

UNITED STATES OF AMERICA
Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Customized Market Mail)
Minor Classification Changes)

Docket No. MC2003-1

INITIAL BRIEF OF THE
OFFICE OF THE CONSUMER ADVOCATE

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TABLE OF CONTENTS

PROCEDURAL HISTORY 2

I. USPS Request..... 2

II. OCA Motion 2

SETTLEMENT 4

TERMS AND CONDITIONS OF THE PROPOSED CMM STANDARD
MAIL OPTION 5

POSITION OF OCA..... 7

MINOR CLASSIFICATION STANDARDS PROVIDE A THRESHOLD BUT
THE USPS MUST MEET THE POSTAL REORGANIZATION ACT
REQUIREMENTS..... 9

SUMMARY OF ISSUES 15

THE RECORD IS DEVOID OF COST, VOLUME AND REVENUE DATA
AND DOES NOT SUPPORT A FAVORABLE RECOMMENDATION 16

I. There are no cost estimates 17

II. There are no volume estimates 25

III. There are no revenue estimates 27

THE RECORD DOES NOT SUPPORT A FINDING THAT THERE IS A
DEMAND FOR CMM AT A RATE THAT WILL RECOVER COSTS 29

CONCLUSION ON DEFICIENT COST, VOLUME AND REVENUE
ESTIMATES 31

CONCLUSION..... 34

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The Office of the Consumer Advocate ("OCA") hereby submits its Initial Brief in this proceeding pursuant to the ruling of the Presiding Officer.¹ Reply briefs are due to be filed by May 15, 2003.

The Commission should reject the CMM Request, because the USPS is unable to provide cost, volume and revenue data to support the permanent CMM mailing option classification. Also, the OCA is not a signatory to, and is opposed to, the Stipulation and Agreement filed by the United States Postal Service ("USPS")² purporting to settle all issues raised in this proceeding.

¹ "Presiding Officer's Ruling on Procedural Schedule," Ruling No. MC2003-1/1, April 23, 2003.

² "Motion of the United States Postal Service for Consideration of the Stipulation and Agreement as the Basis for Recommended Decision," April 30, 2003.

PROCEDURAL HISTORY

I. USPS Request

The USPS filed a formal Request in this proceeding on March 14, 2003 pursuant to 39 U.S.C. § 3623 proposing a new permanent Standard Mail option styled Customized Market Mail ("CMM")³ The request was filed pursuant to the Commission's minor classification rules, 39 CFR §3001.69-69c. Concurrently, the USPS requested waiver of certain filing requirements and requested expedited consideration and issuance of a Commission recommended decision regarding the USPS Request. The Commission noticed the filing and established initial procedures.⁴ The order appointed Shelley S. Dreifuss, Director of OCA, to represent the interest of the general public, authorized settlement discussions and appointed the USPS as settlement coordinator. The order further scheduled a prehearing conference which was held April 9, 2003.

II. OCA Motion

The OCA opposed the USPS motions for waiver and expedition of the proceedings and countered with motions to reject the request to utilize the minor classification rules, suspend the proceedings and to provide the USPS the opportunity to refile its Request.⁵ The OCA contended that in view of the nonexistence of supporting data in the Request, the USPS ought to seek a temporary service and that

³ "Request of the United States Postal Service for a Recommended Decision on Customized Market Mail Minor Classification Changes," Docket No. MC2003-1.

⁴ "Notice and Order on Filing of Request for Expedited Decision on Minor Classification Change Implementing Customized Market Mail," Order No. 1365, March 19, 2003.

⁵ "Office of the Consumer Advocate Response to Motions for Waiver, Expedition, and Settlement Procedures and Motions to Reject Request to Apply Minor Classification Rules, Suspension of Proceedings, and to Defer the Time to Request Hearing," April 3, 2003.

the USPS should be given an opportunity to offer additional quantitative support for its Request.⁶

Pursuant to the Commission's Order No. 1365, settlement discussions were held on April 9, 2003, immediately prior to the prehearing conference. The time for requesting a hearing was deferred until April 19, 2003, pending a Commission ruling upon the OCA motions.

Commission Order No. 1368 ruled on the OCA motions.⁷ The order determined that the USPS Request is to be conducted under the minor classification rules, as filed, and granted the USPS waiver of certain filing requirements, as requested. Significantly, Order No. 1368 granted OCA's motion that, "notwithstanding the use of procedures applicable to requests for minor classification cases," the OCA should be permitted to contend in this proceeding "that the request should be rejected on the grounds that required data has not been provided by the Postal Service...."⁸ This ruling is significant in that, otherwise, because the USPS has filed limited data pursuant to the minor classification rules, and the Commission has granted waiver for certain other filing requirements, the rules provide that unless otherwise demonstrated, a participant might be precluded from contesting the application on the grounds that the USPS had failed to

⁶ Support for the OCA motions was filed by Valpak. The Postal Service filed in opposition on April 10, 2003, "United States Postal Service Answer in Opposition to Office of the Consumer Advocate Motions to Reject Request to Apply Minor Classification Rules, Suspension of Proceedings, and to Defer the Time to Request Hearing."

⁷ "Order on Application of Rules for Minor Classification Changes," Order No. 1368, April 14, 2003.

⁸ Order No. 1368, Ordering paragraph 4. OCA has moved for permission to contend that the Postal Service's minor classification request should be rejected on the grounds that the required data was not provided by the USPS.

file the appropriate data. In granting the motion, the Commission tacitly agreed, as provided in its rules,⁹ that the OCA demonstrated the USPS was unreasonable in the first place in failing to provide the information in support of its Request, even though the Commission did grant a waiver.

No participant requested a hearing in this case. Consequently, pursuant to the Presiding Officer's Ruling No. MC2003-1/1, the time for discovery on the USPS's direct case was completed and the date for briefs was established.¹⁰

SETTLEMENT

The USPS filed a settlement with the Commission on April 30, 2003 which was signed by a number of the parties herein, but not all.¹¹ OCA has explained to the USPS that it is unable to participate in the settlement due to the lack of cost, volume and revenue data in the record and the inability of the USPS (or of the OCA) to determine the costs for CMM satisfactorily and with reasonable assurance or that the service will recover its costs. The OCA is pleased the USPS agreed in the settlement document to collect CMM volume data, but without a concomitant commitment to make an effort to compile cost data for CMM by the next rate proceeding, there is insufficient protection for mailers and no assurances that the Postal Reorganization Act requirements will be met.

