

Revised 2/25/2001

RECEIVED

FEB 25 4 03 PM '02

POSTAL RATE COMMISSION
OFFICE OF THE CLERK

USPS-SRT-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

SURREBUTTAL TESTIMONY
OF
JOSEPH D. MOELLER
ON BEHALF OF
THE UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

	Page
Autobiographical Sketch	1
I. Purpose and Scope of Testimony	3
II. First-Class Mail Settlement Proposal	3
III. Summary of APWU Opposition	5
IV. Good Rate Design is Not a Mechanistic Application of One Principle..	6
A. Passthroughs Greater Than 100 Percent Are Not Unprecedented	7
B. Good Public Policy Requires the Consideration of Relevant Pricing Considerations.....	9
C. The Settlement Rates Are Consistent with the Statutory Ratemaking Criteria.....	11
V. The Settlement Rates Appear to Meet Witness Riley's Stated Rate Design Goal of Comparable Unit Contributions	12
VI. The Commission Should Recommend the Settlement Rates.....	13

Autobiographical Sketch

1 My name is Joseph D. Moeller. I am currently serving as Manager,
2 Classification and Product Development in the Headquarters Marketing
3 Organization of the Postal Service. I joined the Postal Service in 1987 as a Staff
4 Economist in the Rate Studies Division of the Office of Rates, and subsequently
5 worked as a Marketing Specialist for Advertising Mail in Product Management,
6 and as an Economist in Pricing.

7 I have testified on behalf of the Postal Service in several Postal Rate
8 Commission proceedings. In Docket No. R90-1, I presented direct testimony
9 regarding second-class (now termed Periodicals) and third-class (now termed
10 Standard Mail) presort-related and shape-related cost differentials. I also
11 presented rebuttal testimony in that proceeding regarding the third-class
12 minimum-per-piece rate structure. In Docket No. MC93-1, I presented cost
13 estimates and proposed rates for the Bulk Small Parcel Service. I offered
14 testimony in support of the Postal Service's proposals for Standard Mail (A) in
15 Docket No. MC95-1, and in Docket No. MC96-2, Nonprofit Classification Reform.
16 In Docket No. R97-1 and Docket No. R2000- 1, I presented the rate design for
17 Standard Mail (A). In this Docket, I presented testimony on rate policy (USPS-T-
18 29) and Standard Mail Regular and Nonprofit rate design (USPS-T-32).

19 My previous experience includes work as an Industrial Engineer for the
20 Batesville Casket Company of Hillenbrand Industries. My responsibilities
21 included time study analysis of indirect labor. I received a Master of Science

- 1 Degree in Management in 1986 and a Bachelor of Science Degree in Industrial
- 2 Management in 1983 from Purdue University.

1 **I. Purpose and Scope of Testimony**

2 In response to the testimony of American Postal Workers Union, AFL-CIO
3 witness Michael J. Riley (APWU-T-1), I explain why the Postal Service's First-
4 Class Mail rate design (even as modified in the settlement agreement) in this
5 Docket is consistent with sound ratemaking practice, the criteria of the Postal
6 Reorganization Act, and prior Postal Rate Commission precedent. I also explain
7 how, under the settlement rates, unit contribution to institutional costs for
8 workshared mail exceeds that of non-workshared First-Class Mail, thereby
9 satisfying Mr. Riley's guideline that the former be no less than the latter.

10 There are no Library References or workpapers associated with this
11 testimony.

12

13 **II. First-Class Mail Settlement Proposal**

14 On September 24, 2001, Postal Service witness Robinson (USPS-T-29)
15 proposed a set of First-Class Mail rates for implementation in the Docket No.
16 R2001-1 test year. Her testimony explains how those rates are in accord with
17 established ratemaking principles. Following extensive discussions, the Postal
18 Service and other intervenors in this Docket have reached an agreement that
19 proposes a settlement of the issues raised in this Docket. This settlement
20 proposal has been submitted to the Postal Rate Commission and the concurring
21 parties have requested a Recommended Decision consistent with the terms and
22 conditions of a Stipulation and Agreement that makes very minor adjustments to

1 the originally requested rates and classifications.¹ As explained in the Stipulation
2 and Agreement, the 56 supporting parties agree that the rates and classifications
3 “represent[] a negotiated settlement of the Postal Service’s Request for
4 recommendations on changes of postal rates, fees and classifications.”² The
5 only party opposing settlement is the APWU, which sponsored the testimony of
6 witness Riley (APWU-T-1).

7 Compared to the Postal Service’s September 24, 2001, Request, the
8 Stipulation and Agreement makes minor changes in First-Class Mail rates.³ The
9 differences are summarized in Table 1 below.

