost of the Postal Service, not just labor costs?

8 A It would vary by the costs you're talking about.

9 Q Do you mean whether the cost was your client?

10 A The Postal Service has tried drastic labor costs
11 and was doing it when I joined. The result was to drive
12 costs up, not down.

13 Q But the Postal Service has numerous costs in
14 addition to labor, right?

15 A Oh, yes.

16 Q Suppliers?

17 A Yes.

18 Q If it drastically cut what it paid its suppliers,
19 couldn't that have the same severe financial trauma that
20 would do more harm than good?

21 A Yes.

22 Q In a sense, aren't work share mailers customers
23 that could suffer severe financial trauma as a result of
24 cutting what the Postal Service pays them in the form of
25 discounts?

1 A No.

2 Q What's the difference?

3 A The difference is that customers are customers and
4 not suppliers. They prepare mail in advance. When you have
5 a supplier that you force to supply product at much lower
6 prices, there is a tremendous disruption. There's no
7 forcing of customers to pre-bar code or pre-sort mail. It
8 is a voluntary choice on their part.

9 Q Do you think that the work share program has value
10 to the Postal Service?

11 A It has had in the past, and it has some value at
12 present.

13 Q Do you think that work share mailers could suffer
14 severe financial trauma if faced with an 80 percent cut in
15 discounts?

16 A I've not recommended an 80 percent cut. I've
17 recommended a cut to 80 percent pass through. Based on my
18 testimony, the answer is no.

19 Q But your feeling is that labor costs can't be
20 touched, but that business mailers can just be forced to
21 accept significantly lower discounts?

22 A I've not said that, nor do I believe it.

23 Q So then would you agree that your statement that
24 drastic cost cuts forced by severe financial trauma do more
25 harm than good could well apply to cuts in discounts to

1 business mailers?

2 A No.

3 Q If business mailers and work share mailers are
4 valuable partners to the Postal Service, why is it any
5 different to drastically reduce what you pay them in the
6 form of discounts than it would be to say drastically reduce
7 the prices that you would pay a supplier of vital equipment?

8 A The provision of vital equipment is very
9 different than having someone have the option to do work in
10 advance or not do that work in advance. You have a contract
11 to buy equipment, and you agree on a price. Frankly, you
12 just can't cut that price once you've signed the contract.
13 If you could, you would find that you will do far more
14 disruption to that supplier.

15 The work share mailer has the choice of putting in
16 the mail at the single piece rate or taking advantage of the
17 discount. The vast majority of CEOs that I've talked about
18 do the work in the computer at almost zero cost.

19 Q Work share mailers just push a button, and it all
20 happens? It doesn't cost them a thing?

21 A It costs them something.

22 Q Like that equipment that they're using costs quite
23 a bit, doesn't it?

24 A When you're dealing with computerized equipment
25 you find that there is a significant outlay, but the cost

1 per piece is almost zero.

2 Q Let's see if we can find one thing to agree on,
3 Mr. Riley. You've testified as to what you believe is the
4 appropriate percentage of costs avoided that should be
5 passed through in the form of first class automated
6 discounts.

7 Whatever that appropriate pass through percentage
8 is, it should be a percentage of accurately measured cost
9 avoidance, should it not?

10 A I think we've all -- in this case, there's only
11 one set of costs on the record, and those were provided by
12 the Postal Service Witness Miller. I used his costs, and I
13 haven't seen anybody who's put in any testimony to dispute
14 them.

15 Q My question is do you agree that whatever
16 percentage of costs should be passed through should be a
17 percentage of accurate costs?

18 A I always prefer, yes. I prefer more accurate
19 costs to less accurate costs if they're available.

20 Q And if this Commission in its wisdom decides on a
21 particular percentage that should be passed through of costs
22 avoided in order to set the discounts, it would be best for
23 all parties concerned if they applied that percentage to
24 accurately measured costs avoided?

25 A My opinion is it would be best for all parties

1 concerned if they applied it to Witness Miller's testimony
2 because it's the only cost in the record.

3 Q Even if it's inaccurate?

4 A If you've dealt with data and the way it's
5 collected, there is always some minor degree of inaccuracy.

6 Q Are you telling the Commission that you want them
7 to pass through your specified percentage because you like
8 Mr. Miller's avoided costs and that's why you like your
9 percentage, or are you advising them this is an appropriate
10 percentage of the pass through of accurately avoided costs?
11 Which is it?

12 A I have based my numbers on Witness Miller's
13 testimony. It's the only testimony in the record.

14 Q So that if you saw and were convinced that there
15 was a more accurate measure of cost avoidance, you would
16 back away from your percentage advice to this Commission, or
17 would you say no, you should take the percentages that I've
18 advocated, and you should pass those through because these
19 are accurately measured cost avoidance?

20 A I've learned a long time not to deal with what
21 ifs.

22 Q Not if it takes you where you don't want to go, I
23 guess. Let me try it one more time.

24 You have advised this Commission based on your
25 professional reputation that they should pass through a

1 specified percentage of avoided costs. Do you believe that
2 that percentage is equally true and equally beneficial and
3 that that same percentage should be applied to accurately
4 measured cost avoidance?

5 A I'm sorry. I don't understand the question.
6 Equally to what?

7 Q You've recommended a specified percentage or range
8 of percentages of avoided costs.

9 A Yes.

10 Q You've told this Commission it's best, it's in the
11 public interest, it's good public policy that we pass
12 through this percentage of the costs avoided to arrive at
13 the discounts, correct?

14 A Yes.

15 Q Now, is it your testimony then that that same
16 percentage that you've recommended is the percentage which
17 should be applied to accurately measured costs avoided to
18 set the discount?

19 A I mean, my testimony does not deal with which
20 costs are avoided or accurately measured and which ones
21 aren't. I base my testimony on the costs that are in the
22 record that Witness Miller have testified are accurate.

23 Q Why are you reluctant to tell the Commission
24 whether or not they should pass through your recommended
25 percentage pass through? Why are you reluctant to tell them

1 to apply that to accurately measured costs avoided?

2 MS. CATLER: I'm going to object to this line of
3 badgering questions at this point. The witness has stated
4 that these questions are really beyond the scope of his
5 testimony.

6 His testimony has to do with what you do once you
7 have figures on costs avoided, not how you get the costs
8 avoided figure. That's beyond the scope of his testimony,
9 and it's beyond the scope of the APWU's objection to the
10 proposed stipulation.

11 The Postal Service put on Witness Miller's
12 testimony as their cost avoided testimony. The parties have
13 stipulated to that part of the record, and we have not
14 objected to it. Therefore, I don't believe that it is open
15 at this point in this proceeding.