⁹ §3001.69a(b).

¹⁰ "Presiding Officer's Ruling on Procedural Schedule," Ruling No. MC2003-1, April 23, 2003.

¹¹ It is OCA's understanding that Valpak opposes the settlement and will file a brief opposing the Request.

TERMS AND CONDITIONS OF THE PROPOSED CMM STANDARD MAIL OPTION

The new CMM option is designed to permit the mailing of nonrectangular shape mail weighing 3.3 ounces or less in the basic nonletter categories of Standard Mail Regular and Nonprofit subclasses. The CMM pieces are limited in size to a thickness of .007 to .75 inches.¹² The pieces are not required to have a consistent thickness but “would have to be counterstacked when packaged to ensure stability in transit.” (Ashe at 11.) The length must be at least 5 inches and no more than 15 inches. The width must be at least 3.5 inches and no more than 12 inches measured as specified by the USPS. (Proposed DMCS 321.22 and 323.22.)¹³ The piece must be sufficiently flexible for normal handling for casing and delivery and folding or rolling to fit in a small mail receptacle such as a post office box but there are no limitations on material other than safety. (Ashe at 10-11.)

The CMM piece must be physically entered at the destination delivery unit (DDU) although it may be verified at upstream plants (Ashe at 7) and postage verification may be performed under the plant-verified drop shipment program (PVDS) or at the DDU. The mailer may send the CMM pieces to the DDU via Priority or Express Mail. (Ashe at 7.) Current standards for minimum volume would apply to the entire mailing rather than to the amount delivered to each DDU. (*Ibid.*) CMM pieces must be prepared in appropriate containers other than sacks. (Ashe at 8.) Box or envelope drop shipment containers are limited to three distinct sizes per mailing. (Ashe at 10.)

¹² Nonrectangular pieces between 1/4 and 3/4 inches thick are already mailable but for them there is currently no CMM option with optional entry and handling procedures (Ashe at 11, note 4; 13, l. 13-17)

¹³ Request, Attachment A at 2 and 4.

The CMM Regular rate is the nondestination basic nonletter rate (34.4 cents) plus the residual shape surcharge (RSS) (23 cents) for a total fixed rate of 57.4 cents per piece. A lower rate for nonprofit mail applies.¹⁴ CMM must be entered at the DDU. CMM is not eligible for either the barcode or destination entry discounts. Also, the nonmachinable surcharge does not apply.

Most services are not available to CMM mailpieces: no First-Class Mail attachments or enclosures are permitted (DMCS 344.1) and there is no forwarding or return to sender (DMCS 353). Ancillary services (DMCS 360), such as address correction (DMCS 911.21), certificates of mailing (DMCS 947.21), bulk parcel return service, shipper paid forwarding, bulk insurance (DMCS 943.221), return receipt for merchandise (DMCS 945.221), delivery confirmation (DMCS 948.21), and Netpost Mailing Online, are not available. (See Request Attachment A at 5-7; Hope at 4.) Design approval is not required and physical and graphic content would be subject to existing standards and statutes. (Ashe at 11.)

Thus, no new rates, fees or charges are involved. CMM must be marked and bear endorsements, and meet preparation, addressing, and acceptance requirements as specified by the USPS. (DMCS 321.22 and 323.22). Additionally, the piece must bear the words "Carrier Release" to indicate the carrier may leave a deliverable CMM piece at the door. If undeliverable, the piece is not to be returned to the office for customer pick-up, but it is to be discarded. (Ashe at 12; Hope at 2.)

¹⁴ The nonprofit rate is 46 cents per piece: 23 cents basic rate plus an RSS of 23 cents.

POSITION OF OCA

It is OCA's position that the Request and other record materials including the testimony, library references, and responses to the interrogatories fail to demonstrate adequate cost, volume and revenue data to support a favorable recommendation for CMM. Even though this proceeding is a minor classification proceeding pursuant to the Commission's rules which were established to enable expedited treatment for classification proposals of limited impact, the OCA believes that the Commission must require and maintain minimum standards of evidentiary support for classification proposals, even those pursued as minor classification proposals with purportedly limited impact.

The record in this case is devoid of any quantitative analysis that could reasonably be considered probative of the underlying requirement that the new optional service will operate so as to provide a contribution to institutional costs. The net effect is that the Commission is being asked by the USPS to recommend a service that very well may not contribute to institutional costs and likely will not.

Most surprisingly, in the USPS's view, it does not make any difference whether or not the USPS has provided sufficient evidence to demonstrate that CMM will provide a contribution because, as a minor classification case where the impact is not likely to be substantial, the service need not break even. (USPS Response to OCA Motion at 3)

OCA's dominant concern about the USPS's decision to proceed with the proposed change as a minor classification change is the fact that the rate fixed upon for the new service – 57.4 cents (the Standard Mail basic presort rate plus the residual shape surcharge) – is a rate for a grouping within Standard Mail (non-letter/non-flat) that

is heavily subsidized by other shapes of Standard Mail. (Tr. 2/80-84; OCA/USPS-T1-29(c), (d).) Because of concerns about rate shock to the residual-shape mailers, the Commission is moving very slowly toward setting a surcharge that fully reflects the costs of handling this type of mail. It would be imprudent to encourage additional new volume of non-letter/non-flat mail that does not pay a rate high enough to cover its costs and that would impose an additional burden on other shapes of Standard Mail. Without a credible cost estimate for this irregularly shaped, DDU-entered mail, particularly one that demonstrates that the unit cost for handling this mail is well under 57.4 cents, OCA must protest serious consideration of this proposal for recommendation as a new service.

It is important to bear in mind that if the minor classification change is made as requested by the USPS, the USPS is not likely (nor has it proposed) to analyze separately for future ratemaking proceedings the unique costs of CMM. It is possible that the new CMM service will not cover its costs and will exacerbate an already undesirable situation, *i.e.*, that non-residual-shape pieces have to pay even higher rates than they are already paying for the current residual-shape mailstream.

The harm is compounded by making the change a permanent one. At least under market test, provisional, or experimental rules, the costs may be studied and isolated so that a determination can be made whether an existing rate covers the costs of the new service. If a permanent classification is now established, the Commission will not have sufficient data to ascertain whether this new mailstream covers its costs and contributes additional institutional cost or is a new burden imposed on other

mailers. Without a credible cost estimate for CMM, the Commission is unable to fulfill its duty under §3622(b) of title 39.

