

# OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

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In the Matter of: )  
 )  
REQUEST OF THE )  
UNITED STATES POSTAL SERVICE )  
FOR A RECOMMENDED DECISION ) Docket No. R2005-1  
ON CHANGES IN RATES OF )  
POSTAGE AND FEES FOR )  
POSTAL SERVICES )

VOLUME #9

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# ORIGINAL



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C O N T E N T S

WITNESSES APPEARING:  
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 JOHN HALDI

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
Robert W. Mitchell					
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By Mr. McLaughlin	--	5412	--	--	--
By Mr. Ackerly	--	5425	--	--	--
John Haldi					
By Mr. Olson	5465	--	--	--	--
By Mr. Koetting	--	5599, 5688	--	--	--
By Mr. McLaughlin	--	5607, 5630, 5666	--	--	--

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1 anyone have a procedural matter to discuss at this  
2 point before we begin?

3 (No response.)

4 CHAIRMAN OMAS: Mr. Olson, would you please  
5 identify your witness so I can swear him in, please?

6 MR. OLSON: Yes, Mr. Chairman. William  
7 Olson representing Valpak Direct Marketing Systems and  
8 Valpak Dealers Association calling Robert W. Mitchell  
9 to the stand.

10 CHAIRMAN OMAS: Mr. Mitchell, would you  
11 please stand and raise your right hand?

12 Whereupon,

13 ROBERT W. MITCHELL

14 having been duly sworn, was called as a  
15 witness and was examined and testified as follows:

16 MR. OLSON: Should I proceed, Mr. Chairman?

17 CHAIRMAN OMAS: Yes. I'm sorry, Mr. Olson.  
18 Please proceed.

19 (The document referred to was  
20 marked for identification as  
21 Exhibit No. VP-T-1.)

22 DIRECT EXAMINATION

23 BY MR. OLSON:

24 Q Mr. Mitchell, I'd like to hand you two  
25 copies of what is identified as the direct testimony

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1 of Robert W. Mitchell concerning standard enhanced  
2 carrier route mail on behalf of Valpak designated  
3 VP-T-1, and I'd like to ask you if it was prepared by  
4 you or under your direction?

5 A Yes, it was.

6 Q And do you have any edits to make at this  
7 time to the testimony?

8 A There are two small edits which I would like  
9 to make, and both of these edits have been made by  
10 hand in these two copies. The first edit is on page  
11 34, Line 14. There's an extraneous word on that line,  
12 and the word that should be removed is the word  
13 "should."

14 The second edit is on page 49, Line 18. In  
15 the middle of that line there are two words run  
16 together. As it reads as filed it says "coststhe."  
17 There's no space between them. What I would like to  
18 do is to separate "coststhe" and insert between them  
19 "as shown in."

20 With those two adjustments, my testimony is  
21 ready.

22 Q So you adopt this as your testimony in this  
23 docket?

24 A Yes, I do.

25 MR. OLSON: Mr. Chairman, on behalf of

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1 Valpak we move admission of this evidence into  
2 evidence.

3 CHAIRMAN OMAS: Is there any objection?

4 (No response.)

5 CHAIRMAN OMAS: Hearing none, I will direct  
6 counsel to provide the reporter with two copies of the  
7 corrected direct testimony of Robert Mitchell. That  
8 testimony is received into evidence and is to be  
9 transcribed into the record.

10 (The document referred to,  
11 previously identified as  
12 Exhibit No. VP-T-1, was  
13 received in evidence.)

14 //

15 //

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25 //

VP-T-1

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

POSTAL RATE AND FEE CHANGES, 2005 )

Docket No. R2005-1

Direct Testimony of  
ROBERT W. MITCHELL

Concerning  
STANDARD ENHANCED CARRIER ROUTE MAIL

On Behalf of  
VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.

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July 19, 2005

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1           Prior to joining the Postal Service, I was an Assistant Professor of  
2 Business at the University of Wisconsin-Milwaukee, teaching Economic Theory  
3 and Managerial Economics. I have a Bachelor of Science in Mechanical  
4 Engineering from the University of Cincinnati and an M. A. in Economics from  
5 Case Western Reserve University. While at Case, I passed my written and oral  
6 comprehensive examinations for the Ph.D. in Economics, with major areas in  
7 Economic Theory, Econometrics, and Industrial Economics.

8           I have written a number of articles and published papers, primarily on  
9 economic issues relating to postal rates, including: "Postal Worksharing:  
10 Welfare, Technical Efficiency, and Pareto Optimality," in *Emerging Competition*  
11 *In Postal and Delivery Services* (1999), and "Preparing the Postal Service's Rate  
12 Structures for Competition: A Study of How the United States Postal Service  
13 Might Adjust to Increased Competitive Pressure," in *Future Directions in Postal*  
14 *Reform* (2001).



1 knows how long any rates recommended will remain in effect. Funding issues  
2 central to the legislation being considered make such uncertainty unavoidable  
3 (see, e.g., H.R. 22 and S. 662). Moreover, that same legislation may change the  
4 way the Postal Service is regulated and may lead to structures such as price  
5 caps. If price caps were to be based on the rates recommended in this case,  
6 instead of on the rates emanating from a more-traditional next case, the tie to FY  
7 2000 costs (which were not the result of full Commission deliberation, due to the  
8 settlement) could lie behind the rates for some time.

9 Under these circumstances, it seems unwise as well as unfair to proceed  
10 in a way that virtually neglects all current cost relationships and builds without  
11 review on rates built on now-badly-out-of-date costs. Moreover, the ratesetting  
12 scheme outlined in the Postal Reorganization Act of 1970 does not align well  
13 with an across-the-board approach. Accordingly, this testimony has the following  
14 purposes.

15 1. To explain that this case is no different from any other omnibus postal  
16 ratemaking case and, accordingly, that it should be considered under  
17 conventional Commission rules pursuant to the **Postal Reorganization**  
18 **Act**. Its across-the-board character should be rejected.

19 2. To explain that the markup on the Enhanced Carrier Route ("ECR")  
20 Standard subclass should be selected through an independent application

1 of the non-cost factors in the Act and that the markup on ECR costs  
2 should be reduced.

3 3. To make specific proposals concerning the rate design for ECR  
4 Standard mail. Because it is not apparent that suitable costs and cost  
5 avoidances are available on the record, specific rates will not be  
6 proposed.

7

1

## II. POLICY CONSIDERATIONS

### 2 1. The Instant Case Is No Different from Any Other Case and the Same 3 Rules Should Apply.

4 The Postal Reorganization Act of 1970 (hereinafter the "Act") provides  
5 that:

6 From time to time the Postal Service shall request the  
7 Postal Rate Commission to submit a recommended  
8 decision on changes in a rate or rates of postage or in  
9 a fee or fees for postal services if the Postal Service  
10 determines that such changes would be in the public  
11 interest and in accordance with the policies of this  
12 title. [39 U.S.C. section 3622(a).]

13 One of those policies is that "rates and fees shall be . . . sufficient to enable the  
14 Postal Service . . . to maintain . . . the development of postal services of the kind  
15 and quality adapted to the needs of the United States," and another is that "rates  
16 and fees shall provide sufficient revenues so that the total estimated income and  
17 appropriations to the Postal Service will equal as nearly as practicable **total**  
18 **estimated costs** of the Postal Service." (*Ibid.*, section 3621, emphasis added.)

19 The Act goes on to explain that:

20 "**total estimated costs**" shall include (without  
21 limitation) **operating expenses**, depreciation on  
22 capital facilities and equipment, debt service  
23 (including interest, amortization of debt discount and  
24 expense, and provision for sinking funds or other  
25 retirements of obligations to the extent that such  
26 provision exceeds applicable depreciation charges),  
27 and a reasonable provision for contingencies. [*Ibid.*,  
28 emphasis added.]

1           The Postal Service has filed an omnibus case. The Commission's Rules  
2 of Practice and Procedure (39 CFR 3001) require that the revenue/cost balance  
3 and all rate/cost relationships be established by focusing on a prospective test  
4 year, presumably one representative of the period during which the rates will be  
5 in effect.

6           Postmaster General Potter, appearing as a policy witness (USPS-T-1),  
7 explains that "[t]he Postal Service's decision to seek changes in postal rates and  
8 fees at this time represents a policy judgment about the most reasonable,  
9 practical and effective way to meet a currently unavoidable financial obligation  
10 [explained subsequently to be the \$3.1 billion escrow payment] in Fiscal Year  
11 2006." USPS-T-1 at 2, ll. 3-6. Additionally, he explains that "Public Law 108-18  
12 **declares** that the escrow [payment] shall be considered as an **operating**  
13 **expense** of the Postal Service." *Ibid.* at 4, ll. 17-18, emphasis added.

14           Therefore, as an operating expense, the escrow payment is a component  
15 of the Postal Service's "total estimated costs," which the Act specifies shall be  
16 covered by rates and fees set according to its policies. I am not aware of any  
17 basis under the Act for treating this operating expense as any different from any  
18 other operating expense. Indeed, by using the terminology of the Postal  
19 Reorganization Act, Congress has "declare[d]" that it is no different.<sup>1</sup>

---

<sup>1</sup> Treatment of the escrow expense as an operating expense was confirmed by witness Tayman on oral cross-examination when he said: "By statute, it's defined as an operating expense." Tr. 2/221, ll. 8-9.