16 MR. HART: May I respond? I believe that Mr.
17 Riley has stated that he is the witness on public policy,
18 and I think it goes to his credibility as a witness as to
19 whether he is telling you to pass through a percentage of
20 costs avoided because he knows what the result is and likes
21 that result because he likes the result of Mr. Miller's
22 avoided costs or whether he's telling you no, I'm talking
23 about public policy. Once you've accurately measured cost
24 avoidance, then apply this percentage to it.

25 I want him to tell the Commission which is he

1 advising you to do. Is he advising you to pass through a
2 specified percentage of Mr. Miller's costs avoided, or is he
3 advising you to pass through a percentage of accurately
4 measured cost avoidance?

5 CHAIRMAN OMAS: I will allow it. You can
6 continue, Mr. Hart.

7 MR. HART: Thank you.

8 MS. CATLER: Could you repeat the question?

9 MR. HART: Yes. I will.

10 BY MR. HART:

11 Q Mr. Riley, the percentage or range of percentage
12 of avoided costs which you have testified to the Commission
13 should be passed through in setting the discounts, would it
14 be your testimony to the Commission that once they have in
15 their wisdom arrived at what they think is an accurate
16 measurement of avoided costs on the record that they should
17 then take your recommended advice on percentage pass through
18 in setting the discounts?

19 A That's what I did in my testimony was to establish
20 the percentages first. My advice to the Commission is
21 whatever they determine to be the avoided costs, to take 80
22 percent of that and use that to set the discounts if that
23 helps.

24 Q It does except I wonder if you're not back sliding
25 on the percentage. I thought your testimony talked a lot

1 about a range of 80 to 100.

2 A I said 80 to 100, and I have a preference for 80.

3 Q But you'll stand by your testimony on the range?

4 A Absolutely.

5 Q Thank you. Cost avoidance is a difficult measure
6 to take account of, is it not? I mean, have reasonable
7 people differed as to what is an accurate measure of cost
8 avoidance in your experience?

9 A I'm not sure the answer to that is yes. I don't
10 recall anybody reasonably objecting to cost avoided numbers.

11 Q Have you suggested in your testimony that the cost
12 avoidance of Mr. Miller may be overstated?

13 A Let's see what I said in my testimony.

14 MS. CATLER: Are you referring to a particular
15 part of the testimony?

16 MR. HART: The Merlin. The portion of his
17 testimony where he refers to the Merlin tests.

18 THE WITNESS: Oh, sure. There is a part of the
19 testimony where I talk about the difference between should
20 cost and will cost and setting up a revenue assurance unit
21 because we found a large number of disparities with mail
22 being entered at rates for which it did not qualify and
23 large amounts of money due to the Postal Service. That is
24 not taken account of in Mr. Miller's testimony.

25 BY MR. HART:

1 Q To your knowledge, are those Merlin tests
2 finalized?

3 A The Merlin has not been implemented because there
4 are objections from mailers.

5 Q To your knowledge, in the tests that they have run
6 and the read rates that they have received, have they made
7 any distinction between the results for first class mail and
8 say standard mail?

9 A I think you would need to ask a Postal Service
10 witness what they've run for tests, not me.

11 Q But the figures --

12 A My testimony is for policy to this rate
13 commission. It is not to validate any particular number off
14 Merlin.

15 Q But you have suggested that your general knowledge
16 of the Postal Service and the results that you've heard at
17 impact meetings about the results of Merlin testing lead you
18 to believe that the bar coding reading capabilities or the
19 success rate on bar codes may be lower than has been assumed
20 in this case?

21 A One needs to figure out exactly what assumptions
22 have been made, and that's not clear from the record what
23 Mr. Miller has assumed in read rates.

24 Q But your observation about what you were told in
25 an impact meeting. Do you have mail or any other class of

1 mail?

2 A I certainly can't quote you a percentage, but what
3 I can tell you is that we had significant problems with
4 first class mail hedgered into the Postal Service through
5 bulk acceptance units during my time as Chief Financial
6 Officer. And the figures that I've heard from Berwin [ph]
7 show significant problems and I can't tell you whether they
8 are standard mail or first class mail for the letters.

9 Q Has the Postal Service tested its own mail under
10 Merlin? The mail on which it puts a bar code?

11 A That's beyond the scope of my testimony.

12 Q You don't know?

13 A I don't know for a fact.

14 Q Does the Postal Service use similar equipment to
15 the work share mailers that are applying those bar codes?

16 A The equipment is similar in some ways, yes.
17 Largely similar.

18 Q If the Postal Service were having the same
19 problems that you suggest that the Merlin test suggests
20 business mailers are having in applying bar codes, then that
21 would mean that the Postal Service would have to reapply bar
22 codes that were not put on in an effective fashion, is that
23 correct?

24 A If the Postal Service were having the problem it
25 would get fixed immediately because managers get rated and

1 promoted based on how they handle the mail.

2 Q I guess what I'm suggesting to you is that if in
3 fact there is a bar code readability problem couldn't it
4 cause costs avoided to be understated in that the Postal
5 Service, if the Postal Service is forced to do what the work
6 share mailers aren't doing, that the Postal Service will
7 have those same problems in getting readable bar codes and
8 it will therefore cost them more money to do what the work
9 share mailers have done?

10 A Would you repeat that again?

11 Q I don't know if I can. I will try. It was a long
12 question.

13 If the Postal Service is having the same bar code
14 readability problems in putting a bar code -- Let me try it
15 again.

16 If the Postal Service is having the same trouble
17 in putting a readable bar code on a piece of mail as you
18 suggest that business mailers may be having, then wouldn't
19 that cause the costs avoided by the Postal Service to have
20 been understated in this case since in fact it's going to
21 take the Postal Service more time and energy to get correct
22 bar codes on the mail?

23 MS. CATLER: I'm going to object to this because
24 the question assumes facts that are not in the record and
25 goes beyond scope of his testimony.

1 MR. HART: I think it's pretty pertinent. He's
2 made a pretty bold assertion that there's bar code
3 readability problems based on Merlin and this affects cost
4 avoidance, and I'm suggesting that it has at best a neutral
5 effect.

6 MS. CATLER: But what you're saying is assume that
7 the Postal Service has the same problem that the pre-sorters
8 do. And there's nothing in the record that indicates that
9 the Postal Service does have the same problem.

10 MR. HART: There's precious little in the record
11 that suggests that business mail has had the problems other
12 than a conversation at MTAC so I'm trying to explore this a
13 little bit.

14 THE WITNESS: Well, if you want to know where it
15 comes from, the Postal Service is struggling to survive and
16 the governors saw fit to approve and fund the second stage
17 of Merlin as one of only three projects that they were going
18 to come up with money for. They have cut capital spending
19 to the absolute bone and it's complete evidence to me that
20 this is a huge problem. It was a problem when I was the
21 CFO. People who are currently managers of the Postal
22 Service who talk to me tell me that they have similar
23 problems. And I believe that the Postal Service does not
24 have that problem.