OCA's position on CMM does not imply that OCA opposes the text of the classification language. If, hypothetically, the USPS had filed cost estimates for the new CMM mailstream, had submitted its request under rules for the temporary establishment of a new service, and had agreed to take reasonable steps to measure the costs of CMM during the period of temporary implementation, then OCA acknowledges that the classification language itself is reasonable. The OCA supports USPS efforts to introduce eligibility for CMM.¹⁵ The OCA acknowledges that the proposed changes would be beneficial to some advertising mailers in that CMM relaxes existing restrictions to accommodate novel mail pieces. By requiring dropshipment to, or entry at, the DDU, the OCA believes that the USPS designed CMM to have minimal presence in mail processing operations.

MINOR CLASSIFICATION STANDARDS PROVIDE A THRESHOLD BUT THE USPS MUST MEET THE POSTAL REORGANIZATION ACT REQUIREMENTS

The Commission ruled in Order No. 1368 that this docket will be conducted under the rules for minor classification changes, 39 CFR 3001.69-69c. As the Commission noted in the order, the minor classification rules have heretofore been untested. The Commission determined that the USPS Request met the three-part threshold showing necessary to obtain permission to proceed under the minor classification rules. That three-part showing is: 1. there appears to be technical

¹⁵ With the understanding that OCA could only endorse such a proposal as a temporary service and with reasonable cost measurement.

compliance with the requirement that the proposal does not involve a change in rate or fees; 2. the proposal does not impose any additional restriction on basic conditions of eligibility for a subclass or category; and 3. the change does not significantly increase or decrease estimated institutional cost contribution. The Commission concluded that these criteria were met and that, if the USPS evidence is found probative, the CMM change is minor and will have an extremely limited impact on institutional cost contribution. OCA submits, however, that the showing is only of a threshold nature. That is, the USPS met the standards required to evaluate CMM as a minor classification change but, significantly, has not necessarily met the standards for a favorable recommendation under the Postal Reorganization Act.

The Request must be consistent with §3622 of the Postal Reorganization Act to obtain a favorable recommendation. The Commission noted in Order No. 1368 that "it is not responsible for assuring that the USPS sustains its burden of proof." (Order No. 1368 at 5.) The USPS burden is to make a broader showing than to demonstrate the service will have only a minor impact upon the institutional cost contribution. Meeting the minor classification rules merely permitted the USPS to proceed with the procedural advantages of the rules such as limited data filing requirements and expedited procedures.

Nowhere in the rules or in the Commission's order adopting the final rules¹⁶ is there any suggestion that the procedural advantages of the minor classification process also confers any special rights to the USPS that would defer or suspend the substantive requirement to demonstrate CMM is consistent with the Postal Reorganization Act. In

¹⁶ *Rules of Practice and Procedure*, Docket No. RM95-4, Order 1110, "Order Adopting Final Rules," May 7, 1996.

fact, the Commission's order adopting the minor classification rules specifically stated, "Furthermore, in applying the rules the Commission will be bound, as always, by the requirement in §3622(b)(3) to recommend rates that recover estimated costs and contribute to the institutional costs of the Postal Service." (Order No. 1110 at 6.) If the proposed rates do not do so, then the Commission may in appropriate circumstances recommend alternative rates.¹⁷

The order adopting the minor classification rules specifically discussed the problem of non-compensatory services upon other postal ratepayers. In response to comments, the Commission agreed "that new services adopted to meet competitive or other perceived needs *must* be offered at compensatory rates, and cannot be allowed to become a revenue burden on other categories of mail." (Emphasis supplied, Order No. 1110 at 5) The Commission went on to note that in order to prevent such results, the rules should be applied "in a manner that will avoid this potential harm." (*Ibid.*) Although minor classification changes may only have minor impact, the Commission may not ignore the Postal Reorganization Act requirements.

The unequivocal statements of the Commission in Order No. 1110 – that new services established through the minor-classification mechanism (Rule 69) must be offered at compensatory rates and that the rates of such services must satisfy the §3622(b)(3) requirement of recovering estimated incremental costs and contributing to institutional costs – demonstrate that the USPS has seriously misconstrued the language of Rule 69(a)(3). In its answer to OCA's Motions, the USPS maintains that:

¹⁷ See *Bulk Small Parcel Service, 1992*, "Opinion and Recommended Decision," Docket No. MC93-1, August 25, 1993 at 12-13.

the expedited rules are not off limits simply because a participant alleges that a Request might yield an insignificant negative contribution. Indeed, the expedited rules expressly contemplate that a classification proposal having a negative effect on contribution would still be eligible to received expedited treatment under the minor classification change rules as long as the effect on contribution is insignificant. (USPS Answer at 3.)

The USPS appears to hold the view that if it had made an explicit statement in its Request that CMM would generate a loss, but only a small one, and that the rates of the new service would not cover the costs of providing the service, that the USPS might still avoid a summary rejection of the Request under Rule 69. This construction is flatly wrong, as indicated by the Commission in Order No. 1110. The Commission lacks the authority to promulgate rules that violate principles established for classification and ratemaking in the Postal Reorganization Act. Rule 69 *cannot* stand for the proposition that the Commission may recommend a new classification under §3623 that is in conflict with §3622(b)(3).

The only reasonable method of interpreting the Rule 69(a)(3) language that a minor classification change “would not significantly . . . decrease the estimated institutional cost contribution of the affected subclass or category” is to place it in the context of the Commission’s traditional articulation of how prices are set to recover institutional costs. In its Docket No. R2001-1 Opinion and Recommended Decision,¹⁸ the Commission explained:

[T]o enable the Postal Service to break even, the recommended rates must also be adequate to recover the Postal Service’s . . . institutional costs. The process of assigning the institutional cost burden involves relating and ranking the various classes and types of mail

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¹⁸ PRC Op. R2001-1, paras. 2056 and 2058.

The Commission measures the relative cost burden borne by each class or subclass in two principal ways. Cost coverage, the ratio of revenue to attributable cost by class or subclass, provides a simple, useful measure to compare relative institutional cost burdens reflected in proposed rates. . . . [T]he Commission [also] uses a markup index, which compares the markup for each subclass to the systemwide average markup.

Viewing the language of Rule 69(a)(3) in this context demonstrates that when Rule 69 allows the possibility of an insignificant decrease in institutional cost contribution, this is to be understood as a slight reduction in a subclass' cost coverage or markup position, not an absolute loss to the subclass arising from the failure of the proposed rate to cover the costs of the new service. Any other interpretation creates a direct conflict with §3622(b)(3) and the Commission's statements in Order No. 1110.