1           Witness Potter states that “Congress provided no guidance on how the  
2 obligation to fund the escrow account should be allocated among the various  
3 mail classes and services.” *Ibid.*, p. 4, l. 23 through p. 5, l. 1. That action by  
4 Congress is easily explained. Congress had already put in place a scheme for  
5 meeting “operating expenses,” and in P.L. 108-18 it categorized the escrow  
6 expenses using the same words. Had Congress intended that one particular  
7 operating expense should be met in a manner different from other operating  
8 expenses, it would have needed to create a separate set of guidelines. In  
9 addition, it would have had to explain how the two sets of guidelines align with  
10 each other, and how various layers of rates should build on each other.<sup>2</sup>

11           Witness Potter explains at page 4 (ll. 11-14) that “[t]he Postal Service,  
12 thus, finds itself in the peculiar situation of being required to ensure that its  
13 revenues in FY 2006 are sufficient to cover not only actual operational expenses  
14 but also an additional \$3.1 billion to be put in escrow.” Actually, it is not  
15 “peculiar” for the Postal Service to face the requirement to break even, given that  
16 Congress specifically required that the escrow payment be treated as an  
17 operating expense. After all, one would be hard pressed to argue that this case

---

<sup>2</sup>           The conundrum established by having two separate ratesetting procedures would be mind boggling. One can’t help but think of intervening parties arguing about which cost is of which kind and of accountants establishing some variation of last-in, first-out procedures for adjusting rates when a particular expense is removed or when one expense grows more rapidly than another, or even when total estimated expenses are 30 percent of one kind and 70 percent of another.

1 would have been filed in the face of an operating surplus in FY 2006 large  
2 enough to cover the escrow payment.<sup>3</sup>

3 In line with the presumption that the reason for this case being filed is a  
4 projected deficit, Postal Service witness Tayman (USPS-T-6) develops in  
5 considerable detail a financial projection for FY 2006. After many pages, he  
6 says: "The Postal Service's total revenue deficiency in the Test Year [FY 2006]  
7 at present rates would be approximately \$3.0 billion. Changes in postal rates  
8 and fees proposed in this filing will eliminate the deficiency . . . ." USPS-T-6 at  
9 54, ll. 2-4.

10 Except for the Postal Service's unusual decision to propose a contingency  
11 level of zero, it seems purely coincidental that the deficit of \$3 billion in the Test  
12 Year is approximately equal to the escrow payment of \$3.1 billion. But it makes  
13 no difference. Whether the deficit is 30 percent, 100 percent, or 300 percent of  
14 one component or another of Postal Service expenses, including the \$3.1 billion  
15 escrow payment, the deficit must be addressed, and addressed according to the  
16 requirements of the Act.

---

<sup>3</sup> In response to VP/USPS-T27-9 (Tr. 3/426-428), witness Robinson refers to "the reality that, if the escrow obligation did not exist, the Postal Service would not have requested any changes in rates and fees." I take this to mean: given that the Test Year deficit is \$3 billion, a reduction of approximately \$3 billion in any cost category, including the escrow, would have allowed the filing to be avoided. There would seem also to be a reality that: (1) if the escrow **did** exist and there were **no** deficit in the Test Year, a case **would not** be filed; and (2) if the escrow **did not** exist and there **were** a meaningful deficit in the Test Year, a case **would** be filed. The first of these two realities was essentially confirmed by witness Robinson on oral cross examination. See Tr. 3/495, l. 24 through 3/496, l. 1.

1   **2.    As a Matter of Logic, Identifiable Causes for Deficits Do Not Exist.**

2           Generally, one would not expect any logical basis for assigning  
3 responsibility for a deficit. Deficits exist in the aggregate and are residual in  
4 nature. To see this, assume a **base** year with three products and profits of \$300.  
5 Each product makes a contribution equal to its revenue minus its cost. By the  
6 end of the **next** year, suppose the contribution from product No. 1 increases  
7 \$1,000, that from product No. 2 decreases \$1,200, and that from product No. 3  
8 decreases \$500. The new net position involves a deficit of \$400. Is it possible  
9 to assign responsibility for the deficit?

10           What happened during the year is not in dispute. In fact, it is understood  
11 clearly. But one cannot say that the responsibility for the deficit lies in a certain  
12 place. If the contribution from product No. 3 had not declined, there would not  
13 be a deficit; there would be a surplus instead. Does this make product No. 3 the  
14 culprit, even though the decline in the contribution from product No. 2 is much  
15 larger? And do the relative levels of contributions from the three products make  
16 any difference? Suppose inquiry showed that product No. 2 made a contribution  
17 of \$1,800 in the base year and \$600 in the next year; would anyone then want to  
18 argue that product No. 2 caused the deficit? It would be just as logical to argue  
19 that product No. 1 caused the deficit because its contribution should have  
20 increased \$1,400 instead of just \$1,000.

1           Suppose further analysis is done and it is found that product No. 2 pays  
2 an annual licensing fee of approximately \$400. It has paid this fee throughout its  
3 existence, and the fee continues. Would it be logical to argue that the licensing  
4 fee is responsible for the deficit? It is certainly true that if the licensing fee were  
5 removed, there would be no deficit. It is even possible that the licencing fee was  
6 established by a court, in a decision with which the firm totally disagrees. The  
7 escrow payment is much like the licensing fee.

8           What is the conclusion? No logical basis supports a conclusion that the  
9 deficit projected for FY 2006 is caused more by the escrow payment than by any  
10 other expense component, and any relation between their sizes is purely  
11 coincidental.

### 12 **3. The Across-the-board Approach Should Be Rejected.**

13           Faced with a deficit in FY 2006 and the coincidence that its size is roughly  
14 the same as that of the escrow payment, the Postal Service has taken two  
15 positions: (1) that the deficit is due to the escrow (discussed above), and  
16 (2) that the best way to fund the deficit is through an across-the-board ("ATB")  
17 rate increase. The question of the best way to eliminate a deficit must be guided  
18 by the Act. Alternative guidance does not exist.

19           Witness Potter provides two justifications for the ATB approach. The first  
20 is: "This approach is reasonable and fair under the circumstances because it  
21 generally seeks to require that mailers pay the same percentage increase over

1 and above the rates and fees they are paying now.” USPS-T-1, ll. 12-14. But  
2 this reasoning is nothing more than a tautology, and it could be applied to any  
3 deficit, regardless of the developments leading to it. No real weight can be  
4 attached to an argument that the ATB approach is fair because it is ATB.

5 Other Postal Service witnesses echo witness Potter. Witness Robinson  
6 (USPS-T-27) refers to witness Potter as having “determined that a very  
7 reasonable approach to fulfilling the escrow obligation [is] on a *pro rata* basis  
8 through an across-the-board rate increase.” USPS-T-27 at 7, ll. 14-16. She also  
9 refers to the ATB approach as equitable. *Ibid.* at 8, l. 16. Then, in discussing the  
10 ratemaking criteria in the Act, she says: “The Postal Service’s proposals in this  
11 case have fairness and equity as their most fundamental objectives.” *Ibid.* at 11,  
12 ll. 14-16. Witness Taufique (USPS-T-28) refers to witnesses Potter and  
13 Robinson as saying that the ATB approach “reflects an effort to take the existing  
14 rate and fee schedules and to spread the burden of the \$3.1 billion FY 2006  
15 escrow obligation equitably.” USPS-T-28 at 2, ll. 7-8.

16 One can’t help concluding that some notion of fairness has been elevated  
17 above all other considerations. Then, as a check, a perfunctory review of a  
18 range of other factors has been taken to show that the results fall within an  
19 acceptable range.<sup>4</sup> But it is a strange notion of fairness that neglects all current

---

<sup>4</sup> The Commission has been presented with such reviews before. In Docket No. R90-1, the Commission observed: “Witness Lyons does not attempt to evaluate the relative levels of the cost coverages he supports, as the Commission does  
(continued...) ”

1 costs and builds on outdated cost and rate relationships,<sup>5</sup> even relationships that

---

<sup>4</sup> (...continued)

in developing rates. He merely finds that the cost coverage levels he suggests seem reasonable to him.” *Op. & Rec. Dec.*, Docket No. R90-1, pp. IV-6-7, ¶ 4018, footnote omitted. Further on, in the same opinion, the Commission said: “In sum, we find witness Quick’s criticisms persuasive insofar as they show Lyons’ largely formalistic invocation of the Act’s criteria support widely varying rate results. . . . It appears that he has done no more than judge whether certain rate levels might be compatible with the pricing policies of the Act, rather than applying those factors consistently to develop a schedule which fairly apportions institutional costs among the classes and subclasses of mail.” *Ibid.*, p. IV-9, ¶ 4028.

<sup>5</sup> In Docket No. R2000-1, the Commission evaluated a Postal Service request predicated on costs that were just one year older than were available at the time. Specifically, it was faced with relying on FY 1998 costs after FY 1999 costs became available. It required the Postal Service to update the costs. In assessing the results, the Commission said:

The recommended rates reflect more recent actual operating results, and thus are **fairer** to both mailers and affected private businesses. Additionally, the update provided the Postal Service with the opportunity to correct earlier longer-range projections, identifying both underestimates and overestimates. The Service acknowledged that it should experience lower costs to process flat-shaped mail than it initially projected. The rates recommended by the Commission reflect these reductions. The Service also identified several recent events, such as increasing fuel prices, that should increase its overall revenue needs. The rates recommended by the Commission also take account of these cost increases. [*Op. & Rec. Dec.*, Docket No. R2000-1, p. iii, emphasis added.]