¹ See, Motion of the United State Postal Service Submitting Second Revised Stipulation and Agreement and for the Establishment of a Preliminary Procedural Mechanism and Schedule (December 17, 2001). Although the Stipulation and Agreement was further revised on December 26, 2001, and on January 17, and February 13, 2002, those further revisions did not pertain to First-Class Mail rate design.

² Stipulation and Agreement at 1.

³The Stipulation and Agreement also makes minor changes to the rates and classifications in the Postal Service’s Request for Periodicals, Standard Mail, and Package Services. No party opposes these changes.

1
2

Table 1
First-Class Mail Rates

	Requested (USPS-T-29)	Settlement
<u>Letters and Sealed Parcels Subclass</u>		
Qualified Business Reply Mail Letters	34.5	34.0
3-Digit Automation Letters	29.4	29.2
5-Digit Automation Letters	28.0	27.8
<u>Cards Subclass</u>		
Qualified Business Reply Mail Cards	20.5	20.0

3

4 Lastly, the Stipulation and Agreement incorporates an expected
5 implementation date of no sooner than June 30, 2002, considerably before the
6 implementation date originally foreseen by the Postal Service in its Request.

7

8 **III. Summary of APWU Opposition**

9 In his testimony, APWU witness Riley does not challenge the worksharing
10 cost avoidance estimates of Postal Service witness Miller (USPS-T-22). Mr.
11 Riley "propose[s] that the Postal Rate Commission adopt discounts for First-
12 Class automated and presort mail of 80 percent to 100 percent of the estimated
13 costs avoided by the Postal Service." Tr. 12/4864. He argues that any discounts
14 based on worksharing cost avoidance passthroughs of greater than 100 percent -
15 - such as those proposed by Postal Service witness Robinson (USPS-T-29), or
16 those incorporated in the Settlement Agreement -- "violate good management
17 practice and are disruptive to the long-term financial interests of the Postal
18 Service." Id. Witness Riley also criticizes the settlement rates as violating his

1 stated principle that the unit contribution to institutional cost for both workshared
2 and non-workshared First-Class Mail should be equivalent. Tr. 12/4856.

3 To the contrary, as I explain below, the Postal Service's requested rates
4 (even as modified by the settlement agreement) are consistent with the statutory
5 rate-making requirements of section 3622(b) of the Postal Reorganization Act,
6 sound rate-making principles, and past Postal Rate Commission precedent.

7

8 **IV. Good Rate Design Is Not A Mechanistic Application Of One Principle**

9

10 In its Docket No. R87-1 Recommended Decision, the Postal Rate

11 Commission explained its approach to rate design:

12 [4000] . . . Developing rate recommendations in an omnibus rate
13 case involves balancing a great number of factors to derive literally
14 thousands of rates which all must qualify as fair and equitable. Some of
15 these factors are complementary, but others are less so -- there are valid
16 reasons for restraining rate increases for all classes of mail, and arriving at
17 a balanced recommendation is an iterative process.

18 [4001] There is no single set of rates which is so "right" that any
19 deviation from it would produce rates which would be unlawfully unfair or
20 inequitable. But the task of developing a single set of rates which all meet the
21 test of being consistent with the numerous policies set out in the Postal
22 Reorganization Act requires innumerable value judgments.

23 PRC Op., Docket No. R87-1 at 360. The Postal Service's requested rates,
24 including the First-Class Mail rates proposed by witness Robinson (USPS-T-29),
25 were based on a careful consideration of the many factors surrounding the
26 thousands of rates requested consistent with the Postal Rate Commission's
27 stated approach to rate design. Following the Governors' decision to file the
28 Docket No. R2001-1 Request, unprecedented national events, including the
29 terrorist attacks at the World Trade Center and at the Pentagon, and the use of

1 the mails for acts of biological terrorism, have substantially changed the world in
2 which the postal community finds itself. As the Presiding Officer recognized,
3 “unique and unprecedented challenges are facing the Postal Service” suggesting
4 that “cooperative efforts to promptly resolve issues through a settlement might be
5 the right course of action.” Tr. 1/39-40. As a result, the Postal Service
6 coordinated discussions among the intervenors in the current case. The product
7 of those discussions is the filing of a nearly unanimous settlement agreement
8 that has been embraced by a broad coalition of intervenors, including postal
9 service users, mailer organizations, the Office of the Consumer Advocate, and
10 postal competitors – entities whose diverse postal and economic interests often
11 are diametrically opposed. The variety of interests supporting the proposed
12 settlement serves as a barometer of its reasonableness, and of the gravity of the
13 circumstances that have brought together such a diverse coalition.