In addition, one immediately wonders why the USPS (if it is a businesslike organization, as it so often alleges) would want to introduce a new service on a permanent basis that loses money (i.e., does not cover its costs) and generates a small loss. Certainly one would expect that a vitally important goal (other than financial soundness) would be proffered as the reason for taking such a seemingly irrational step, but the record of this proceeding contains no evidence justifying the commencement of a new service that will (or may) lose money.

The USPS's legal position – that money-losing services may be safely litigated under Rule 69, so long as only a small loss is involved – appears to have shaped its decision to present only qualitative evidence suggesting that the volume and revenue impact of the new service would be small. Up until the USPS's April 10 Opposition and witness Hope's response to interrogatory OCA/USPS-T1-29,¹⁹ the USPS never even bothered to allege that CMM would cover its costs and make a small contribution to

¹⁹ Redirected from witness Ashe, filed April 15, 2003; Tr. 2/80-84.

institutional costs. The Request itself cites witness Hope's testimony for the proposition that "CMM will not cause a significant impact on the contribution of Standard Mail toward institutional costs." (Request at 4.) Notably, this language reflects the USPS's indifference to whether the impact is positive or negative. Witness Ashe echoes this sentiment in his testimony, "As witness Hope notes, it is reasonable to conclude that implementing the classification changes associated with CMM will have no substantial effect on institutional contribution." (Ashe at 7.) Again, witness Ashe is agnostic on the question whether CMM will lose money or not. Witness Ashe seemingly interprets Rule 69 as permitting a minor classification change that decreases institutional cost contribution so long as the decrease is not significant. (*Id.* at 13, l. 9-10.)

In keeping with the view that "insignificant" losses caused by CMM are permissible under Rule 69, witness Hope not only failed to develop precise cost estimates for CMM mail, but did not even expend the effort to develop ballpark cost estimates. (Tr. 2/79; OCA/USPS-T1-13 redirected from witness Ashe.) Indeed, the only basis for the USPS's belief that CMM might cover its costs is an "implicit assumption." (*Ibid.*)

The USPS's choice to test Rule 69 in connection with irregular Standard Mail pieces that pay the RSS rate is a puzzling one. RSS is notable for its large negative cost coverage. Efforts to attract new mail volumes that stand a high chance of losing money are not easily understood. The failure to develop a cost estimate is compounded by the election to make CMM a permanent new classification. Had the USPS filed its Request under one of the rules that implement the new service only for a trial period, OCA might not have urged the Commission to reject the USPS's proposal.

Of course, even a trial implementation would have had to be accompanied by an agreement to take reasonable steps (not at a prohibitive cost) to measure the costs of the new mailstream. It is conceivable that the measurement of the costs could result in a low enough cost figure that the RSS rate would not appear to be a good fit, but excessive. OCA does not wish to see CMM charged exorbitant prices, only fair prices that comport with the principles of the Postal Reorganization Act. It is simply not possible from the complete lack of cost estimates in this proceeding to know where to set the price for CMM.

SUMMARY OF ISSUES

The issue presented by this case is whether the Commission can or ought to recommend a new permanent classification when the Commission cannot reasonably discern from the record whether the new permanent classification would either contribute to or would be a drain on institutional costs. Thus, is it ever appropriate for the Commission to approve a new permanent classification, even if there may be only a minor impact, where there is no supporting data?

The USPS response that the impact will be small sidesteps the important principle at issue here: whether the USPS ought to be engaging in fishing expeditions to enhance its services with projects that may very well drain resources. Thus, is it appropriate to recommend the service if the impact is minor and the Commission extrapolates from existing data and determines that, with its best guess, the service may not contribute to institutional costs?

THE RECORD IS DEVOID OF COST, VOLUME AND REVENUE DATA AND DOES NOT SUPPORT A FAVORABLE RECOMMENDATION

The Request does not provide the Commission with enough information to determine the impact on postal costs and revenues. Nor is it possible to determine the impact on other mail users of Standard Mail. If the CMM service is unprofitable and does not contribute to institutional costs there could be an unfavorable impact upon those Standard Mail users. There must be a minimum amount of information supplied to the Commission to approve a request for a new classification. The USPS's admitted lack of studies quantifying the impact of the service indicates that CMM is not ready for consideration as a permanent classification under the minor classification rules.

In OCA's view, the USPS has been unreasonable in failing to secure some cost, volume and revenue information. Further, without the information, the Request is materially deficient. Some level of analysis must be required. Even if detailed analysis normally done for more significant classification changes is not feasible, there must be an attempt to provide some cost, volume and revenue estimates, as practicable. In this Request, there is a total absence of any cost estimates assignable to CMM (*i.e.* the non-letter Standard mail residual shape DDU entry service) in the USPS testimony and library references submitted with the Request.

Also absent are numerical estimates of projected revenues. The USPS has not provided information "in the greatest level of detail practicable" for this record. In all likelihood, the USPS prepared an analysis for this project estimating the return on investment (ROI) at some point before the project was approved by management. But, not only is no study provided, there is not even a cursory calculation provided in the filing for the Commission to evaluate the potential for profitability of the Request. It

stretches credulity that the USPS has moved ahead with this project with no cost, volume or revenue analysis or projected ROI analysis other than that presented in the materials filed.

The USPS has not provided reasons why they have not done a market test that would provide some estimate of revenues. They have not explained why they have failed to provide the cost calculations to support the application of the residual shape surcharge being applied to CMM. Nor have they attempted to calculate the possible revenue leakage resulting from the substitution of CMM mail for current Standard Mail. USPS wants the Commission to disregard any suggestion that leakage would occur. No reasons have been given why they cannot calculate the start-up costs for this service and any other product specific overhead costs.

Studies regarding costs, volumes and revenues to support the classification change are so fundamental to an adequate record that the Commission cannot merely waive these requirements and recommend approval. The OCA has combed all of the submitted testimony, library reference USPS-LR-2, and the formal Request for cost, volume and revenue estimates offered by the USPS to support this permanent classification request. There are no numbers anywhere. Responses to interrogatories have also failed to elicit meaningful numbers. In fact, they confirm that no calculation estimates exist.