In Docket No R94-1, which was also filed as an ATB case, the Commission said: “Without such evidence [that an ATB approach will actually tend to further reclassification], there is no classification-related reason for freezing existing inter-class rate relationships, and the across-the-board proposal does not override the need to insure a balanced application of the other factors in the Act, including questions of **fairness and equity**.” *Op. & Rec. Dec.*, *Ibid.*, p. I-5, ¶ 1016, emphasis added.

Concerns of these kinds, all hinging on issues of fairness, suggest that the ATB case’s neglect of current costs is not inherently fair, and certainly not as fair as could be.  
(continued...)

1 were the result of a settlement. Making matters worse is that both the prior  
 2 settlement and this case should rise to the challenge of being steps along a path  
 3 to a better future, and no one should be content with anything less than full  
 4 review and consideration. This is a high standard, but it is neither unfair nor  
 5 unreasonable. In fact, it is perfectly in order. These issues will be discussed  
 6 further below.

7           Notions of fairness are well known to exist to a considerable degree in the  
 8 eye of the beholder, and it is not uncommon for discerning observers to  
 9 disagree. In my opinion, however, the beginning point for considerations of  
 10 fairness should be review and recognition of current costs, which the Postal  
 11 Service's ATB proposal circumvents entirely.<sup>6</sup> In this regard, the Commission  
 12 has explained:

13           The Commission begins the rate design process  
 14 assuming equal implicit markups. This is a neutral  
 15 starting position which seems to be implied by  
 16 § 3622(b)(1), a **fair and equitable** schedule. It is  
 17 consistent with the Commission's general policies that  
 18 the rates for each rate category be above cost; that  
 19 **rates reflect the costs developed in the record;**  
 20 and that rate design results in identifiable  
 21 relationships between rate categories. Equal implicit  
 22 markups, however, are only a starting place, and  
 23 often may not be practical or appropriate. [*Op. &*

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<sup>5</sup> (...continued)

<sup>6</sup> I agree with the Commission's observation that "[a]ttempting to keep rate increases for all subclasses equal would make the exacting determination of cost causality meaningless." *Op. & Rec. Dec.*, Docket No. R90-1, p. IV-35, ¶ 4109.

1                    *Rec. Dec.*, Docket No. R2000-1, p. 390, ¶ 5533,  
2                    emphasis added.]

3                    The Postal Service's notion of fairness does not stand up to review. It is  
4 inconsistent with previous Commission practice, just as it is out of line with the  
5 ratesetting guidance in the Act. It constitutes an inadequate justification for an  
6 ATB proposal.

7                    Witness Potter's second justification for an ATB approach is more  
8 pragmatic. He says:

9                    One compelling justification for this approach is the  
10                    likelihood that it will enhance the prospect for  
11                    settlement of issues in this proceeding, permit a more  
12                    expeditious conclusion, and allow the Postal Service  
13                    to begin early in calendar year 2006 to generate the  
14                    additional revenues necessary to meet the obligation.  
15                    [USPS-T-1 at 5, ll. 15-18.]

16                    On oral cross-examination, he addressed this same issue, saying:

17                    It was a policy decision that was made by the  
18                    governors to file this case, to do it in an across-the-  
19                    board manner so we could expedite it so that we  
20                    would not harm the finances of the Postal Service  
21                    going forward. It's as simple as that. [Tr. 2/89, ll. 20-  
22                    24.]

23                    My view of settlements has been somewhat different, as follows. First,  
24 the Postal Service proposes a set of rates, according to Commission rules and  
25 the policies of the Act. Then interested parties review that proposal. If the  
26 parties believe that the proposal is fully justified and that it does not present  
27 problems, they can sign a settlement. But adopting a particular rate approach in  
28 hopes of facilitating a settlement, rather than according to the requirements of

1 the Act, simply is not appropriate ratemaking. Put another way, increasing the  
2 likelihood of achieving a settlement is not one of the non-cost factors in the Act.  
3 And arguments that the Postal Service has a financial interest in implementing  
4 rates a month or so sooner lack merit. The Postal Service has had full control  
5 over the timing of this case and it has known of the escrow requirement since  
6 P.L. 108-18 was enacted on April 23, 2003.<sup>7</sup> Borrowing options are available to  
7 allow flexibility and to smooth things out over time. Neither a desire for a  
8 settlement nor a hurry to realize increased revenue is a credible justification for  
9 an ATB approach.

10 One more issue relating to the justification for a settlement needs to be  
11 addressed. Although the Commission must make the final recommendation,  
12 both the Postal Service and the Commission are impartial reviewers in the sense  
13 that they themselves are not users of specific categories of rates. On the other  
14 hand, intervening parties generally do use specific categories of rates and  
15 generally do stand to gain if the rates of those categories are reduced. They are  
16 not, therefore, impartial reviewers. Intervenors inquire into the bases of the  
17 proposed rates in hopes of being able to show that their rates should be lower.  
18 In pursuing this interest, however, they know that the Commission is the final  
19 reviewer and that the Commission will not give weight to bad arguments.

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<sup>7</sup> It is true that extensive preparation is needed to file a well-supported rate case and that these preparations take time. But the analyses needed in support of such a case are no different from those that should be available on an on-going basis in any well-managed firm, public or private.

1           Focusing on settlement as a goal in such a situation introduces a dynamic  
2 that may be out of line with appropriate ratemaking. It is altogether possible that  
3 the Postal Service, in negotiating with intervening parties, who may represent the  
4 interests of some mailers to the neglect of others, will find that it can achieve  
5 settlement by proposing rates that it cannot justify as most appropriate, in hopes  
6 that the Commission will do little more than certify that the rates in the settlement  
7 are within a range allowed by law instead of being the best for the nation. The  
8 incentives of such a dynamic are unacceptable and should not be allowed to  
9 dictate the nation's postal rates and fees.

10 **4.     ATB Fails as a Special Assessment.**

11           In places, the Postal Service's proposal makes the ATB proposal sound  
12 like some kind of special assessment. Witness Robinson argues that the escrow  
13 expense "is unrelated to the provision of postal services," is "independent of the  
14 volume and mix of mail," and that were it not for the escrow expense, the Postal  
15 Service "would not . . . be proposing changes in rates and fees" at this time.  
16 USPS-T-27 at 6 (ll. 22-23), 7 (l. 8-9), and 6 (ll. 20-21). She even goes on to  
17 recount that "some commentators have observed [that] the \$3.1 billion escrow  
18 burden is not unlike a 'tax' that has been placed on the Postal Service and,  
19 ultimately, on its customers." *Ibid.* at 6, l. 24 through 7, l.1.

20           Special assessments are not uncommon, such as in a special tax to help  
21 pay for a much-needed road, or for a war, although even here there is often a

1 concern that ability to pay should be considered or that equal sacrifices should  
2 be made.<sup>8</sup> There can also be attention to benefits received. But in all such  
3 cases, consideration is given at the same time to what will happen when the road  
4 is built or the war is over. More specifically, a plan is put in place to remove the  
5 special assessment when the need has been met.

6 The Postal Service has not presented any plan to remove the ATB  
7 increase when some change is made in what can be done with the escrow  
8 funds. In fact, it is clear without question that no such plan is feasible and that if  
9 the ATB increase is implemented, the next rate increase will be built on top of the  
10 ATB rates. The ATB rates, then, if implemented, will effectively generate a  
11 **platform** on which future rates will be built, and could therefore have an effect  
12 for some not inconsequential period of time.<sup>9</sup> It is evident on its face that two  
13 sets of best future rates cannot exist and that future rates built on an ATB

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<sup>8</sup> A few years ago, my church began a building program. The slogan was “equal sacrifice.” It could have, but did not, suggest that everyone permanently increase their giving by 30 percent. In any case, as discussed further in the text, the extra giving, which took the form of pledges, was understood to be for a certain term only.

<sup>9</sup> The establishment of just such a platform, or base, was emphasized by witness Potter on oral cross examination, when he said: “The narrow need is the escrow account and the notion that we build that funding into our base . . . . Again, the policy decision that was made by the board of governors was to pursue an across-the-board increase with a very narrow purpose: to build funding into our rates such that it covered the escrow account.” Tr. 2/79, ll. 8-18. In a similar response at Tr. 2/74, ll. 2-9, he said: “. . . , let me just state that we’re dealing with this escrow, and we’re trying to get the escrow built into the base – assume no legislative change occurred. You would want that built into your base going forward, okay, the \$3.1 billion, and you can see from Witness Tayman’s testimony that that rises going forward.” Witness Tayman also referred to getting the escrow into the Postal Service’s “base prices.” Tr. 2/231, l. 23.

1 platform would be different from future rates built on a more traditional platform.  
2 Therein lies the inconsistency – an ATB case does not fit well with a process  
3 that focuses on generating the most appropriate rates. Quoting witness  
4 Robinson: “this docket is in contrast to the approach to rate and fee levels  
5 usually taken.” *Ibid.* at 3, ll. 9-10.

6 **5. An ATB Approach Is Inconsistent with the General Ratemaking**  
7 **Scheme of the Act.**

8 The ratemaking scheme under the Act has both static and dynamic  
9 aspects. The ATB approach is consistent with neither.

10 At first reading, the Act may be thought to present a static process. The  
11 Postal Service shows a need for revenues and files a proposal with the  
12 Commission. The proposal contains a full justification for all rates therein. This  
13 process requires the Postal Service to present and discuss all bases for the rates  
14 proposed. It must be transparent with all of its policy positions. Following the  
15 filing, the Commission and interested parties examine the case, explore  
16 alternatives, and have an opportunity to supplement the record with information  
17 and analysis that might be helpful to the Commission. In the end, the  
18 Commission makes a recommendation based on the Act, its judgment, and the  
19 record developed.