25 MR. HART: I'm not sure if he ruled on his

1 counsel's objection.

2 CHAIRMAN OMAS: I think he's tried to answer the
3 question.

4 MR. HART: All right.

5 CHAIRMAN OMAS: Sorry, counsel

6 MS. CATLER: It was a good answer.

7 THE WITNESS: True.

8 MR. HART: A few more questions, if I may.

9 BY MR. HART:

10 Q Are you aware that this Commission in the past,
11 including the most recent R-2001 case, has assumed 100
12 percent volume variability of direct labor costs in
13 calculating avoided costs?

14 MS. CATLER: I'm going to object. This is way
15 beyond the scope of his testimony.

16 CHAIRMAN OMAS: Continue, Mr. Hart.

17 MR. HART: I didn't understand your ruling, Mr.
18 Chairman. Do you want me to just withdraw the question or -
19 - I'll do whatever the Chairman wants me to do.

20 CHAIRMAN OMAS: He can answer that.

21 THE WITNESS: I didn't spend any time studying
22 differences in methodology other than to read parts of
23 Miller's testimony where he claims to have had the same
24 methodology as the last time.

25 BY MR. HART:

1 Q To your understanding is it the same methodology
2 that was utilized by the Commission?

3 A I think you'd have to ask Witness Miller that.

4 Q You don't know that then?

5 A I did not study what methodology was used. You
6 need to ask Witness Miller.

7 Q I'm not trying to be critical.

8 A I'm here to talk about policy, not differences in
9 methodology.

10 Q Do you think it's possible that work share mailers
11 performed some services for the Postal Service that result
12 in savings that in fact are not measured by Mr. Miller's
13 measures of cost avoidance?

14 A No.

15 Q Are you aware of the fact that work share mailers
16 sleeve and band trays that are delivered to the Postal
17 Service?

18 A I've seen banded and sleeved trays comes into the
19 Postal Service from work share, I guess I prefer to call it
20 discounted mailers.

21 Q Are you aware that work share mail, automated
22 first class mail is subject to move update requirements?

23 A Yes.

24 Q Is it your understanding that single piece or bulk
25 metered mail entered at today 34 cents is subject to any

1 move update requirements?

2 A Most major mailers participate in update
3 addresses. I don't know the answer to your question is a
4 better answer.

5 Q Are you aware that work share mailers expend funds
6 to educate -- Let me rephrase that. That pre-sort bureaus
7 who obtain work share mail from business mailers expend
8 funds to educate their mailers on getting their mail in
9 automation compatible fashion?

10 A Yes.

11 Q Why is it that you believe that there are
12 absolutely no costs avoided that may be missed by Mr.
13 Miller's testimony?

14 A If you really want to check into what Mr. Miller's
15 testimony covers, you ought to talk to Mr. Miller. But if
16 you're asking my opinion, you may recall in the past that
17 unit used to report into the Chief Financial Officer.

18 Q Are you aware of the fact that in this case Mr.
19 Miller used a proxy to calculate delivery costs for
20 automated mail that resulted in a cost avoidance measurement
21 of 1.89 cents less than had he used the very same proxy he
22 used in the last case and that was used by the Commission in
23 the last case?

24 A I think you need to ask that of Mr. Miller. I'm
25 here to talk about discounts and policy and not his choice

1 of methodology.

2 Q One more lines of questions if I may, Mr. Riley.

3 Could you turn to your response to ABA and NAPM's
4 number six?

5 (Pause)

6 A Yes.

7 Q In that question we asked you to confirm that the
8 cost difference between first class single piece letters and
9 first class pre-sort letters has since 1990 consistently
10 grown right through to the latest CRA for fiscal year 2000.
11 Your response was, "I cannot confirm or deny your assertion.
12 To my knowledge, data to answer this question are not on the
13 record."

14 A That's correct.

15 Q You're certainly aware of the cost revenue
16 analysis.

17 A Yes.

18 Q Are you aware of the fact that the Commission is
19 allowed to take judicial notice of public documents?

20 A I would assume that would be the case, yes.

21 Q You truly have no idea as to whether or not -- let
22 me backtrack.

23 Are you aware that the cost revenue analysis since
24 1990 has shown a cost per piece for first class single piece
25 and a cost per piece for all pre-sort first class letter

1 mail?

2 A What the CRA does is it take an average over all
3 weights and it has the volume and it has the revenue and the
4 cost. You can divide one number into another, but it
5 doesn't not give you any information about the cost
6 differential between processing one piece or another piece.

7 Q Your counsel and I can argue about that at a later
8 time, but are you aware of the fact that the gap between the
9 single piece cost per unit and the pre-sort cost per unit
10 have continued to increase since 1990?

11 A I thought the CRA in its reporting, because it
12 does not report down to specific rates. It's totally
13 irrelevant to the testimony that I put in. I didn't spend
14 any time looking at history on it.

15 Q So you simply don't know the answer to that
16 question because you don't -- Well, you don't know the
17 answer to that question?

18 A I know in the last few years it, the average cost
19 per piece of single piece compared to discounted mail has
20 grown closer together. I think it's irrelevant to my
21 testimony.

22 Q What --

23 A To the extent I have looked at what you've seen
24 it's going the opposite direction from what you allege.

25 Q Which years were those?

1 A The last few years. I didn't pay a lot of
2 attention.

3 Q Well you're either going to give us an answer or
4 you're not. You sort of know but you don't know. Which
5 years --

6 A I'm not here to testify about the CRA and --

7 Q Can you tell me a single year, from year to year,
8 when the cost differential between single piece and pre-sort
9 dropped in the CRA? Can you give us a single year?

10 MS. CATLER: Do you have a copy of the CRA? He's
11 said that he hasn't memorized the CRA. He hasn't looked at
12 the CRA in depth on this. I object to the form of the
13 question. It's beyond the scope of his testimony.

14 MR. HART: So you don't want a copy of the CRA?
15 You changed your mind.

16 Well, there's an objection. I think it's a simple
17 question, it's my last on.

18 BY MR. HART:

19 Q Can you give us a single two years where the CRA,
20 the differential between single piece and pre-sort dropped?

21 A I don't recall the years off the top of my head.

22 MR. HART: Thank you. I have nothing further.

23 CHAIRMAN OMAS: Thank you, Mr. Hart.

24 Mr. Hall for Keyspan Energy and Major Mailers
25 Association.

1 MR. HALL: Thank you, Mr. Chairman.

2 Mr. Riley, good afternoon. My name's Mike Hall
3 and I'm going to be asking you some questions on behalf of
4 Keyspan Energy and Major Mailers Association.