I. There are no cost estimates

Costs of the CMM service are mentioned only once by witness Hope with a conclusion unsupported by other evidence. Witness Hope testified, "application of the rates...helps to assure that the CMM price and costs are not misaligned. Given that

CMM pieces will bypass operations at the mail processing plant, from a qualitative perspective, it would appear that CMM pieces will yield positive contribution at the applicable rates." (Hope at 10, I.1-4.) Note that the perspective cited by witness Hope is qualitative rather than quantitative and it "would appear" the contribution will be positive. No numerical calculations are provided whatsoever to support even her tentative conclusion. Logically, how can any business, especially a major business such as the USPS, manage its affairs and offer a new product like CMM without quantitative data?

Witness Ashe does not testify about costs and only refers once to witness Hope's prepared testimony that "CMM will not cause a significant impact on the contribution of Standard Mail toward institutional costs." (Ashe at 14, I. 1-2.) However, upon questioning, witness Hope admitted that she is unable to provide any workpapers or data performed to determine the contribution each piece of CMM would make to institutional costs because "quantitative calculations were not performed for CMM." (Tr. 2/78; OCA/USPS-T1-8 redirected to witness Hope.) Given this admission, the credibility of witness Hope's conclusions about the contribution CMM will supposedly make to institutional costs is shown to be without foundation, undermined, and entirely discredited and thus cannot support a Commission finding that CMM will contribute to institutional costs.²⁰

The admitted total lack of studies even undermines her suggestion based upon her "understanding" of the cost of mail processing (53 cents) that will be avoided by the DDU entry of CMM. Even then, she hedged her comment and said that "much" of the

²⁰ Other testimony of witness Hope confirms that the RSS only passes through approximately 27 percent of the cost difference between flats and residual-shaped pieces. However, without further studies her "understanding" about mail processing costs is equally without foundation and, therefore, not credible. (See Tr. 2/80-84; OCA/USPS-T1-29 redirected to witness Hope)

mail processing cost will be bypassed, but the record offered by the USPS is no more specific than that. (Tr. 2/80-81; OCA/USPS-T1-29(d).) Her response also makes clear that there will be some mail processing costs for CMM but there are no studies or even estimates of the amount of those costs.

The marketing report (Library Reference LR-2) (hereafter "Report")²¹ sponsored by witness Ashe did not provide a useful discussion of costs except to highlight one USPS cost that may or may not impact contribution. The Report notes that the USPS expenses for approving CMM mailing should be free to the mailer because no one is willing to pay for such a review and this would be true even if "pilot tests" were conducted (which the USPS apparently has not done).

Also, the cost of the USPS's reviewing and approving mailings of CMM pieces was not estimated by the USPS. For instance, witness Ashe testified that no studies have been done to determine the per piece and total cost of approving the physical or graphic content of CMM. (Tr. 2/68; OCA/USPS-T1-26.) Even though design approval would not be required and the physical or graphic content must meet existing standards and statutes, (Ashe at 11.) pieces of irregular thickness must be stackable and meet other safety standards. (Ashe at 8, 11.) All of these factors must be considered by the USPS before the mail is entered at a DDU and will incur USPS mail processing costs related to CMM.

The Request points to witness Hope's vague conclusory testimony, noted above, that CMM would not cause a significant impact on the contribution of Standard Mail toward institutional costs. The potential impact on contributions from the CMM service

²¹ *The Market Potential for Customized Marketmail, Qualitative Insights*, prepared for the USPS, November 4, 2002.

are not estimated. The Request incorporates, by reference, cost assignments pertaining to classes of mail from Docket No. R2001-1. (Request, Attachment D, page 5..) The USPS reference does not provide specific citations to the record in Docket No. R2001-1 for Standard Mail cost assignments or specific exhibits or testimony and is grossly insufficient. The USPS notes that it has not prepared a "full analysis of the effects on the USPS' costs, revenues or volumes...." (*Id.*) The USPS has apparently done *no* analysis and certainly has not presented any to the Commission in this case.

The interrogatory responses from witnesses Ashe and Hope have confirmed the conclusion that there has been no cost analysis performed by the USPS. The record clearly states USPS personnel in planning CMM did not discuss or calculate the specific costs for accepting and handling CMM pieces at DDU's as compared to the costs for handling a nonletter Standard Mail piece. (Tr. 2/76-77; OCA/USPS-T1-1 redirected to witness Hope) Further, "[t]he Postal Service did not perform any analysis or studies that examined the carrier time needed to handle and deliver Customized Market Mail" (although they concluded without study that there will be no noticeable impact on handling/processing and delivery at a DDU). (Tr. 2/24-25; OCA/USPS-T1-2.) Irregular shaped, flexible pieces may require extra carrier time for handling. No estimates were made. Also, no studies have been performed to determine the per piece savings and total cost savings that would arise from discarding undeliverable-as-addressed CMM pieces. (Tr. 2/69; OCA/USPS-T1-27; See Tr. 2/24-25; OCA/USPS-T1-2.) Also witness Hope testified, "quantitative calculations were not performed for CMM," (Tr. 2/78; OCA/USPS-T1-8 redirected from witness Ashe.) and, "I have not calculated a ballpark [unit] cost figure." (Tr. 2/79; OCA/USPS-T1-13 redirected to witness Hope.)

There would be costs for implementing the service such as roll-out costs and training costs that may never be recovered. The Report in USPS-LR-2 recognizes there will be a certain amount of implementation costs. The Report says, the USPS will need to, "Educate mail acceptance clerks and carriers, iron out the delivery kinks (e.g., non-damaged placement in mailboxes), gather data on recipients' impressions and likely responses." (USPS-LR-2 at 35.) Also, the Report says the USPS must work with its sales force and business partners to ensure adequate lists of post office addresses, compile lists linking delivery addresses to DDUs, identify consolidators willing and able to handle drop shipments, educate mail houses and printers as to the new procedures, drop shipment options, and reasonable cost alternatives. (*Id.*)

At the very least, information must be provided to the DDUs for handling CMM together with some degree of training or explanation to the personnel who may be responsible for handling CMM. Even though the CMM is to be entered at the DDU at the basic Standard Mail rate which eliminates some transportation and processing costs, the amounts are not estimated by the USPS and may actually be more than offset by added carrier costs and DDU processing. All of these activities have costs. If the revenues will be as meager as the USPS suggests, there is a distinct possibility that CMM will not be profitable. CMM implementation costs cannot be insignificant when compared to the limited revenue.