20 In my view, the Commission recommends the set of rates that it believes  
21 to be best aligned with the policies of the Act and that is, under those policies,

1 best for the nation. It may be that a large number of sets of rates could be  
2 viewed as lying within a range that is legal, but I believe it demeans the Act to  
3 argue that the Commission should be satisfied if it does nothing more than  
4 assure the nation that it has found one of those sets. More than this should be  
5 expected of the Commission and the ratesetting process.

6 An appropriate Commission process has two central aspects: (1) to  
7 examine current costs critically and (2) to select markups carefully. As carried  
8 out in a number of omnibus cases, this process is quite involved. It generally  
9 includes complex analyses to develop estimates of costs and then detailed  
10 workpapers that begin with the costs and show all steps leading to the proposed  
11 rates. The nature of the steps varies, but common elements include recognizing  
12 transportation costs, determining how these costs vary with distance, separating  
13 piece-oriented costs from those those that are pound-oriented, laying out cost  
14 differences associated with such things as piece shape, piece weight, kind of  
15 containerization, and machinability, and paying special attention to cost  
16 differences and avoidances associated with preparation activities such as  
17 presorting, prebarcoding, and dropshipping. In the case of many of these cost  
18 differences, specific consideration is given to trends in the costs over time and to  
19 the proportions of differences that should be passed through into rate  
20 differentials.

1           Virtually none of these steps have been taken in this case.<sup>10</sup> The Board of  
2   Governors of the Postal Service appears to have decided in favor of an ATB  
3   approach before looking at any of the cost elements. Furthermore, none of the  
4   usual workpapers are presented, not even on an after-the-fact basis. More  
5   specifically, the transportation costs are not examined, the range of cost  
6   differences is not displayed or discussed, and the passthroughs<sup>11</sup> are given no  
7   attention at all.

8           It would be a coincidence of monumental unlikelihood for the full scheme  
9   outlined in the Act to collapse into a simple ATB proposal. But finding out  
10   whether or not it does requires attention to all of the steps just outlined, and the

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<sup>10</sup>           In Question 3(b) of POIR No. 4, the Commission asked about the effects on mailers, competitors, and overall economic efficiency of building in Parcel Select on rates that are now understood to be out of alignment with the cube-weight relationships. In response, witness Robinson explains that “the escrow requirement does not vary depending on cube-weight relationships.” Tr. 3/471. She fails completely to acknowledge the fact that if the current rates are misaligned with costs, then any rates that build proportionately on them will be misaligned as well. She even argues that if a customer received a “lower-than-average rate increase,” that customer “effectively . . . would have borne [proportionately] less of the escrow burden.” To allocate certain portions of revenue to certain fixed costs is to engage in an unacceptable practice that is normally referred to as restricted institutional costing. One of the problems of such tracing can easily be seen by considering the situation of a subclass like Periodicals, where the proposed coverage is less than 105.4 percent. If 5 percent or so of its revenue were allocated to the escrow, its rates would have to be viewed as below cost.

<sup>11</sup>           In rate case parlance, “passthroughs” are understood to be the proportion of relevant cost differences that are passed through into rate differentials or discounts. The passthroughs are normally expressed on a percentage basis and can be less than, equal to, or greater than 100 percent of the cost difference.

1 Postal Service has circumvented those steps.<sup>12</sup> The Postal Service simply has  
2 not justified its proposal.

3 **6. This Case Is More Troublesome Dynamically than Statically.**

4 The analysis above is primarily static. But once the notion of a rate  
5 platform is introduced, on which future rates will be built, the importance of the  
6 process through which rates play themselves out over time becomes clear.

7 The key to the dynamic impact of a particular omnibus rate docket lies in  
8 the importance of considering the **effects** of the increases on mailers and other  
9 parties. Indeed, the Act specifically requires that consideration be given to “the  
10 effect of rate increases upon the general public, business mail users, and  
11 enterprises in the private sector of the economy engaged in the delivery of mail  
12 matter other than letters.” 39 U.S.C. section 3622(b)(4).

13 It is perfectly obvious that if an ATB increase is implemented instead of an  
14 increase that varies in size among rate categories, the increases required in the

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<sup>12</sup> In its *Opinion and Recommended Decision* in the Docket No. R94-1 ATB case, the Commission said:

The Postal Service’s across-the-board filing is inconsistent with cost-based ratemaking. The request ignores changing differences in costs between the classes of mail, includes no analysis of changing cost patterns within subclasses; and would result in substantial changes in the allocation of institutional costs among the subclasses of mail. The Service’s rate proposal ignores changes in attributable costs. [*Op. & Rec. Dec., Ibid.*, p. 1-5, ¶ 1017.]

These concerns apply with equal strength to the instant case.

1 **next** case to reach a meritorious rate position will be for some categories larger  
2 than otherwise would be the case, and thus that an ATB case will lead in all  
3 likelihood to arguments of rate shock in the next case, which might keep the  
4 meritorious position from being reached.<sup>13</sup> Therefore, the nation would be  
5 expected to be worse off. Such a result cannot be considered a consistent  
6 application of the provisions in the Act.

7         No suggestion is being made that rates recommended in a normal rate  
8 case would never turn out to involve proportionate increases in some collections  
9 of rates, possibly including entire subclasses. One can make the case, in fact,  
10 that if a set of markup indexes is approximately maintained and neither relative  
11 costs nor a range of relevant exogenous factors change, the natural outcome of  
12 a normal rate process would be expected to have an ATB character.

13         But even if exogenous factors are taken to change slowly, it is perfectly  
14 clear that relative costs are in a state of flux, perhaps as a natural outcome of  
15 business activity. The Postal Service is and has been tightening its operations  
16 and increasing its productivity. New equipment and new technologies are being  
17 introduced. Also, mailers are changing the way their mail is prepared, a factor  
18 identified in the Act as important. See 39 U.S.C. section 3622(b)(6). Under

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<sup>13</sup> Mailers receiving lower-than-appropriate rate increases in an ATB case could receive tempered rates in the next case, at a cost to other mailers, but they would not likely be asked to make catch-up payments. In a related situation in Docket No. R90-1, the Commission said: "We must recommend test year rates which are fair and equitable for test year mailers; they should not, and are not, designed to provide a 'catch-up' for past decisions." *Op. & Rec. Dec.*, Docket No. R90-1, p. IV-35, ¶ 4112.

1 these conditions, there is no justification for presuming that an ATB approach is  
2 in line with the Act and good ratesetting principles, certainly not without careful  
3 examination, which is absent from this case.

4 **7. A Quantitative Showing that an ATB Case Is Generally Inconsistent**  
5 **with the Rate-setting Scheme under the Act.**

6 Using a relatively simple model, it is easy to show that an ATB case is  
7 generally inconsistent with the rate setting process prescribed by the Act, and  
8 that such a case leads to suboptimal rates and undue effects on mailers.

9 To create a reference or base position, assume three normal rate cases.  
10 Each case is fully litigated and the Commission makes recommendations on  
11 each record. Three products are adequate to make the point. In the first rate  
12 case, the Commission selects a rate for the first product of A (cents per piece).  
13 The rates for the second and third products may be expressed as proportions of  
14 A, therefore being  $\alpha_2 A$  and  $\alpha_3 A$ , where the proportions  $\alpha_2$  and  $\alpha_3$  can be less  
15 than, equal to, or greater than 1. In the second and third rate cases, the rates for  
16 the first product are B and C, with the rates for the second and third products  
17 similarly expressed as proportions. The following rates therefore are  
18 recommended:

1		<u>Product 1</u>	<u>Product 2</u>	<u>Product 3</u>
2	Case 1	A	$\alpha_2 A$	$\alpha_3 A$
3	Case 2	B	$\beta_2 B$	$\beta_3 B$
4	Case 3	C	$\delta_2 C$	$\delta_3 C$

5 This reference position is perfectly general. The Commission considers fully the  
6 evidence in each case and decides on a best recommendation. The effects on  
7 mailers are also considered. When the rate for Product 1 is considered in Case  
8 2, the difference B - A is considered. Importantly, this difference is the difference  
9 between two rates that are both set in perfectly general rate cases, conducted  
10 under Commission rules and the Act.

11 Now consider a first case that is normal, as above, a second case that  
12 uses an ATB approach, and a third case that attempts to return to normality.  
13 Assuming the ATB proportion is  $\kappa$ , get:

14		<u>Product 1</u>	<u>Product 2</u>	<u>Product 3</u>
15	Case 1*	A	$\alpha_2 A$	$\alpha_3 A$
16	Case 2*	$\kappa A$	$\kappa \alpha_2 A$	$\kappa \alpha_3 A$
17	Case 3*	C	$\delta_2 C$	$\delta_3 C$

18 Case 1\* is the baseline and is identical to Case 1. Case 2\* is an ATB case and  
19 is not the same as Case 2. Case 3\* shows the rates that Commission would

1 prefer to recommend in Case 3\*, *i.e.*, the rates that it finds meritorious and best  
 2 for the nation under the circumstances at the time of Case 3\*, absent any  
 3 tempering to reduce effects. These rates may or may not be in line with a set of  
 4 preferred markup indexes. They are the rates that would result from a string of  
 5 perfectly normal rate cases, and are therefore identical to Case 3. One might  
 6 say that the rates in Case 3\* are the rates that the Commission would like to get  
 7 back to, after an ATB interruption, and that it **must** get back to if the ATB  
 8 interruption is not to distort natural rate paths.