14 It would be poor public policy for the Postal Service to refuse to consider
15 minor alterations to its September 24, 2001, Request, in the belief that the
16 originally requested rates were the mythical “single set of rates that is so ‘right’
17 that any deviation from it would be . . . unlawfully unfair or inequitable.”
18 Conversely, it would be poor public policy to dismiss the broadly supported
19 Settlement Agreement based on witness Riley’s narrow approach to rate design.

20

21 **A. Passthroughs Greater Than 100 Percent Are Not Unprecedented**

22 APWU witness Riley proposes that First-Class Mail worksharing discounts
23 be set at 80 to 100 percent of USPS witness Miller’s (USPS-T-22) estimated cost

1 avoidances. He claims that “[t]he Postal Rate Commission has consistently
2 encouraged rates that pass through no more than the calculated savings within a
3 sub-class.” APWU-T-1 at 17; Tr. 12/4855.

4 The Postal Service understands the Postal Rate Commission’s general
5 goal of promoting economic efficiency by setting discounts equal to avoided
6 costs (USPS-T-29 at 9-10); however, in past cases, the Commission has
7 considered a variety of other factors in its determination of the appropriate
8 passthroughs for various workshare discounts. The result has sometimes been
9 passthroughs either significantly above or significantly below estimated cost
10 avoidances, in circumstances where the Commission considered this to be
11 warranted.

12 A review of prior Commission decisions indicates that the Commission has
13 considered factors such as large changes in the results of cost avoidance
14 studies, concern about the impact of rate changes on mailers, concern over the
15 impact of reductions in workshare discounts on the automation program and
16 concern with appropriate rate relationships.

17 For instance, the Commission has recommended passthroughs greater
18 than 100 percent out of concern for the impact of proposed rate increases on
19 mailers. Two recent examples from Docket No. R2000-1 are analogous to the
20 situation at hand. In the first such instance, regarding Standard Mail Enhanced
21 Carrier Route (ECR) and Nonprofit Enhanced Carrier Route (NECR), a 100
22 percent passthrough of the letter/flat differential would have meant significant

1 rate increases for certain categories in NECR. The Commission ultimately
2 concluded that its:

3 recommended treatment of the letter/flat differentials varies from retaining
4 the current percentage passthroughs to passthroughs greater than 100
5 percent to avoid rate shock in adversely affected rate categories.

6
7 PRC Op. R2000-1 at 331.

8
9 The Commission faced the same issue as it designed rates for Automation
10 flats in Standard Mail. There, the Commission concluded that:

11 To avoid undue rate increases for automation flats, and to recognize that
12 the value of these flats will likely be higher in the test year than the Postal
13 Service anticipates in its filing, the Commission recommends the Postal
14 Service's proposed letter/flat passthrough and passthroughs greater than
15 100 percent for automation flats.

16
17 PRC Op. R2000-1 at 349-50. The impact of rate increases on mailers is a factor
18 in postal rate design that should not be ignored. In my opinion, the settlement
19 rates reflect appropriate consideration of this important criterion.

20

21 **B. Good Public Policy Requires the Balancing of Relevant Pricing**
22 **Considerations**

23
24 In his discussion of the Postal Service's First-Class Mail rate design (as
25 modified by the Settlement Agreement), witness Riley focuses solely on cost-
26 based arguments. Although consideration of costs is obviously an important
27 aspect of ratemaking, and should be accorded significant weight, one should not
28 be blind to the other relevant considerations embodied in the ratemaking criteria
29 set forth in the Postal Reorganization Act.

30 For example, on cross-examination, APWU witness Riley was unable to
31 identify the resulting percentage rate increases for each First-Class Mail rate

1 category implied by application of his prescribed passthrough percentages. Tr.
2 12/4930. Percentage change calculations are a key consideration when
3 evaluating Criterion 4 of section 3622(b). Mr. Riley's acknowledgment that he
4 had not calculated the percentage changes when he appeared before the
5 Commission implies no consideration was given to section 3622(b)(4). In fact, in
6 response to USPS/APWU-T1-7(d), Mr. Riley states that he is "not proposing that
7 the Commission set rates by looking at the percentage change in any rate
8 category." Tr. 12/4896. The Postal Service certainly agrees that percentage
9 change should not be the sole basis for setting rates, if that is what Mr. Riley is
10 stating. However, while advocating the general principle that "[g]ood economics
11 and good public policy require a limit of discounts to a maximum of cost avoided"
12 (Tr. 12/4855), witness Riley fails to consider other factors that should and must
13 be considered in postal ratemaking.

14 For instance, had Mr. Riley calculated his proposed percentage change
15 for First-Class Mail 5-digit automation letters before testifying, he would have
16 known then that, under his 100 percent passthrough scenario, he is proposing a
17 16.1 percent rate increase. And, under his 80 percent passthrough scenario, he
18 is proposing a 22.0 percent increase.