Significantly, the residual shape surcharge is not likely to cover and offset any additional costs incurred by CMM service. The residual shape surcharge covers only a small fraction of the true difference in cost between presorted parcels and flats. In Docket No. R2000-1, the flat-parcel cost differential, after adjusting for the presort and

dropship differential, is 84.1 cents. (Tr. 2/80-81; OCA/USPS-T1-29(a)-(c).)²² The current residual shape surcharge of 23 cents is designed to recover some of the costs related to the shape differences, but only 27.3 percent of those costs are passed through to the mailer. (23 cents / 84.1 cents is 27.3 percent.) (Tr. 2/80-84; OCA/USPS-T1-29(d).) The Commission permitted flow-through of only a portion of the actual flat-parcel cost differential in order to mitigate the rate shock on mailers subject to the residual shape surcharge.²³ Thus, there is no excess revenue contribution available from that surcharge to ameliorate losses from excessive CMM carrier, acceptance and implementation costs.

The USPS claimed in its answer to OCA's motions, *supra*, (USPS Answer at 5) that CMM mail differs from parcels. It pointed out that parcels may weigh up to 16 ounces and CMM is limited to 3.3 ounces. CMM mail may weigh less than the average parcel but we do not know that and, even if it does, we do not know whether that weight difference, which may be very small, is significant. Also, the USPS said that CMM mail may be thinner than 1/4 inch although pieces can be up to 3/4 inches thick, suggesting CMM may be easier to handle than parcels. The thinner irregular shape mail may actually be more difficult to handle than the average thicker regular shape parcel. If CMM has no envelope and has protrusions and is irregular in thickness, CMM could very well disrupt the handling of the remainder of the mail, particularly if that mail is part of a bundle.

²² See LR-J-58, Tables 5 and 6, Docket No. R2000-1. The difference in cost between handling a Standard Mail flat and a parcel is 93.6 cents less a 9.5 cent adjustment to reflect the difference in presorting and entry profile, or 84.1 cents.

²³ "Opinion and Recommended Decision," Docket No. R2000-1 at 353; "Opinion and Recommended Decision," Docket No. R97-1 at 404.

Moreover, weight may not be the critical cost factor when measuring processing and handling costs of irregular shape pieces. Irregular shape pieces are currently permitted by the USPS, but the USPS has not provided any study measuring their processing and handling costs. CMM mail by definition may be odd shaped or unusually flexible and will likely be awkward to clutch and especially difficult to handle in even small quantities. This could cause additional handling and delivery costs that cause CMM mail to exceed the cost of handling regular shape rectangular parcels. These questions all relate to the cost of handling CMM mail versus handling parcels and the answers are simply not known by the USPS, and yet it suggests that CMM is less costly to handle than the average parcel. The record on this issue is silent and without quantitative analysis.

The USPS claims may also cut the other way as well. If CMM is not like a parcel, then why did the USPS select the RSS surcharge rate that applies to residual parcels? If the USPS claims were correct and the CMM physical characteristics were totally unlike a parcel, then the RSS surcharge may represent an arbitrary selection of a rate for CMM that does not bear an appropriate relationship to costs. The burden is on the USPS to demonstrate that the rate for the new classification is rationally related to the costs of the mail in that class. If the Commission can approve CMM on this sparse record then the USPS could request all types of new permanent mailing options and apply any existing rate (whether or not the new option relates to that rate) in order to attract one or two low volume mailers. In the end, the practice would yield a hodge-podge of confusing services at rates unrelated to actual costs and that are probably not contributing to institutional costs but draining resources and, yet, the USPS will continue

to say the classifications are too small to warrant cost analysis. It is a slippery slope indeed for the Commission to accept the USPS record as sufficient for a new permanent classification

CMM is a new mailing option. The rate charged for that option must cover its costs. As noted above, the RSS barely covers 1/4 of the flat-parcel cost differential and so does not provide for the recovery of attributable costs. While the concern for rate shock may have been relevant to the decision to set the RSS rate well below attributable costs for existing services, it should not be a factor in determining the viability of new services. Otherwise, the new service will clearly be subsidized by other users in the rate category. A new service should not be approved if the USPS can only argue that by blending the costs of the mail category, or by averaging costs, the negative impact of the new but unprofitable service will be diminished.

The important point is that the USPS has not even attempted to quantify the CMM costs to demonstrate that revenues will exceed costs. Given the current shortfall in the residual shape surcharge (revenues below costs), the presumption must be that the revenues for parcel shaped CMM mail will not recover costs. To support the case that the overall impact of the change on postal costs and revenues will be minimal, the Request only cites to the unsupported conclusions of witnesses Hope and Ashe (who relies on Hope), that "the proposal would have no appreciable impact on contribution." (Attachment D at 10.) But the proposal must not decrease the estimated institutional cost contribution of the affected subclass or category of service. It is clear from the above review of the record materials presented by the USPS that the Commission is

unable to determine whether or not this is true. In any event, it is at least possible and even probable that the new service will be subsidized by other Standard Mail users.

II. There are no volume estimates

As with the missing cost analysis, the volume and revenue analyses are equally deficient and are insufficient to support approval. Witness Ashe provides the limited volume estimate evidence. With surprising candor, witness Ashe says, "there is no documented record of demand or use for CMM. Obviously, when something has never been available before there cannot be a record of its use...." (Ashe at 5-6.) Further, witness Ashe stated, "there is no basis for making volume projections of the sort relied upon to conduct a ratemaking analysis. No quantitative market research exists to inform such an analysis." (Tr. 2/39; OCA/USPS-T1-7.) His only other volume related comments refer to the market Report (USPS-LR-2) stating that the CMM was "received with enthusiasm" by the focus groups, (Ashe at 6, l 13-4.) but there was "a desire to evaluate its effectiveness before using it in widespread mailings." (*Id.* at l. 16.) Witness Ashe concludes that for the foreseeable future CMM would remain a low-volume form of mail. (Ashe at 6-7.) Again, there was no attempt to even estimate a volume. Witness Ashe points out that the low volume was deemed to be so low (we do not know how low) that it would rarely qualify for destination entry discount or another presort rate and therefore, in the interests of simplicity, those rates were not recommended. (Ashe at 9, l. 11-17.)

Witness Hope notes CMM is a "low-volume" product (Hope at 3, l. 1.) Further she reiterates witness Ashe's testimony that "there is no estimate of volume for [CMM's] use." Witness Hope continues that as one of many advertising vehicles available, "it is

clear that CMM would likely be used in limited circumstances." Again, witness Hope's testimony contains only qualified statements of volume usage drawn from the limited quantitative market research, apparently only that in USPS-LR-2.