9 For Product 1, the effect of the rate increases on mailers in Case 3\* is  
 10  $C - \kappa A$ , and in Case 3 it was  $C - B$ . The **excess** effect on mailers of Case 3\* is  
 11  $(C - \kappa A) - (C - B)$ , which reduces to  $B - \kappa A$ . Calculated in this way, the excess  
 12 effects of the rate increases on mailers using the three products become:

	<u>Excess effect</u>	<u>Which reduces to</u>
13 Product 1	$(C - \kappa A) - (C - B)$	$B - \kappa A$
14 Product 2	$(\delta_2 C - \kappa \alpha_2 A) - (\delta_2 C - \beta_2 B)$	$\beta_2 B - \kappa \alpha_2 A$
15 Product 3	$(\delta_3 C - \kappa \alpha_3 A) - (\delta_3 C - \beta_3 B)$	$\beta_3 B - \kappa \alpha_3 A$

17 In order for the excess effects on mailers to be zero, each expression in  
 18 the final column above must be zero. From Product 1, if  $B - \kappa A = 0$ , then B must  
 19 equal  $\kappa A$ , which requires that  $B/A = \kappa$ . Similarly, from Product 2, it is required

1 that  $B/A = \kappa\alpha_2/\beta_2$ , and from Product 3,  $B/A$  must =  $\kappa\alpha_3/\beta_3$ . The only way all three  
2 excess effects can be zero is if  $\alpha_2/\beta_2 = 1$  and  $\alpha_3/\beta_3 = 1$ .

3           Given the reality that relative costs change over time, due to changing  
4 technologies and other factors, it is clear that these conditions generally would  
5 not be met. Therefore, the excess effect of returning to normalcy after an ATB  
6 case is non-zero. Faced with a non-zero excess effects on mailers, the  
7 Commission would in all likelihood consider tempering the rate increases and  
8 recommending a set of rates in Case 3\* that is different from  $C$ ,  $\delta_2C$ , and  $\delta_3C$ .  
9 That is, the preferred set of rates would not be recommended in Case 3\* and the  
10 nation would be worse off. It being unreasonable that the same Act could  
11 sanction a set of rates in one case that would prevent a best set of rates in the  
12 next case, it follows that an ATB case is inconsistent with the Act.

13           Using simple figures selected to keep the math easy, an example of  
14 **excess effects** was presented to witness Robinson during oral

1

**Figure 1**

2

**Alternative Rate Scenarios, Illustrating Excess Effect on Mailers**

3	Rate	Case	Product 1	% Δ	Product 2	% Δ
4	Case	Type	Rate-cents		Rate-cents	
5	Case 1	Baseline	20		50	
6	Case 2	ATB 20%	24	20%	60	20%
7	Case 3	Conventional w/o Factor 4	32	33.3%	63	5%
8	Alternate Case 2	Conventional	25	25%	56	12%
9	Alternate Case 3	Conventional	32	28%	63	12.5%

12 cross-examination. As presented in Figure 1, the example involves two products  
 13 with base rates of 20 cents and 50 cents, and an ATB case that increases these  
 14 rates by 20 percent, to 24 cents and 60 cents. Then a few years later, it is  
 15 assumed that a conventional case is filed (Case 3), which recognizes then-  
 16 current costs. Now suppose that the Commission in conventional Case 3 case  
 17 examines the then-current costs and the then-current market conditions, and  
 18 considers all of the non-cost factors in the Act, except factor No. 4 (39 U.S.C.

1 section 3622(b)(4)), having to do with the effects of any rate increases, and  
2 arrives at candidate rates of 32 cents and 63 cents. But then the Commission  
3 notices that these rates would involve increases from the ATB rates of 33.3  
4 percent and 5 percent, respectively, and becomes concerned about the effects  
5 on mailers.

6 If the Commission alters the candidate rates in the conventional Case 3,  
7 and recommends rates of, say, 29 cents and 67 cents, it will have **deviated** from  
8 the most appropriate set of rates, because of consideration of effects. Assuming  
9 the underlying costs and market conditions changed in a well-behaved way over  
10 the time periods in question, this deviation could have been avoided by  
11 recommending in Case 2, shown as Alternate Case 2, the rates of, say, 25 cents  
12 and 56 cents. From a platform of these alternate rates, the desired rates of 32  
13 cents and 63 cents would have been achievable, with a relatively smooth pattern  
14 of rates over time. It may be viewed as unfortunate that Product 1 has such a  
15 strong upward trend in its rates, but the ATB case is clearly unfair to Product 2.

16 The point is that an ATB case can disrupt normal rate trends and cause  
17 excess effects on mailers, as in the increase of 33.3 percent in Case 3. Witness  
18 Robinson's response to the example was, variously: "You're proposing a  
19 situation that I find very hard to understand", "you're imposing an order on the  
20 consideration of the criteria", and "I think the premise is fundamentally flawed in  
21 how the costing criteria and the other criteria of the act interact." Tr. 3/501 (ll. 12-  
22 13), 502 (ll. 4-5), and 508 (ll. 20-22), respectively. But the example is illustrative

1 of a fundamental problem. No one would expect the Commission to be able to  
2 consider the effects of rates on mailers until they have candidate rates to  
3 consider. It is clear that an ATB case not only can result in disruptive rate  
4 patterns and excess effects on mailers in future cases, but also can prevent  
5 meritorious rate positions from being reached.

6 **8. This Case Presents Other Dynamic Difficulties.**

7 Progress in rates over time requires changes. Given this, any procedure  
8 that slows the development and implementation of optimal rates or makes them  
9 more difficult to attain is suspect on its face.

10 Numerous changes in rate design have occurred in virtually every  
11 subclass of mail. One example is second class, now referred to as Periodicals.  
12 At the time of reorganization in 1970, mail sent as second class was charged by  
13 the pound; piece rates did not exist. This sent terrible signals to mailers. It said:  
14 If you double the weight of your periodical, we will double your postage, even  
15 though our costs do not anywhere near double. One could argue that such a  
16 rate structure penalized mailers for adding weight, even though they had done  
17 nothing wrong. That is not what the Postal Service is here for.

18 In the first rate case (Docket No. R71-1), the Commission recommended  
19 piece rates for second class, to go with the pound rates. Over time, the reliance  
20 on piece rates increased. In Docket No. R84-1, 55 percent of Periodicals  
21 revenue was obtained from the piece rates. This was increased to 60 percent in

1 Docket No. R87-1. Along the way, presort discounts, prebarcode discounts,  
 2 additional dropship discounts, and pallet discounts were introduced. One would  
 3 be hard pressed to argue that these changes were not improvements or that the  
 4 rates of Periodicals are not more efficient today. And, obviously, the  
 5 Commission would not have recommended the changes if it did not think the  
 6 changes were best under the Act.

7 It should be noted that the effects of these changes in the structure of  
 8 Periodicals rates were not small. When, following Docket No. R84-1, the  
 9 proportion of revenue from the piece rates was increased, the piece rate for  
 10 basic presort increased 75.7 percent, the piece rate for 3/5-digit presort  
 11 increased 77.8 percent, and the piece rate for carrier route presort increased  
 12 77.3 percent. See USPS-LR-K-73, Domestic Mail Rate History. There were, of  
 13 course, associated reductions in the pound rates. Nevertheless, the effects on  
 14 mailers were pronounced, with some mailers affected much more than others.<sup>14</sup>

15 Rate improvements such as those implemented for Periodicals must await  
 16 the occasion of the Postal Service filing an omnibus rate case, unless the  
 17 Commission begins a mail classification case on its own volition,<sup>15</sup> which has

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<sup>14</sup> Effects on mailers must be accepted if changes of import are to be made. In regard to the structural changes in third class in Docket No. R90-1, the Commission said: "Even so, the percentage point spread between the lowest and highest percentage rate changes is about the same as the Service's spread – about 40 percentage points." *Op. & Rec. Dec.*, Docket No. R90-1, p. V-246, ¶ 5971.

<sup>15</sup> Except in response to a complaint from a mailer, the Commission cannot begin a rate case, even when underlying cost relationships change. Remedies,  
 (continued...)

1 turned out to be a very weak authority, or the Postal Service files special cases,  
2 which has, in my opinion, happened too infrequently. And even then, if, as a  
3 result of timidity and excessive tempering, baby steps are taken toward improved  
4 positions, progress can be very slow, which suggests, I contend, that the nation  
5 on the whole is worse off for it. All this suggests that an opportunity to make  
6 improvements should not be lost, which will occur if an AtB increase is  
7 implemented.

8 Admittedly, a release of all AtB constraints in this case will not bring forth  
9 into the record a bevy of classification improvements. But it is well known that  
10 the Postal Service is considering what have been called "product redesign"  
11 changes for the case after this one, and a decision to recognize costs more  
12 completely in this case will in all likelihood make it easier to proceed with product  
13 redesign in that next case.<sup>16</sup> Conversely, an AtB approach in this case will in all  
14 likelihood make product redesign more difficult and less effective. The  
15 Commission should not recommend the AtB rates.

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<sup>15</sup> (...continued)

therefore, must await a filing by the Postal Service. The fact that the Commission does not have this authority could be viewed as a weakness in the Act, because, as witness Robinson explained in response to Question 3(b) of POIR No. 4, "these changes [in the underlying cost relationships], in and of themselves, do not necessarily result in a Postal Service request to change rates and fees." Tr. 3/470.