5 THE WITNESS: Good afternoon, Mr. Hall.

6 CROSS-EXAMINATION

7 BY MR. HALL:

8 Q First could you turn to your response to MMA's
9 interrogatory number two?

10 A If you'll just wait for a minute until I get it in
11 front of me.

12 Q Sure.

13 (Pause)

14 Q In that interrogatory we pointed you to an
15 instance in which the Postal Service was recommending 150
16 percent pass-through with a cost difference for five digit
17 automated standard letters and asked you why you had ignored
18 that cost savings.

19 A I have the wrong interrogatory in front of me,
20 unfortunately. I'm looking at USPS instead of the Major
21 Mailers. If you'll give me another minute.

22 (Pause)

23 A Okay.

24 Q We pointed you to an instance in which the Postal
25 Service was recommending 150 percent pass-through for five

1 digit automated standard letters and asked you to explain
2 why you were proposing first class discounts that were less
3 than the alleged cost savings but ignored standard rate
4 discounts that were greater than the alleged cost savings.

5 Your answer was that the APWU had opposed the rate
6 designed for first class mail and it didn't file an
7 opposition to the rate designed for standard mail.

8 Now our question went to you, not your client. So
9 I'd like to ask you at this time why it was that you ignored
10 the situation in standard mail?

11 MS. CATLER: I'm going to object to this question.
12 Mr. Riley is filing testimony on behalf of the American
13 Postal Workers Union in this very unusual procedure where
14 the only thing that is open, because everybody else has
15 signed off on a proposed settlement. The only issue that is
16 open are the issues that the APWU has challenged. The APWU
17 opposed the proposed stipulation because it opposes the rate
18 design proposed for first class mail because the proposed
19 discounts exceed cost avoidance. That is the scope of this
20 proceeding at this point is ask Mr. Riley about standard
21 mail and why he didn't address standard mail in his
22 testimony. I object to that.

23 MR. HALL: I'm going to get around to why APWU
24 didn't take on, file an opposition to standard mail, but I
25 was trying to figure out basically, Mr. Riley, I'm trying to

1 figure out with you here whether the principal that you've
2 enunciated, basically that the discounts ought to be set at
3 between 80 percent and 100 percent of accurately measured
4 cost avoidance applies only to first class discounts or does
5 it apply to all classes?

6 THE WITNESS: I had understood it was beyond the
7 scope of what I was to testify to, but if you're asking my
8 opinion, I'd apply it to all classes.

9 BY MR. HALL:

10 Q In this instance when were you first approached by
11 APWU to testify?

12 A I think it was January 14th.

13 Q So prior to that time you had not been doing any
14 work, analysis, or consultation on their behalf?

15 A Let me see if I have your question right with my
16 answer. I had not been working with the APWU prior to that
17 time with anything to do with this rate case.

18 Q And when you were approached by APWU on or about
19 January 14th, was it an officer of the union that approached
20 you or was it counsel?

21 A I was approached by counsel on behalf of Mr.
22 Burrows, the president of the union.

23 Q At the time you were discussing what you would be
24 doing in this case, had APWU already filed its opposition?

25 A I don't know.

1 Q Had you been observing the case on behalf of any
2 other client prior to that time?

3 A No.

4 Q What had your status been in terms of reviewing
5 the case, the details of the case prior to that time?

6 A I take a general interest in what goes on in the
7 Postal Service and from that point I was generally aware of
8 what was happening.

9 Q So you would have been aware, were you aware prior
10 to that time that for standard mail the Postal Service was
11 proposing a 150 percent pass-through in the automation five
12 digit category?

13 A I have not looked at standard mail either before
14 or after being retained by the APWU.

15 Q So you were unaware that that situation existed at
16 all?

17 A I think that's yes.

18 Q And the APWU didn't ask you to go out and figure
19 out if this existed in any other class other than first
20 class.

21 A That's correct.

22 Q Turn now if you would, please, to page 22 and 23
23 of your testimony where you're discussing the ABRM discount.

24 I think there's been a fair amount of cross-
25 examination and discussion with you over the question of

1 accurately measured cost avoidances and what would happen,
2 how your principle of 80 to 100 percent would apply, but I
3 just want to make sure that that discussion would also apply
4 to QBRM cost avoidance and discounts.

5 A Perhaps I read more into the accurately avoided
6 question than is intended, but I've never assumed anything
7 other than that Witness Miller's cost avoidance numbers were
8 accurately measured.

9 Q Let's get to that specific one because you do have
10 I think perhaps an uncertainty principle that applies here
11 and I'd like to discuss that with you in a moment.

12 But let's go back to the Commission in its
13 infinite wisdom which has been discussed a lot on the
14 record --

15 A -- very grateful for the Commission's wisdom which
16 I might not call infinite, but certainly is there.

17 Q I too, and I wanted to be on record as supporting
18 that. And I am unanimous in that.

19 (Laughter)

20 CHAIRMAN OMAS: Can we just settle it right now?

21 MR. HALL: I think we've got the basis for
22 settlement.

23 MR. TIDWELL: I would join in but I think there's
24 something wrong with my microphone.

25 (Laughter)

1 CHAIRMAN OMAS: Thank you, Mr. Tidwell.

2 BY MR. HALL:

3 Q In other words, to illustrate how your principle
4 would work as applied to QBRM, if the Commission in its
5 wisdom were to find say that the accurately measured or
6 appropriately measured cost avoidance or cost savings for
7 QBRM was not .84 cents, not 1.6 cents, but five cents, then
8 would it be your recommendation that they adopt a discount
9 for QBRM of four cents? To understand how your --

10 A Is there were a witness who testified to five
11 cents and they were to believe him, yes. With that
12 qualification.

13 Q And I guess it could be between four and five
14 cents, is that right?

15 A Eight percent of a nickel is four cents and 100
16 percent of a nickel is five cents.

17 Q And that would be higher than the existing
18 discount, right?

19 A That's correct.

20 Q With respect to your uncertainty principle, if I
21 can just set the stage for this. I guess we can agree that
22 USPS Witness Miller first came up with a cost savings of
23 .846 cents. Is that right?

24 A I think I remember reading .846 in his testimony,
25 but I don't recall -- there are three changes and I'm not

1 sure which one occurred in which order.

2 Q I'm reading page 22 of your testimony.

3 A Oh, sure. I took .846 as the lowest.

4 Q Okay. Then he adjusted it twice, made corrections.

5 Is that your understanding?

6 A I think he had three different figures over the
7 course of the last few months.

8 Q And he finally ended up at 1.6 cents?

9 A I believe that's right.

10 Q I guess you say that if there's uncertainty the
11 choice should be the conservative or lower number, right?

12 A Yes.

13 Q In that case you choose the first number that he
14 put on the record, is that right?

15 A It would have been the last number if it had been
16 lower. I chose the lowest number.

17 Q I see, okay. That's a fair comment. I think it's
18 consistent with what I've been asking you. Let me see,
19 though. Is there any question in your mind that what he was
20 doing was correcting errors in his earlier analysis?