The market Report (USPS-LR-2) says, "All test mailings are likely to be incremental volume," (Report at 23) and "Given advertisers' desire to market test, the initial volume is likely to be manageable." (Report at 35). The focus groups were not large and consisted of only 18 advertising firm executives and 18 different advertiser company executives for a total of 36 marketing people, but they did not provide a commitment to CMM use and indeed did not have the particulars of CMM available when the focus groups were conducted. (Tr. 2/55-56; OCA/USPS-T1-17(c),(d); Tr. 2/57-58; OCA/USPS-T1-18(c),(d).)

Potential CMM customers recognized that CMM "would be more costly to produce than a traditional Standard Mail letter or postcard." (Tr. 2/43; OCA/USPS-T1-12.) A comment by one focus group attendee was "I know [CMM] would be worth a little extra if we were allowed to do this...." (Tr. 2/43; OCA/USPS-T1-12.) That is the only positive statement in the record by any potential customer, but that statement was made before the limitations of CMM were known, such as DDU entry and the actual surcharge for the irregular shape mail. The Commission does not even know if the "little extra" cost that CMM might be worth to that lone advertiser who commented bears any relation to the actual price of the CMM option being offered. It is a slim reed to rely upon as the market potential for CMM.

The Request adds nothing regarding the estimated volumes. It only notes the "low-volume of CMM." (Request at 2.) The record is bare of reasonable estimates of

the impact of volumes on cost contribution, *i.e.* whether the contribution from CMM is positive or negative.

Consequently the Commission is faced with a paltry market potential for this product. The USPS essentially is relying upon unconfirmed anecdotal history to justify a market for CMM. Incredibly, even when interrogated about requests for the CMM mailing option, witness Ashe only relies upon "informal anecdotal history" as referred to in his testimony and his recent discussions with two mailers who did not promise to use CMM. While the two mailers either create or manufacture irregular shape mail, in neither case does witness Ashe indicate that they would actually use CMM or that they are even seriously interested in using CMM. (Tr. 2/38; OCA/USPS-T1-6.) Thus, again, even now at this late date, the USPS cannot point to any one customer for CMM. CMM is a product in search of a market.

III. There are no revenue estimates

The record regarding revenue estimates is also very sparse. The only record cite regarding revenues is witness Ashe's statement that there will be "small revenues." (Ashe at 7.) The market Report (USPS-LR-2 sponsored by witness Ashe) indicates that there may only be, at best, a tentative and small market and, thus, revenue support for CMM service is minimal. The market Report (USPS-LR-2) notes that the exact price per piece had not yet been determined when it was conducted; therefore the Report could not estimate revenues with any degree of certainty. (USPS-LR-2 at 2.) Realistically, there are no definitive statements of intent to use the service from mailers. The market Report demonstrates such an insufficient market for this service that it is likely the USPS is attempting to establish another money losing service.

It is also significant that the USPS is requesting a permanent classification, rather than planning a market test (which they have not even done). The history of Mailing Online is recalled as relevant.²⁴ There the initial market analysis proved optimistic. The USPS incurred large losses implementing that service with negligible revenues.²⁵ The CMM marketing study consists of indefinite statements suggesting only that potential customers might be interested in the CMM service. In fact, for the Mailing Online project, the USPS did a brief market test followed by an experiment²⁶ in order to "avoid premature commitment to a permanent service in need of adjustment."²⁷ In this case, without any known market, without any specific cost estimates or overhead cost estimates, and without any experimental-change test, the USPS expects the Commission to approve a permanent classification, all on an expedited basis.

There is no known market and the USPS has not pointed even to one customer ready to use the service. As stated by the USPS, the revenue will be negligible, if any, so there will be no revenue benefit from an early decision. In fact, the sooner the classification is approved, the sooner the USPS may incur losses on this service.

The filing repeats several times that CMM will have no substantial effect on institutional contribution. (Ashe at 7; 13; 14.) (Hope at 3; 9.) (Request, Attachment D at 10.) Witness Hope concludes more specifically with respect to the CMM profitability,

²⁴ See *Mailing Online Service*, "Opinion and Recommended Decision on Market Test," Docket No. MC98-1, October 7, 1998; *Mailing Online Experiment*, Docket No. MC2000-1, "Opinion and Recommended Decision," June 21, 2000.

²⁵ *Mailing Online Experiment*, Docket No. MC2000-2, at 5, 8-12.

²⁶ *Mailing Online Service*, Docket No. MC98-1 at 1, 4-6.

²⁷ *Id.* at 6.

without foundation, that "it would appear that CMM pieces will yield positive contribution at the applicable rates." (Hope at 10.) Only a cursory analysis suggests the opposite—that the new service will be a burden on those existing Standard Mail customers who do not make use of the new service. Surely, the Commission would not approve a new unprofitable service on the theory advanced by the USPS that the market is so small and the costs so limited that the overall institutional cost contribution of Standard Mail or Standard Mail non-letter basic will be only slightly impacted (although detrimentally so). Nor can the Commission recommend a request where the USPS admits from the outset that it has no cost, volume or revenue estimates and where any realistic appraisal indicates the service will not contribute to recovery of institutional costs.

THE RECORD DOES NOT SUPPORT A FINDING THAT THERE IS A DEMAND FOR
CMM AT A RATE THAT WILL RECOVER COSTS

At a minimum, sound business decisions are based on the following interrelated issues: (1) is the product or service feasible – can it be produced or performed; (2) what is the cost of providing the product or service; and (3) is there a demand for the product or service given a price that covers, at a minimum, all relevant costs?

The first analytical step in deciding to offer a new product is whether the product is a logical extension of existing product or service line. The initial idea for a new product may involve looking for product add-ons to fill in the gaps of an existing product line-up. That may have been the case with CMM although the testimony seems to leave the impression that it was engendered by customer requests. However, CMM fits neatly into the existing product line--*i.e.* a thinner irregular shaped piece than currently permitted.

Once the idea for an expanded product line is expressed, the second analysis requires an understanding of the cost of the product. The USPS does not know the cost of the CMM product.