<sup>16</sup> The logical basis for this statement can be spelled out very simply. The changes made in any "product redesign" initiative are likely to improve the alignment of rates and costs, and fuller recognition of costs (including updating) in this case is likely to decrease the distance between the initiative rates and the then-existent rates.

1 Another aspect of making changes over time is that sometimes they are  
2 made incrementally. Using Periodicals again as an example, piece rates were  
3 introduced in Docket No. R71-1, were increased in Docket No. R84-1, and were  
4 increased again in Docket No. R87-1. As a practical matter, decades can pass  
5 before desired rate positions are reached. Again, opportunities to make  
6 improvements should not be lost.

7 **9. The Pace of Change in Standard Mail Has Been Anemic.**

8 A number of changes were made to Standard mail (then third class) in  
9 Docket No. R90-1, including a letter/flat differential, dropship discounts, and  
10 saturation rates. In order to help make these changes smoothly, a number of  
11 passthroughs were deliberately set at low levels and the passthroughs for some  
12 already-existing discounts were actually reduced. There was every expectation  
13 on the part of the Postal Service that steps would be taken in the next rate case  
14 to recognize costs more fully, increase passthroughs, and improve the signals  
15 sent to mailers.

16 But Docket No. R94-1 was filed as an ATB case, and even though the  
17 Commission rejected its ATB foundation, many ATB aspects could not be  
18 avoided. Docket No. MC95-1, the reclassification case, made structural  
19 changes, but was contribution neutral. Docket No. R97-1, then, a full seven  
20 years after the changes in Docket No. R90-1, was the first normal post-R90-1  
21 case. Docket No. R2000-1 was also normal, except that the base year was

1 updated during the case, and it is not clear that the Postal Service's case was  
2 fully updated.<sup>17</sup> Docket No. R2001-1 was settled, and thus did not receive the  
3 benefit of what I would call full Commission deliberation. My point is that from  
4 Docket No. R90-1 to date, a period of approximately 15 years, there have been  
5 only two normal rate cases, one of which involved a difficult cost update, and one  
6 contribution-neutral reclassification case. Progress is occurring very slowly.

7       The fact that progress is occurring slowly should be a cause for concern.  
8 Observers, including the Postal Service itself, are quick to point out that  
9 technology is advancing rapidly, mailer capabilities are improving, competitive  
10 pressures are increasing, alternatives to the mail are proliferating, and that to be  
11 effective, organizations must focus on doing whatever it takes to meet customer  
12 needs. One hears arguments that business-like behavior is required and that the  
13 Postal Service's financial position will deteriorate if it cannot be more responsive  
14 to all that is going on. Rate improvements ~~should~~ are a key part of this dynamic,  
15 and the opportunity presented by this case should not be lost.

16       The instant case should be reviewed fully. All costs should be updated  
17 and examined. Changes should be made where found appropriate. Handling  
18 this case as such would be in line with the common cry for a series of small,

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<sup>17</sup>       The basis for this statement is that the Postal Service did not revise its request when it updated its costs. It seems difficult to believe that a full case based on newer costs would be the same as one based on earlier costs.

1 predictable rate adjustments instead of large-but-infrequent ones. Sitting back  
2 and waiting for some future opportunity is not justified.

3 **10. Summary.**

4 As witness Potter explains, Congress has declared that the escrow  
5 requirement is an operating expense of the Postal Service and has provided no  
6 special guidance on how it should be covered. Therefore, the expense qualifies  
7 fully as one that should be met according to Commission rules, implementing  
8 the Act.

9 Witness Tayman projects a deficit for Fiscal Year 2006 that it is, merely by  
10 coincidence, approximately equal to the escrow payment. Accordingly, this case  
11 has been filed to meet that deficit. But no logic suggests that the deficit is  
12 caused in any meaningful way by the escrow. In fact, it is clear that if some  
13 other Postal Service expense had been projected to be \$3 billion lower, no deficit  
14 would exist and no case would have been filed. Since this would occur despite  
15 the escrow, it cannot be said that the escrow caused the deficit.

16 The Postal Service elevates non-cost factor No. 1 (39 U.S.C. section  
17 3622(b)(1)) to a position of undue priority, and then argues that an ATB approach  
18 is the fairest way to fund the deficit. But this requires a notion of fairness that  
19 neglects all current costs and builds solely on out-of-date cost and rate  
20 relationships, many of which have changed. Such a notion cannot truly be  
21 viewed as fair. The ATB approach fails also as a special assessment, because

1 no procedure exists for withdrawing it when the need has been met. And  
2 perhaps the most egregious characteristic of an ATB approach is that it creates a  
3 new rate platform, built on old cost relationships, in such a way that updating  
4 costs in the future will almost undoubtedly entail more burdensome effects on  
5 mailers than would otherwise be the case, and that might well slow progress  
6 toward more efficient rates.

1       **III. ECR COST COVERAGE IS TOO HIGH AND SHOULD BE REDUCED**

2       **1. An Independent Application of the Non-cost Factors in the Act Is**  
3       **Required.**

4           The starting point for selecting an appropriate cost coverage is that a  
5 subclass must receive an independent application of the non-cost factors in the  
6 Act. The Commission has said:

7                       Since the late 1970s the Commission has followed  
8                       the practice of establishing only subclasses of mail  
9                       having “unique characteristics . . . which would  
10                      warrant an independent application of all of the §  
11                      3622(b) ratemaking criteria to [the] category.” [*Op. &*  
12                      *Rec. Dec.*, Docket No. MC95-1, pp. III-7-8, ¶ 3019  
13                      quoting *Op. & Rec. Dec.*, Docket No. R77-1 at 247,  
14                      brackets in original.]

15 In that docket, in reference to a proposed subclass in First Class, the  
16 Commission stated: “If presorted first-class constitutes a ‘class of mail’ or ‘type  
17 of service’ for purposes of [section 3622(b)], it follows that the rate adopted **must**  
18 be based on an independent application of the § 3622(b) factors.” *Op. & Rec.*  
19 *Dec.*, Docket No. R77-1, p. 241, fn. 1, emphasis added.

20           The Postal Service agrees with this approach. In this case, witness  
21 Robinson was asked whether “the Postal Service sees elevating the cost  
22 coverage of the ECR subclass as one way to help achieve a rate for ECR Basic  
23 letters that is higher than the rate for Regular prebarcoded 5-digit letters.” She  
24 responded:

25                       No. The selection of cost coverages for the Standard  
26                       Mail ECR subclass is based on the application of the

1            nine pricing criteria of Title 39, section 3622(b). While  
 2            the relative coverages of the subclasses has some  
 3            effect on the prices within the subclasses, this  
 4            particular rate relationship has not driven the  
 5            selection of either the cost coverages for Standard  
 6            Mail ECR or for Standard Mail Regular in this docket  
 7            or in previous dockets. [Response to VP/USPS-T28-  
 8            21(c), redirected from witness Taufique, Tr. 3/464.]

9            Therefore, the cost coverage for ECR should depend on how the non-cost  
 10           factors are applied, with the understanding that financial breakeven is required.  
 11           Accordingly, the level of the coverage should not depend on its historical levels,  
 12           except that the effect of rate increases on mailers should be considered. Such  
 13           consideration, however, would be short-term in nature. That is, effects might be  
 14           reduced by achieving a desired coverage in several steps instead of one, but  
 15           attention to effects should not prevent eventual achievement of an appropriate  
 16           result.<sup>18</sup>

17           **2.        The Goals of the Reclassification Case Suggest that the Current**  
 18           **Coverage of ECR Is Too High.**

19                    The focus of the Docket No. MC95-1 reclassification case was on whether  
 20           the proposed ECR grouping warranted an independent application of the non-  
 21           cost factors of the Act. Speaking broadly, the Commission said:

22                                    The "subclass issue" is paramount in this docket.  
 23                                    The Reorganization Act speaks only of "classes."

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<sup>18</sup>            39 U.S.C. section 3622(b)(4) refers to the "effect of rate increases," not to the effect of rate levels. Therefore, one could not say that the effect of a rate level is too great.

1           See for example, 39 U.S.C. § 3623, and the function  
2           of mail classification is to create mail groupings which  
3           allow, and even help, the Postal Service to charge fair  
4           and equitable rates. The significant role of  
5           “subclasses” has evolved through Commission  
6           decisions – they have become integral to ratemaking  
7           in accordance with the Act. Courts have confirmed  
8           that such classification distinctions exist for the  
9           purpose of ratemaking. [*Op. & Rec. Dec.*, Docket No.  
10          MC95-1, pp. III-6-7, ¶ 3017.]

11           In response to a Postal Service argument that additional subclasses are  
12          needed to help reflect costs and demand and to promote its automation strategy,  
13          the Commission said: “The Commission concludes, based on this record, that  
14          the only benefit of disaggregating subclasses further would be the ability to  
15          reflect differences in demand or other non-cost factors of the Act in separate  
16          markups.” *Ibid.*, p. IV-115, ¶ 4253.

17           On the question of the subclass proposal in First Class, the Commission  
18          said: “Proponents of the Postal Service’s proposed subclass structure for First-  
19          Class Mail have failed to show that the proposed structure better warrants  
20          independent application of the § 3622(b) ratemaking criteria than that which  
21          exists today.” *Ibid.*, p. I-5, ¶ 1011. In regard to a similar proposal in Docket No.  
22          R97-1, the Commission said: “The critical factors to be considered are ‘whether  
23          the cost characteristics and market demand characteristics of presorted First-  
24          Class [Mail] are sufficiently different to warrant independent evaluation under the  
25          § 3622(b) factors.’” *Op. & Rec. Dec.*, Docket No. R97-1, p. 605, ¶ 6518,  
26          brackets in original, quoting *Op. & Rec. Dec.*, Docket No. R80-1, p. 273, ¶ 0686.