19 Another troubling concern with Mr. Riley's testimony is the implication of
20 the strict adherence to, and limited application of, the principles he espouses.
21 While Mr. Riley's testimony only addresses First-Class Mail, the rigid adherence
22 to the 80 percent to 100 percent passthrough has implications for many other
23 classes. There are a variety of circumstances in this filing where passthroughs

1 exceed or fall below the 80 to 100 percent parameters set out by Mr. Riley.
2 While he does acknowledge that there might be some instances where even his
3 approach may be tempered, he fails to provide any indication of when and where
4 such temperance should occur. As such, the Commission is left with a
5 mechanistic approach that has unwanted consequences for other classifications.

6
7 **C. The Settlement Rates Are Consistent with the Statutory**
8 **Ratemaking Criteria**

9
10 The rates reflected in the Stipulation and Agreement, resulting from minor
11 changes to the rates originally requested by the Postal Service, are consistent
12 with the ratemaking criteria. The proposed settlement does not materially alter
13 the rate levels for the various subclasses, or the relationships among them, when
14 compared to the Postal Service Request. The 0.2-cent adjustment in two of the
15 requested First-Class Mail automation rates proposed as part of the settlement
16 results in a relatively small reduction in First-Class Mail revenue from workshared
17 pieces. The implicit cost coverages presented in my direct testimony (USPS-T-
18 28) were 294.1 percent for "presort and automation letters" and 176.1 percent for
19 "single piece letters and sealed parcels." Exhibit USPS-28B. This large gap
20 would barely budge if the settlement rates were substituted for the proposed
21 rates.⁴

⁴ Although a volume forecast and rollforward have not been presented for the rates resulting from the Stipulation and Agreement, the relatively small reduction in expected revenue from workshared letters would not significantly change the implicit coverage. However, for illustration, if \$80 million were subtracted from the TYAR revenue (without any volume effect), the implicit cost coverage for workshared letters would be 292.7 percent.

1 The larger resulting discounts for some categories in First-Class Mail can
2 be justified in light of further consideration of section 3622(b)(4), in that the
3 adjustments in the settlement agreement help temper the rate increases for
4 these categories. Such accommodation is not unreasonable, especially when
5 the Commission considers the expected advancement of the Docket No. R2001-
6 1 implementation date as a part of the settlement agreement, in combination with
7 the recency of the two Docket No. R2000-1 rate increases experienced by
8 workshared First-Class Mail in calendar year 2001. Consideration of such
9 factors also appears consistent with the Commission's authority under section
10 3622(b)(9).

11

12 **V. The Settlement Rates Appear to Meet Witness Riley's Stated Rate**
13 **Design Goal of Comparable Unit Contributions**

14
15 Mr. Riley claims that, in rate design, "the primary focus should be on the
16 absolute contribution per piece, not the percent markup." Tr. 12/4855. He
17 further states that contribution for a piece should be measured "so that the
18 contribution of any piece will be the same regardless of in which rate category in
19 the subclass that piece enters the mail stream." Tr.12/4852. Interestingly,
20 available data indicate that the originally proposed rates, and the settlement
21 rates, come closer to meeting this objective than do Mr. Riley's alternative rates.
22 Under the Postal Service's original Docket No. R2001-1 request, the TYAR
23 contribution per piece for single piece First-Class Mail is 20.18 cents; for
24 workshared First-Class Mail it is 20.56 cents. Tr. 7/1546. The settlement rates
25 would lower the contribution per piece for workshared mail, but the contribution

1 would still exceed the single piece contribution, and would appear to meet the
2 objective of making unit contributions more comparable, which Mr. Riley seems
3 to advocate.⁵ The Postal Service by no means believes that rate design should
4 be driven by a desire to equalize unit contribution, as measured by CRA-type
5 cost differences. At the same time, as indicated by witness Robinson (USPS-T-
6 29 at 13), these data can provide meaningful information. As the only measure of
7 unit contribution in the filing, the data suggest the proposed and settlement rates
8 are reasonable.

9

10 **VI. The Commission Should Recommend the Settlement Rates**

11 In response to the encouragement of Chairman Omas, the settlement
12 rates are the result of a good-faith effort by almost "everyone connected with this
13 process -- to be statesman-like and to work together to proactively meet the
14 serious challenges facing the postal system." See Tr. 1/42. Although the wide
15 support among intervenors is indicative of the reasonableness of the settlement,
16 the resulting rates also are fully compliant with the Postal Reorganization Act,
17 and should be recommended by the Commission.

⁵ The higher rates for workshared mail proposed by Mr. Riley would move the relative unit contribution figures further apart.