21

22 A Oh, sure there's a question in my mind. There are
23 adjustments made to library references and I guess it's fair
24 to say I didn't spend any time trying to figure out why
25 things changed and what changed and who sponsored what

1 change. I'm not sure that anybody's testified that there's
2 been a change. It may be that somebody has.

3 Q Well you certainly have, haven't you?

4 A I certainly haven't sponsored his library
5 references.

6 Q You testified that he made changes, didn't you?

7 MS. CATLER: I think the record reflects that he
8 filed several errata. That's what Mr. Riley has said.

9 COMMISSIONER GOLDWAY: Could you pull the
10 microphone closer to you?

11 CHAIRMAN OMAS: Ms. Catler, why don't you pull it
12 a little closer to you? You seem to be straining to get to
13 it.

14 MS. CATLER: Thank you.

15 COMMISSIONER GOLDWAY: Do you need to repeat that?

16 BY MR. HALL:

17 Q I said you've testified, haven't you, that Mr.
18 Miller made certain changes?

19 A I think it was Mr. Miller. The numbers that would
20 form the basis of his testimony were changed.

21 Q Okay.

22 A You asked if there's any uncertainty in my mind
23 about how it happened, and sure. I'm not sure who did the
24 calculation.

25 Q So your testimony isn't that Mr. Miller was

1 uncertain, is that right? Your testimony is that you were
2 uncertain?

3 A I don't know how one -- I have no way of knowing
4 whether Mr. Miller is certain or uncertain unless you ask
5 him.

6 Q The point is you didn't ask him, did you?

7 A No.

8 Q And did I just understand one of your previous
9 answers to be that you hadn't looked into the reason for
10 these changes or tried to determine --

11 A Right, I --

12 Q -- if the first iteration was obviously inaccurate
13 and a change had to be made or not?

14 A The purpose my testimony is to testify about the
15 policy of setting discounts at 80 to 100 percent, and when
16 it was my choice as to which number to use I picked the
17 lowest number because I assumed that there was -- I picked
18 the lowest number of the three since there were different
19 numbers entered at different times.

20 Q If the first number that was the lower number had
21 simply been a typographical error you would still choose
22 that number because it was the lowest number?

23 A I didn't make any attempt to discover whether or
24 not it was a typographical error.

25 MR. HALL: Those are all my questions.

1 CHAIRMAN OMAS: Thank you, Mr. Hall.

2 Mr. Tidwell for the Postal Service.

3 MR. TIDWELL: Good afternoon, Mr. Riley. You look
4 familiar.

5 THE WITNESS: Good afternoon, Mr. Tidwell. That's
6 because you've roasted me in your column a couple of times.

7 (Laughter)

8 THE WITNESS: And treated me very kindly others.

9 MR. TIDWELL: We'll get to my cross-examination
10 exhibits later.

11 (Laughter)

12 CHAIRMAN OMAS: Mr. Tidwell, excuse me. Before
13 you start why don't we just take about a ten minute break so
14 that we can just follow through with you.

15 MR. TIDWELL: Five minutes.

16 CHAIRMAN OMAS: Oh, you're five minutes away?
17 Proceed please, sir.

18 MR. TIDWELL: Thank you.

19 CROSS-EXAMINATION

20 BY MR. TIDWELL:

21 Q Mr. Riley, in your exchange with counsel for ABA-
22 NAPM you made a statement to the effect that you learned a
23 long time ago not to deal with what if's.

24 As the Chief Financial Officer of the Postal
25 Service were you responsible for the presentation of cost

1 and revenue to volume forecast to the senior management and
2 the Board of Governors?

3 A I think I usually had somebody present it and
4 introduce them. And the CRA was under my overall
5 management, yes.

6 Q Would any of these forecasts have been based on
7 any what you would describe as what if's?

8 A The CRA is not a forecast.

9 Q The volume forecasts.

10 A the volume forecasts were very carefully done
11 based on the best econometric models available at the time
12 and turned out to be very accurate.

13 Q Do those models, are they based on anything that
14 you would characterize as a what if?

15 A No.

16 Q They're not?

17 You would say the same is true with respect to in
18 your revenue forecast?

19 A Let me distinguish between revenue forecast and
20 revenue budgeted. The revenue forecast was not based on any
21 what if's. The revenue budgeted suffered from some overly
22 optimistic projections for every year I'm aware of that came
23 out of marketing.

24 Q I turn your attention to your response to Postal
25 Service interrogatory 7D.

1 (Pause)

2 A Yes.

3 Q In that interrogatory we asked you to compare the
4 current first class rates to the rates that you were
5 proposing for each rate category and to state the percentage
6 rate change implied by your proposals. And taking with it
7 your response to the interrogatory, I was disappointed not
8 to find any of those calculations performed.

9 Have you had an opportunity to perform those
10 calculations?

11 A It would seem the Postal Service could perform
12 calculations like that if it chose to.

13 Q Have you had a chance to perform them?

14 A I've had the opportunity if I chose to do so.

15 Q But you haven't performed them as of now?a

16 A No.

17 Q Do you know how long it might take you to do it?

18 A No.

19 Q You're not sure, you have no estimate of how long
20 it might take you to perform the calculation?

21 A It would certainly be less than an hour.

22 Q Thank you.

23 MR. TIDWELL: Mr. Chairman, rather than take up
24 less than an hour here in the hearing room asking the
25 witness to provide a response to the interrogatory, the

1 Postal Service would like to request that the witness be
2 given until let's say next Tuesday, the 19th, to provide the
3 calculations that are requested in the interrogatory.

4 CHAIRMAN OMAS: Mr. Riley?

5 MS. CATLER: I don't think that those calculations
6 are relevant. If the Postal Service wants to perform the
7 calculations, they can go and do them. He hasn't testified
8 to any of these sorts of things, and to have him go and do
9 calculations seems inappropriate.

10 CHAIRMAN OMAS: Can you do the calculations, Mr.
11 Riley?

12 MR. RILEY: Yes.

13 CHAIRMAN OMAS: If the witness can do it we'd like
14 for him to do it, please.

15 MS. CATLER: Certainly.

16 CHAIRMAN OMAS: Thank you.

17 MR. RILEY: No further questions.

18 CHAIRMAN OMAS: Thank you, Mr. Tidwell.

19 Is there anyone else who wishes to cross-examine
20 Witness Riley?

21 Questions from the bench? Commissioner Goldway?

22 COMMISSIONER GOLDWAY: I have a few questions for
23 you.

24 Mr. Tidwell mentioned that you had been
25 responsible for overseeing the revenue forecasts.

1 THE WITNESS: Yes.

2 COMMISSIONER GOLDWAY: Were you also responsible
3 for the forecasts that were part of the rate cases presented
4 to the Postal Rate Commission?