1 The Commission explained:

2 In the past, a showing of cost and demand  
 3 differences has been important for concluding that  
 4 independent application of all of the § 3622(b)  
 5 ratemaking criteria is warranted. . . . The market-  
 6 demand characteristics test reflects the need to  
 7 classify mail for purposes of assigning institutional  
 8 costs, particularly to take into account “the value of  
 9 mail service actually provided each class or type of  
 10 mail service to both the sender and the recipient . . . .”  
 11 39 U.S.C. § 3622(b)(2). [*Op. & Rec. Dec.*, Docket  
 12 No. MC95-1, p. 1-3.]

13 In reference to its decision to recommend ECR as a separate subclass,  
 14 the Commission said: “Quantitative and qualitative evidence in the record **does**  
 15 support a finding that there are market differences between carrier route and  
 16 noncarrier route Standard Mail.” *Ibid.*, p. 1-7, ¶ 1017, emphasis added. “The  
 17 Commission is satisfied that the proposed Enhanced Carrier Route subclass **has**  
 18 distinct demand characteristics which indicate differences in value to senders.”  
 19 *Ibid.*, p. III-46, ¶ 3121, emphasis added. And: “With the exception of the  
 20 proposed Standard Enhanced Carrier Route subclass, there is not sufficient  
 21 evidence on this record for the Commission to find that the subclasses proposed  
 22 exhibit different demand characteristics. They do **not** consist of different  
 23 products which serve different markets.” *Ibid.*, p. 1-4, ¶ 1009, emphasis added.<sup>19</sup>

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<sup>19</sup> One of the Postal Service’s proposals was to separate now Regular Standard into an automation and a non-automation subclass. The Commission said: “While there are differences in costs between the proposed Automation and Regular Standard Mail, there is not substantial evidence of demand differences between them. Hence, the Commission cannot recommend separate subclasses for these categories.”  
 (continued...)

1 Similarly: “there is sufficient evidence on the record for the Commission to  
 2 conclude that carrier route and noncarrier route Bulk Rate Regular mail **are**  
 3 distinct markets.” *Ibid.*, p. V-189, ¶ 5459, emphasis added. Relating this issue  
 4 to economic efficiency, the Commission said:

5           the own-price elasticities and other demand  
 6           characteristics of carrier route and noncarrier route  
 7           mailers are sufficiently different so that separate rates  
 8           and discounts for carrier route and noncarrier route  
 9           mail should improve the equity and economic  
 10          efficiency of the postal rate structure. [*Ibid.*, p. V-189,  
 11          ¶ 5460.]

12           It is clear that the Commission’s decision hinged strongly on non-cost  
 13          factor (b)(2) of section 3622, and therefore on value of service and associated  
 14          demand measures. In the first sentence of its summary, the Commission said:  
 15          “In this case, the Postal Service proposes ‘market-based classes’ of mail . . . .”  
 16          *Ibid.*, p. i. Very little role was played by other factors.<sup>20</sup> Since it is clear that the  
 17          value of service is lower for ECR than for most other subclasses, and particularly  
 18          lower than the average value of service for the former third class, it is clear that

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<sup>19</sup>           (...continued)  
*Op & Rec. Dec.*, Docket No. MC95-1, p. V-161, ¶ 5385.

<sup>20</sup>           It was clear throughout the case that a subclass would allow costs (factor  
 (b)(3)) to be recognized, but that costs could also be recognized without a separate  
 subclass. Some attention was given to the fairness of the proposals, without apparent  
 effect, except in Periodicals and First Class. At one point the Commission explained:  
 “To be fair, rates should not only reflect direct and indirect attributable costs, but also  
 the ‘noncost’ factors set forth in the ratemaking section of the Act, § 3622.” *Op. & Rec.*  
*Dec.*, Docket No. MC95-1, p. III-22, ¶ 3056. Also, the Postal Service indicated that it  
 faced stronger competitive pressures in ECR than in Regular Standard. *Ibid.*, USPS-T-  
 18 at 5.

1 the cost coverage for ECR should have declined. This was implied by the  
2 reasoning in the reclassification case. As will be discussed further below, the  
3 cost coverage has not declined.

4 The expectation of a lower cost coverage for ECR has also been part of  
5 the Postal Service's position. In policy testimony in Docket No. MC95-1, under  
6 the heading of "Efficient Mail Pays Disproportionate Contribution," Postal Service  
7 witness McBride said: "Exactly the same situation occurs in bulk regular third  
8 class, where the efficient carrier route category has a cost coverage 94  
9 percentage points higher than the other category." Docket No. MC95-1, USPS-  
10 T-1 at 16-17. Similarly, Postal Service witness Moeller, the rate design witness  
11 for the proposed new subclasses of Automation, Regular, and ECR Standard  
12 (only the latter two of which the Commission recommended), when asked about  
13 the cost coverage that should apply to ECR, absent tempering to lessen the  
14 effects of the rate changes on mailers, said:

15 . . . if we were starting from a situation where the  
16 coverages for the three subclasses were equal, a  
17 **somewhat lower coverage for Enhanced Carrier**  
18 **Route relative to the combined coverage for the**  
19 **three new subclasses could be supported.** Even  
20 with the waiver of the constraint of avoiding major rate  
21 relationship changes, I have insufficient information to  
22 speculate as to how much lower of a coverage could  
23 be supported, but in the situation you describe it  
24 could be as little as 10 percent. [Docket No. MC95-1,  
25 response to OCA/USPS-T18-18, Tr. 2/4275-6,  
26 emphasis added.]

1           The Postal Service has continued to take the position that the coverage  
2 on ECR should be lower. In Docket No. R97-1, Postal Service witness O'Hara  
3 said: "This [percentage rate increase for ECR] is somewhat below the system-  
4 wide average increase, reflecting a desire to lower the very high cost coverage of  
5 this subclass." Docket No. R97-1, USPS-T-30 at 34, ll. 20-21. In Docket No.  
6 R2000-1, Postal Service witness Mayes, in regard again to the percentage rate  
7 increase for ECR, said: "This is somewhat below the system average increase,  
8 **reflecting a desire to lower the very high cost coverage of this subclass.**"  
9 Docket No. R2000-1, USPS-T-32 at 38, ll. 6-8, emphasis added. Most recently,  
10 in Docket No. R2001-1, in support of the cost coverages proposed for ECR,  
11 witness Moeller said:

12                   The Postal Service is proposing a cost coverage of  
13                   217.8 percent over volume variable costs for the  
14                   ECR/NECR subclass, which results in a 6.2 percent  
15                   average rate increase for ECR, and a 6.5 percent  
16                   increase for NECR. These are somewhat below the  
17                   system average increase, **reflecting a desire to**  
18                   **lower the very high cost coverage for this**  
19                   **subclass.** [Docket No. R2001-1, USPS-T-28 at 36, ll.  
20                   15-19, emphasis added.]

21           In the instant docket, witness Robinson (USPS-T-27) was asked if she  
22 would agree that if the cost coverage of ECR is not reduced over some period of  
23 time following its creation, then the creation of ECR as a separate subclass will  
24 have failed to achieve more equitable rates and to reflect market characteristics.  
25 She declined to agree, and added, in part, two observations.

1           First, she said: "The Enhanced Carrier Route subclass provides options  
2 for customers mailing geographically targeted advertising that are not available in  
3 the Standard Regular subclass." Response to VP/USPS-T27-5 (Tr. 3/406).  
4 Since ECR and Regular were cut from and included in the former third class, and  
5 since all of the features of ECR were or would have been part of third class, this  
6 response is accurate but deceptive. When asked on oral cross-examination  
7 what she meant by this, she said: "There are pricing structures that allow high-  
8 density advertising mail to be provided as a product for customers to use." Tr.  
9 3/510, ll. 17-19. The fact is that there are no pricing structures in ECR that were  
10 not or would not have been part of third class.

11           Second, she said: "By creating a separate ECR subclass, market and  
12 demand differences were recognized not only in the rate structure, but also to a  
13 greater extent in the classification structure." Response to VP/USPS-T27-5 (Tr.  
14 3/406). On oral cross examination, she was asked how market and demand  
15 differences have been recognized in the classification structure. Her response  
16 did not address classification structures. See Tr. 3/510-11.

17           Aside from the institution of the residual shape surcharge, the line-of-  
18 travel requirement on preparation, the requirement for high density and  
19 saturation letters to be prebarcoded, and the provision for automation letters  
20 weighing from 3.3 to 3.5 ounces (which was provided as well to Regular mailers),  
21 there have been no changes in the classification structure of ECR, and all of  
22 these could have and in all likelihood would have been made in the same way if

1 ECR were still part of third class. The cost coverage has not been reduced, and  
2 I find no basis for the argument that market or demand differences have been  
3 recognized.