The third analytical step is whether there is a market for the product. Will there be a market for the product at the minimum price at which the product can be sold, the out-of-pocket or attributable cost? More specifically, will there be a sufficient market for the product to warrant the expense of offering the new product and whether it will cover out-of-pocket costs and contribute to overhead costs. The USPS eliminates the market problem by ignoring the market. In its view, it has chosen a price that it says exceeds the out-of-pocket cost (even though it has done no cost studies and the RSS surcharge it is imposing only covers 27 percent of costs). The USPS position seems to be that the volume and the market are irrelevant. As long as the price exceeds the attributable cost there will be a contribution to institutional costs and the volume does not matter. However, it is obvious the USPS is not only ignoring the shortfall in the RSS surcharge rate but that it is also ignoring some mail processing costs, potential additional delivery costs, and start-up costs. Nor does the USPS plan on tracking CMM costs to determine whether or not the proposed retail price will actually cover the cost of providing the service.

The USPS has stated that it does not have CMM volume estimates. When queried about "anecdotal history" behind CMM, witness Ashe was unable to provide further information regarding potential customers who may have expressed interest in a CMM type service. (Tr. 2/38; OCA/USPS-T1-6.) Market interest for CMM seems to be assumed by the USPS. The focus group study did not provide solid leads for potential

users of CMM service, if it was offered, but expressed only very tentative interest. The USPS has not shown that there will be any CMM usage; in fact, the USPS admits volumes, at best, will be minimal.

The USPS does not state there is much interest in CMM. The USPS is unable and/or unwilling to provide a cost and/or volume estimate because the expected level of interest does not warrant the cost of preparing estimates. Given the lack of cost and volume data and the USPS's lack of interest in developing a cost and/or volume estimate, one wonders why is the USPS even pursuing CMM? Again, there is no known market for it – no volumes, and there are no cost estimates. Thus, why would any astute company propose a CMM service given the apparent lack of interest on the part of potential customers?

CONCLUSION ON DEFICIENT COST, VOLUME AND REVENUE ESTIMATES

The above discussion emphasizes the total lack of cost estimates available in the record on which to base a decision and which prevents the Commission from reasonably reaching a conclusion that the USPS has met the requirements of the Postal Reorganization Act. The finality of the USPS classification request imposes a heavy burden on the USPS to insure the service will provide a contribution to institutional costs. The USPS has not met that burden.

Presumably, the Commission would not approve CMM if it were known to be a money loser, even if the Standard Mail rate category (*i.e.*, 34.4 cent nonletter basic rated mail) still continues to contribute to institutional costs. If the Commission did

approve CMM, it would unfairly impact users of other Standard Mail categories, contrary to the claim of witness Hope (Hope at 7.)

In response to interrogatory OCA/USPS-T1-29 (Tr. 2/80-84), witness Hope made a partial attempt to identify RSS costs that CMM mail would avoid. OCA does not dispute her conclusion that 10.3 cents of transportation cost would be avoided by DDU-entered CMM. Furthermore, it is plausible that many upstream sorting and cross-docking costs will be avoided. An insurmountable difficulty still remains since neither witness Hope nor any other USPS spokesperson has provided an estimate (or even a means to produce an estimate) of which upstream mail processing costs are avoided and which are incurred by CMM. This leaves the Commission without any basis for determining whether the 57.4-cent rate that will be charged CMM will cover its costs.

The Commission's action in the *Bulk Small Parcel Service, 1992 (BSPS)* case²⁸ is relevant and instructive. There, despite relatively extensive USPS testimony relating to potential markets, including market surveys and opinion evidence of attributable costs, the Commission nevertheless found the evidence unreliable and rejected the classification request.²⁹ For instance, as to costs, the Commission found there was no "reliable estimate" of overall attributable costs. (*BSPS Op.* at 50) Even though witness Moeller provided opinion evidence estimating attributable cost, the Commission found the evidence was not "sufficiently reliable...for purposes of §3622(b) ratemaking"

²⁸ *Bulk Small Parcel Service, 1992*, "Opinion and Recommended Decision," August 25, 1993.

²⁹ The Commission went on to propose an alternative for the Governors to consider. However, in this case an alternative recommendation is not feasible because the Postal Service has not proposed a new rate and has proposed a permanent classification.

(*BSPS* Op. at 59.)³⁰ The USPS did not even attempt to estimate attributable costs for this CMM service.

As for the market evidence, in *BSPS* the Commission likewise found deficiencies. Even though there were extensive surveys undertaken, the Commission gave "very little weight to the quantitative results." (*BSPS* Op. at 10.) The Commission recognized that reliable data is hard to obtain for a new service but emphasized that is all the more reason why it is important to collect actual cost and demand data. The Commission also noted a "serious problem" in that the rates proposed during the survey differed from the rates proposed to the Commission. (*BSPS* Op. at 33.) Similarly, the two focus groups on CMM did not have the final rates before them.

The indications of market interest from potential customers for the new *BSPS* classification were found to be inadequate to support volume estimates. (*BSPS* Op. at 16.) The Commission concluded that the unreliability of the cost and volume estimates precluded a finding that the *BSPS* would cover attributable costs. (*BSPS* Op. 77.) If the evidence there was insufficient to demonstrate attributable costs, the total lack of evidence offered by the USPS as to the attributable costs for CMM must fall short of the statutory standard.

The deficiencies in the *BSPS* case pale in comparison to the sparse record support the USPS has offered the Commission in this proceeding. Even though each case is different, the statute nevertheless requires a finding that the proposed revenues will cover the costs, no matter what the size of the project. The statute makes no

³⁰ The Opinion noted that the standard of reliability would be lower if it were an experiment. *BSPS*. (Op. at 65.)

distinction as to size when it comes to the edict in §3622(b)(3).³¹ This record is so deficient as to the costs of the CMM mailing option that it would not be feasible for the Commission to even attempt to fashion an alternative rate, even if it had the authority to do so. The USPS has tested and fallen short of the minimum limits of evidentiary requirements needed to support a classification request.

CONCLUSION

Wherefore, OCA respectfully requests that the Commission reject the Request and the settlement offer. The USPS may then select an alternative course of action if it chooses to pursue the CMM option by obtaining better cost and market information and/or in the meantime applying for a temporary classification change under one of the various alternatives available in the Commission's rules. In any event, market tests and cost analyses to provide evidentiary support will be necessary before the Commission can reasonably recommend a permanent classification for CMM.

Respectfully submitted,

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³¹ Commissioner Crutcher said it succinctly in his *BSPS* concurring opinion, "There exists a very strong possibility that [the rate] would drop revenues below costs, and thus be illegal." *BSPS*, concurring Op. at 2.