5 THE WITNESS: The answer is generally yes to your
6 question. There were some things that were, in a large
7 organization like the Postal Service you win some and you
8 lose some. And some of what got into rate cases was when I
9 got overruled on a few things.

10 COMMISSIONER GOLDWAY: Just as an aside, I'm
11 always confused about the numbers that we receive versus the
12 numbers that the Postal Service makes decisions on in other
13 cases, and you've mentioned there's a difference between the
14 revenue you forecast and the revenue that was budgeted which
15 adds yet a third layer of numbers that may or may not
16 correspond.

17 But I guess what I was interested in was whether
18 this issue of the 80 percent to 100 percent pass-through of
19 a discount was discussed at the time that rates were
20 proposed and presented to the PRC in your tenure at the
21 Postal Service.

22 THE WITNESS: Yes, it certainly was.

23 COMMISSIONER GOLDWAY: And did you discuss this
24 policy issue and advocate the same position at that time?

25 THE WITNESS: That or a smaller pass-through in

1 one or two cases. Yes. Extensively.

2 COMMISSIONER GOLDWAY: Did you discuss it with
3 regard to only first class mail, or did you discuss it with
4 regard to --

5 THE WITNESS: No, I discussed it with absolutely
6 everything. First in standard.

7 COMMISSIONER GOLDWAY: Because standard mail is
8 overwhelmingly automated and mechanized it seems to me the
9 relative benefit of automation seems to be shrinking more
10 there than it does in first class mail if there's a larger
11 portion, if it's all automated.

12 THE WITNESS: I haven't looked at that, but I
13 suspect you might be right.

14 COMMISSIONER GOLDWAY: I'm struck that we're
15 focusing on first class mail in this discussion.

16 THE WITNESS: My understanding, Commissioner, is
17 that was all we could focus on at the time because of what
18 my client chose to object to.

19 COMMISSIONER GOLDWAY: Then I have one other
20 question which is the issue of revenue assurance.

21 THE WITNESS: Yes.

22 COMMISSIONER GOLDWAY: One of the frustrations we
23 have as a Commission is that we can decide on rates but not
24 on operations. And it seems to me what you've pointed out,
25 and I think the public record, at least in terms of records

1 of the MTAC meetings and reports on what they've discussed
2 and the items I've read in industry newsletters about
3 Merlin, does seem to corroborate your concern that there is
4 a real distinction, a difference and dispute about whether
5 the mail that enters the system is as appropriately
6 automated as it ought to be given the discounts that it
7 gets. it's a dispute that's going on.

8 But if your suggestion is that the Rate Commission
9 set lower rates or lower discounts to account for that
10 dispute, aren't we then putting a burden on those mailers
11 who are performing their job accurately and who are
12 presenting their mail, and we're saying we're allowing
13 either the Postal Service or the sloppy mailers to have the
14 benefit by spreading that cost as opposed to making more
15 efficient implementation at the operation level, rather than
16 at the rate level?

17 THE WITNESS: I would have chosen 80 to 100
18 percent pass-through even if all of the mail were entered
19 accurately. I'm pointing out the problem as evidence that
20 if there is any bias towards the cost avoided numbers it's a
21 bias upward because it doesn't consider this fact. Your
22 concern about burdening mailers who perform all the rules
23 was a concern of mine, and as a matter of fact we would get
24 mailers turning in their compatriots to the inspection
25 service because they were able, by cheating, to underprice

1 the cost of some of the other mail service bureaus.

2 It's my opinion and has been that the Postal
3 Service should be absolutely adamant at enforcing its rules
4 for revenue assurance and enforcing the revenue assurance
5 outcome for Merlin. Am I answering your question?

6 COMMISSIONER GOLDWAY: You're answering my
7 question. Again, it's an area where unfortunately neither
8 you nor I can actually input the final action.

9 THE WITNESS: Sometimes when I had a say in the
10 matter I lost four to one.

11 COMMISSIONER GOLDWAY: Thank you for that, I
12 appreciate your comments and your forthrightness.

13 CHAIRMAN OMAS: Thank you, Commissioner Goldway.
14 Commissioner Covington?

15 COMMISSIONER COVINGTON: Thank you, Chairman Omas.
16 I was thinking Mr. Riley I was going to let you
17 slide, but --

18 THE WITNESS: I'm sorry I changed your mind.

19 (Laughter)

20 COMMISSIONER COVINGTON: My colleague,
21 Commissioner Goldway, raised two pretty good contingents
22 that I would like some clarification on. And prior to your
23 being sworn in to give us testimony here in the case you and
24 I were elaborating on this fact that we do share an interest
25 in a common acquaintance [ph], and you just alluded to the

1 fact that on your watch or during your tenure you primarily
2 saw a need to more or less establish what USPS now knows as
3 revenue assurance.

4 THE WITNESS: That's correct.

5 COMMISSIONER COVINGTON: And I always equate that
6 with being more or less the IRS of the Postal Service.
7 Right? In some respects.

8 THE WITNESS: I like to think of it as having more
9 heart and compassion --

10 (Laughter)

11 COMMISSIONER COVINGTON: Well you know, that's a
12 good point, Mr. Riley.

13 THE WITNESS: But your point's well taken,
14 Commissioner.

15 COMMISSIONER COVINGTON: There will be some that
16 would beg to disagree with you.

17 But it's safe to say that in the actual concept,
18 and when you recognized the need to do that that you came
19 from the private sector into USPS. You do, and I feel quite
20 sure you still realize what a large mailer has to offer the
21 U.S. Postal Service by way of not only volume but revenue.

22 THE WITNESS: Yes.

23 COMMISSIONER COVINGTON: In this particular
24 instance do you still agree with the contention that the
25 discounts to the major mailers if left as it is right now,

1 you would be looking at somewhere in the ball park of \$80 to
2 \$85 million that the Postal Service would or would not be
3 getting?

4 THE WITNESS: The \$80 to \$85 million is the
5 difference between the Postal Service proposed rates, or
6 what I understand to be the difference. It's about right.
7 I would have guessed around \$100 million. Between the
8 Postal Service proposed rates and the rates of the
9 settlement. If that's your question.

10 COMMISSIONER COVINGTON: Can you answer this for
11 me? Having been the Chief Financial Officer of the U.S.
12 Postal Service which is more important? Volume or revenue?

13 THE WITNESS: The answer is profit. The Postal
14 Service needs a positive net income. It's not a profit
15 maximizer, but it has to have that profit to continue to
16 invest in the capital and they are today mortgaging their
17 future to the point where I wonder if they'll survive
18 because they've cut the capital to the absolute bone.

19 Because of the losses last year and the huge
20 losses that are being driven by the anthrax attack on
21 September 11th, and the revenue and the volume are good and
22 nice and evidence of the service the Postal Service provides
23 to the American public. But it's foolishness to underprice
24 your product and do it badly, especially with major mailers.
25 I used to work for three of them. I was in charge of the

1 credit card operations for United Airways, I was Treasurer
2 of Michigan Bell Telephone, and I was an Assistant
3 Controller for collecting bills at Northeast Utilities. And
4 mailers are pleased to get discounts, but when you talk to
5 the CEO of American Express he wants service, he wants
6 service, he wants the float reduced to get his cash faster
7 and he wants happy customers. And when I asked him what he
8 thought about the R-97 rate case he didn't even know they
9 had one going on.

10 COMMISSIONER COVINGTON: And that was your initial
11 baptism to the rate process, is that correct?

12 THE WITNESS: My initial baptism was R-94. I
13 chose the revenue requirement in R-94 and I'm very proud of
14 the fact that the Postal Service performed extremely well in
15 terms of service, in terms of customer satisfaction, in
16 terms of employee morale, and in terms of profits for three
17 and three-quarter years after that.

18 COMMISSIONER COVINGTON: Let me ask you this then,
19 Mr. Riley. We all know about that dreaded word subsidies,
20 and I think in some ways, I think it's APWU's contention
21 that subsidies somehow or another on the part of the pre-
22 sort business and major mailers is affecting them adversely.

23 THE WITNESS: That's right. And discounts above
24 100 percent are in fact subsidies. Somebody else has to
25 make up for an added benefit that's undeserved and given to

1 a special group.

2 COMMISSIONER COVINGTON: Do you see where there
3 can ever be any common ground in regards to this contention?
4 Because it's my belief that if you take the life out of the
5 pre-sort business and if the major mailers were to pick up
6 their marbles and find somewhere else to go, what is that
7 going to do to the financial integrity of the Postal
8 Service? And then likewise how is that going to benefit the
9 membership of the American Postal Workers Union?

10 THE WITNESS: I worry about all postal workers
11 their long term future. Nobody's served by an unhealthy
12 Postal Service. It causes layoffs, it means that people
13 can't make wise investments. There are a number of things,
14 very short term paybacks that are excellent investments that
15 are not being made today because they're in such financial
16 difficulty. And I don't believe that there's any threat
17 whatsoever to the major mailers.

18 And for the pre-sort bureau, the pre-sort bureaus
19 knew when they started that the discount for pre-sorting
20 mail increasingly fine sortations was going to go away
21 eventually.

22 I'm not particularly concerned because I've been
23 there and I've talked to numbers of CEOs of major mailers.

24 COMMISSIONER COVINGTON: Mr. Riley, may I ask you
25 this contention then. Can you give me an honest opinion --

1 First of all, during your watch when you were the Chief
2 Financial Officer at the U.S. Postal Service, how often did
3 you monitor what was going on over at the mail technical, at
4 MTAC? Then in addition to monitoring, how much credence or
5 how many good ideas do you think came out of that body?

6 THE WITNESS: I wouldn't even hazard a guess as to
7 how many good ideas.

8 I met with mailers probably eight to ten times a
9 year in various forums and maybe attended an MTAC meeting
10 per se of the full group once or twice a year.

11 COMMISSIONER COVINGTON: In other words do you
12 think, in your opinion, this is just you and I talking, what
13 do you think about work sharing? Do you see where work
14 sharing is all that bad? To you see where work sharing is,
15 it needs some fine tuning? Or do you think as far as your
16 position here today on behalf of APWU that it's kind of like
17 a curse or an albatross around the neck of the membership?

18 THE WITNESS: Work sharing should never be done to
19 give away, in my opinion even 101 percent of what you save.
20 When you engage in something like the discounts for pre-
21 sorting mail, you want there to be a benefit for the
22 organization you're in, whether it's a business or an
23 organization and you want there to be a benefit, and frankly
24 the mailers have a choice. If they choose to do it, they
25 get a benefit. If they choose not to do it they're not

1 hurt.

2 I think in the early days the Postal Service
3 benefitted and needed mailers to do pre-sort and to put bar
4 codes on it. But even before there were bar codes major
5 mailers -- Northeast Utilities which was my first job after
6 getting my doctorate, bought special computer equipment and
7 I sat on the committee that approved the computer equipment,
8 to put the mail in the form that was absolutely the easiest
9 for the Postal Service to deliver because returning the
10 check back from the customer was unbelievably important.

11 Cash flow, cash flow, cash flow is what drives
12 major mailers. And at the risk of volunteering, the Postal
13 Service has in a PR sense cried wolf about electronic
14 diversion and having big mailers go away for just about 150
15 years. Starting with the telegraph.

16 I used to keep in my desk drawer an annual report
17 of the Postmaster General in 1875 -- not 1975, 1875 -- where
18 he said to Congress the equivalent of, with the recent
19 advances in fax technology, I didn't even know it existed
20 back in 1875, with the recent advances in fax technology,
21 the Postal Service's very existence is threatened.

22 If major mailers could find a way to switch to
23 electronics and have the public like it, they'd switch in a
24 second because an extra e-mail is close to zero.

25 COMMISSIONER COVINGTON: I agree.

1 Mr. Riley, we've got a General Counsel here by the
2 name of Steve Shardman, and one of the things I learned from
3 Mr. Shardman was that he said at one time the Postal Service
4 was best known for its ability to sort mail. To sort it.
5 That was their claim to fame. And I would imagine once you
6 start sorting it then the processing end comes in. You
7 know, which leads me into my next question which is what you
8 were saying that you had previously been exposed to.

9 Now when you start talking about cost avoidance
10 and so forth, you know for a fact what it is that USPS has
11 been trying to do with automation.

12 THE WITNESS: I've been intimately involved in
13 numerous presentations to the Board and numerous effort to
14 check on automation within the Postal Service during the
15 five years that I was there.

16 COMMISSIONER COVINGTON: And you know for a fact
17 that they used to be the 881s and the now the 1,000s and now
18 we're talking about the 100s. The main thing when it boils
19 down there you're talking about the most important people in
20 that operation is the people that are doing the feeding and
21 the people doing the sweeping. Am I correct?

22 THE WITNESS: There are an awful lot of important
23 people in the Postal Service who are really dedicated to
24 doing a good job. Frankly, when you compare it to other
25 postal administrations, we do an awful good job in the U.S.

1 Post Office. Marvin Runyun and I hosted nine Japanese
2 people who came over to see how we could do it so well in
3 comparison to what they did.

4 COMMISSIONER COVINGTON: So in other words, but
5 you don't see any common ground as it relates to where the
6 pre-sort mailers, major mailers can meet with what it is
7 that we're talking about as far as discounts in that 80
8 percent to 100 percent pass-through. You don't see any
9 common ground --

10 THE WITNESS: My guess is that if you brought in
11 the CEOs of the top 30 mailers, at least 25 of them would be
12 happy to accept the proposal that I offered and move ahead
13 and have a healthy, happy, financially secure Postal
14 Service.

15 I think there's a real common ground. Where there
16 tends to be a problem is with the lawyers and the lobbyists.

17 COMMISSIONER COVINGTON: Do you think that that's
18 something -- So in other words, conceivably you don't see us
19 being doable as it relates to the current case, R-2001-1?

20 THE WITNESS: I believe if you had access to the
21 decisionmakers in the organizations represented by the
22 American Bankers Association and the Major Mailers, you'd
23 find a easy common ground.

24 COMMISSIONER COVINGTON: Let me ask you this, one
25 final question, Mr. Riley.

1 We've talked about the pre-sorts and we've talked
2 about the major mailers and so forth. How much
3 consideration or what was the crux for your basis of for
4 APWU's contentions that there is basically unfair costs
5 being imposed on smaller mailers. And if you're saying
6 smaller mailers, what are we talking about in regard to
7 size, or in regard to how much mail they're dropping in the
8 system on an average day, month, or quarterly basis?

9 THE WITNESS: If I understand your question and
10 the Postal Service were in decent financial health, I might
11 have advised you to look strongly at a 36 cents stamp and an
12 80 percent pass-through.

13 COMMISSIONER COVINGTON: As opposed to the 37 cent
14 proposed --

15 THE WITNESS: As opposed to the 37 cent proposal.

16 During my time in the Postal Service after a lot
17 of discussion we came up with the thought that because of
18 the concerns of Congress about the poor individuals in this
19 country, that we wanted to not raise the stamp price more
20 than a penny at a time. And we actually had a vote of the
21 Governors, if I recall right. We certainly had a discussion
22 and a general agreement to go in that direction. At the
23 same time we committed to not have huge losses. That's been
24 changed since I left.

25 COMMISSIONER COVINGTON: I really appreciate the

1 exchange, Mr. Riley.

2 That's all I have, Chairman Omas.

3 CHAIRMAN OMAS: Ms. Catler, would you like some
4 time with your witness?

5 COMMISSIONER GOLDWAY: Do you have any questions?

6 CHAIRMAN OMAS: No.

7 COMMISSIONER GOLDWAY: I have one other question.

8 CHAIRMAN OMAS: All right. Commissioner Goldway.

9 COMMISSIONER GOLDWAY: I have a question for you
10 that deals with the general overall health of the Postal
11 Service and it's general revenue requirements.

12 THE WITNESS: Sure.

13 COMMISSIONER GOLDWAY: We have a proposed
14 settlement in front of us which if we agree upon and all
15 parties agree to will ensure that the Postal Service gets,
16 is it about \$1.5 billion more than it might have gotten had
17 we gone through the rate case as it was originally filed and
18 rates were to have gone into effect at the end of September.
19 Basically the settlement allows us a half a billion per
20 month. And all of the participants who have so far signed
21 onto this agreement are recognizing that with the settlement
22 the Postal Service will get some additional revenue.

23 If we are to consider the challenges that are
24 being presented in front of us we might not have the
25 settlement, because all of the signatories can agree to walk

1 away if things aren't exactly as they're proposed. And the
2 difference we're talking about is about \$100 million in
3 revenue from the initial proposal to the settlement that the
4 APWU is focusing on.

5 What do you think about the cost/benefit of the
6 risk we're taking in reviewing the settlement versus just
7 going ahead with the settlement and getting the Postal
8 Service this additional revenue more quickly than it would
9 otherwise.

10 MR. RILEY: Let me first talk about the
11 settlement. There were really two choices the Postal
12 Service had. One was updating its numbers like you asked
13 them to do which it refused to do, and not having a
14 settlement.

15 It's easy to speculate, but we could guess that it
16 would probably be somewhere around \$2 billion or \$2.5
17 billion a year more that they would have asked for once
18 September 11th happened. The Governors approved the rate
19 case on September 11th which is somewhat ironic.

20 COMMISSIONER GOLDWAY: Yes.

21 THE WITNESS: And the big news, know that they're
22 going to get a buy with a much lower price increase for a
23 period of probably 15 to 25 months. The Postal Service had
24 its arm twisted and agreed to not file for another rate case
25 prior to September of this year. And they also were pushed

1 back to not implement rates on June 1.

2 I view it as taking advantage of a desperate
3 situation. Now that you have set a hearing schedule and are
4 there, I don't think there's anybody in their right mind
5 could back out of the settlement because they recognize that
6 if this thing were to go the Postal Service stands the risk
7 of not being able to remain solvent over the summer months.

8 So I think the Commission has total discretion.
9 In R-94 we attempted to have a settlement. A lot of people
10 signed on. I picked the 10 percent revenue requirement, a
11 little extra actually because we wanted to round it off to
12 three cents. And we had lots of people agree to do that.
13 And when the Commission issued its order it issued it
14 differently than we had proposed it. And frankly I'm
15 grateful because they managed to cut a month and a half off
16 the time schedule and that gave the Postal Service the
17 momentum to really get a jump start to go on and do some
18 great things over the next four years.

19 So I for one was absolutely grateful and not
20 entirely certain we had were able to accomplish the
21 wonderful things we did if the Commission hadn't chosen to
22 act differently than we expected they would and act faster
23 than the normal ten months requirement. I'd encourage you
24 to do the same thing in this case, to issue a decision
25 before the end of March, and frankly, to take the 80 percent

1 pass-through which is going to give more than a billion
2 dollars a year to the Postal Service and get them at least
3 halfway to where they need to be.

4 COMMISSIONER GOLDWAY: Thanks for that answer.

5 CHAIRMAN OMAS: Ms. Catler? Would you like some
6 time with your witness prior to cross-examination?

7 MS. CATLER: I see no need for that at this time.
8 Thank you very much.

9 CHAIRMAN OMAS: Thank you, Mr. Riley, that
10 completes your testimony here today. We appreciate your
11 appearance and your contribution to our record. Thank you
12 and you're now excused.

13 (Witness excused)

14 That concludes the hearing today, and we stand
15 adjourned.

16 (Whereupon, at 2:25 p.m. the hearing was
17 adjourned.)

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REPORTER'S CERTIFICATE

DOCKET NO.: R2001-1
CASE TITLE: Postal Rate and Fee Changes
HEARING DATE: January 14, 2002
LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission.

Date: January 14, 2002

Tamica Northcutt

Official Reporter

Heritage Reporting Corporation

Suite 600

1220 L Street, N.W.

Washington, D C. 20005-4018