4 **3. Rates for ECR Mail Are Higher Now than They Would Be If No**  
5 **Separate Subclass Had Been Created for It.**

6 Third-class mail, now called Standard mail, underwent a major  
7 restructuring in Docket No. R90-1. At that time, the letter/flat differential was  
8 introduced and was implemented at a 50 percent passthrough of the cost  
9 difference. Also, dropship discounts were introduced. They were proposed at a  
10 passthrough of 75 percent, and implemented at a slightly higher level due to  
11 revised costs. In order to help accommodate these changes and to temper their  
12 effects on mailers, passthroughs on some of the already-existing presort  
13 discounts were reduced. Then in Docket No. MC95-1, just five years later,  
14 reclassification occurred and third class was split into Regular Standard and  
15 ECR Standard. If reclassification had not occurred, it seems clear that rates for  
16 the former third class would have moved toward passthroughs of 100 percent (in  
17 the case of some passthroughs that were reduced, back towards 100 percent), in  
18 line with oft-expressed preferences of the Commission and the Postal Service for

1 full recognition of cost differences in rates and for sending appropriate (efficiency  
2 improving) signals to mailers.<sup>21</sup>

3 Even given reclassification, the rates in Standard mail recognize cost  
4 differences among the various rate categories in substantial degree. To the  
5 extent to which 100 percent of the cost differences are passed through into  
6 rates, the outcome is that the various categories have approximately the same  
7 per-piece contribution to fixed costs.

8 The expectation of reasonably uniform per-piece contribution levels allows  
9 a check to be made. Specifically, if ECR had not been made into a separate  
10 subclass and the cost differences among the categories in third class had been  
11 fully recognized, as I believe they would have been, then the average **per-piece**  
12 contribution for the categories now in ECR Standard would be approximately the  
13 same as the average per-piece contribution of the categories now in Regular  
14 Standard.

15 Note that this expectation holds despite the well-understood phenomenon  
16 that workshared pieces within a subclass have a higher implicit **percentage** cost  
17 coverage than non-workshared pieces. That is, the average percentage

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<sup>21</sup> Note that Docket No. R94-1, which occurred between the restructuring in Docket No. R90-1 and the reclassification in Docket No. MC95-1, cannot be used as an indicator of the course that post-R90-1 rates would have taken, because it was filed as an ATB case. It is true that the Commission rejected the ATB approach and sought to recognize costs more fully, but this was done only in limited degree, due to an absence of cost information. In most cases, the rates within subclasses were increased a uniform amount, but not the proposed ATB amount. This means that the rates going into reclassification were not those that would have resulted from full Commission consideration in Docket No. R94-1.

1 contribution of the pieces now in ECR Standard would be higher than the  
 2 average **percentage** contribution of the pieces now in Regular Standard, but the  
 3 average **per-piece** contribution would not.

4 Figure 2 shows the results of performing this check under three sets of

5

**Figure 2**

6

**Unit Contribution of Standard Mail Subclasses**

	<b>Average Contribution in Cents per Piece</b>		
<b>Item/Basis</b>	<b>FY 2004</b>	<b>TYBR</b>	<b>TYAR</b>
	<b>(1)</b>	<b>(2)</b>	<b>(3)</b>
<b>Regular</b>	<b>6.46</b>	<b>6.18</b>	<b>7.24</b>
<b>ECR</b>	<b>9.06</b>	<b>8.65</b>	<b>9.52</b>
<b>Difference: ECR-Regular</b>	<b>2.60</b>	<b>2.47</b>	<b>2.28</b>

7  
 8  
 9  
 10  
 11  
 12  
 13 Source: Based on volumes and revenues (w/o fees) from USPST28Aspreadsheets.xls  
 14 in USPS-LR-K-115; FY 2004 costs from Docket No. IM2005-1\_CRA-PRC-2004.pdf filed  
 15 3/15/05 with PRC and FY 2006 TYAR and TYBR costs from  
 16 R2005.FY2006BRC\_DRpt.PRC.AMX.xls and R2005.FY2006ARC\_DRpt.PRC.AMX.xls  
 17 in USPS-LR-K-95.

18 conditions, FY 2004 base year, test year before rates (TYBR), and test year after  
 19 rates (TYAR). In the test year before rates, column 2, which is a projection  
 20 under the assumption of no rate changes, the per-piece contribution of Regular  
 21 Standard is 6.18 cents and of ECR Standard is a whopping 8.65 cents, for a  
 22 difference of 2.47 cents. A similar result is shown in the other columns.

23 Since the per-piece contribution of ECR is, on average, substantially  
 24 higher than the per-piece contribution of Regular, ECR flunks the test and we

1 can say that the rates for the categories in ECR would in all likelihood be lower if  
2 ECR had never been made into a subclass. It is true that this is a relatively  
3 rough test. But the difference (2.47 cents TYBR) is not by any means small.

4       The interpretation of this check is not that a difference in the per-piece  
5 contribution of zero is ideal. A difference of zero would mean only that the rates  
6 for ECR are approximately equal to what they would be if no separate subclass  
7 for it had been created. But a primary reason for creating the ECR subclass was  
8 to allow recognition of differences in the ECR and non-ECR markets, which, as  
9 will be argued below, should have caused the rates to be lower than they  
10 otherwise would have been and the per-piece contribution of ECR to be lower  
11 than the per-piece contribution of Regular. In other words, the difference in per-  
12 piece contribution, shown in the figure to be approximately 2.47 cents, is  
13 **positive, and it should be, to some degree, negative.**

14 **4. A Quantitative Showing that ECR Rates Would Be Lower without the**  
15 **Creation of a Separate Subclass.**

16       The conclusion just discussed, that the now-ECR categories would have  
17 lower rates if the ECR subclass had not been created, can be shown  
18 quantitatively. Again, the estimation process is not exact, and does require  
19 assumptions, but the results are not equivocal.

20       I developed rates based on the following assumptions: (1) The revenue  
21 requirement for the combined subclass is equal to the sum of the revenue

1 requirements proposed by the Postal Service for Regular Standard and ECR  
 2 Standard. (2) Rates as proposed by the Postal Service are assumed for the  
 3 non-machinable letter surcharges, the residual shape surcharges, the barcode  
 4 discount for qualifying residual-shape-surcharge pieces, and all four pound rates.  
 5 (3) The average revenue-per-piece levels for the two nonprofit categories are  
 6 separately set at 60 percent of those of the corresponding commercial  
 7 categories, to the extent allowed by conventional rounding practices, before  
 8 fees.<sup>22</sup> (4) Dropship savings are updated and Commission costs are used, and  
 9 the passthroughs for them are at the levels recommended by the Commission in  
 10 Docket No. R2001-1. (5) With three exceptions, explained further below, a 100  
 11 percent passthrough is used on all avoidances and cost differences shown in the  
 12 presort tree, including between such categories as 3/5-digit letters and basic  
 13 carrier route letters, which are now in separate subclasses. (6) Adjustments for  
 14 the negotiated service agreements are handled the same as in the Postal  
 15 Service's proposal. (7) For cost differences, shown in the presort tree, I used  
 16 Commission costs for mail processing and Postal Service costs for delivery. The  
 17 latter seems reasonable given the anomalous costs that appear to result from  
 18 updating the Commission's delivery costs<sup>as shown in</sup> the update of PRC-LR-7 from Docket  
 19 No. R2001-1, as provided by the Postal Service.

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<sup>22</sup> The term "commercial" is sometimes used to help refer to either the for-profit category of Regular Standard or the for-profit category of ECR Standard. Officially, there are no names for these categories, and the identifiers available are more confusing than helpful. When necessary for reasons of balance, "commercial" will be capitalized.

1 Under the preceding assumptions, the rates are revenue neutral for the  
2 combination of ECR Standard and Regular Standard, as proposed by the Postal  
3 Service, ATB. In Docket No. R2001-1, based on USPS costing, 15 passthroughs  
4 were selected in the combined commercial category. These are shown, but not  
5 confirmed, in the Postal Service response to VP/USPS-T28-48, redirected from  
6 witness Taufique (Tr. 8/\_\_\_\_\_). Seven of these were equal to 100 percent; two  
7 were over 100 percent; and six were below 100 percent. Three of those below  
8 100 percent (for mixed AADC automation, 3-digit automation, and basic ECR  
9 automation) have been preserved, based on a presumption that their levels were  
10 selected because the costs of the host category included non-machinable mail.  
11 One could note that it is unlikely that all passthroughs except these three would  
12 exactly equal 100 percent sans the ECR subclass. It is the case that in any  
13 particular rate proceeding, each passthrough would be examined, along with  
14 trends, and might be adjusted for various reasons. As a rough estimate,  
15 however, the assumption is undoubtedly indicative.

16 The results for the commercial categories now in ECR are shown in  
17 Figure 3. Column E contains results for the joint subclass and, for reference  
18 purposes, column G shows the ATB rates proposed by the Postal Service in this  
19 case. The basic ECR letter rate is 16.7 cents, a full 3.7 cents below the  
20 proposed rate of 20.4 cents. In all cases, rates in the joint subclass are  
21 substantially lower, except for the pound rate, which was constrained by  
22 assumption.

1

**Figure 3**

2

**Rates For Now-ECR Categories If No Subclass Had Been Created**

<b>Now-ECR Categories</b>		<b>Hypothetical</b>	<b>USPS</b>
<b>Built as Though No ECR Subclass Had Been Created</b>		<b>Combined</b>	<b>Proposed</b>
<b>Minimum-per-piece Rates, cents/pc</b>		<b>Subclass</b>	<b>Rates</b>
		<b>Rates</b>	<b>(reference)</b>
<b>Letter Piece Rates</b>			
	Basic ECR	16.7	20.4
	Automation ECR	13.3	18.0
	High Density ECR	13.5	17.3
	Saturation ECR	13.2	16.0
<b>Non-Letter Piece Rates</b>			
	Basic ECR	17.3	20.4
	High Density ECR	14.0	17.8
	Saturation ECR	13.6	16.9
<b>Destination Entry Discounts, per piece</b>			
	DBMC	2.3	2.2
	DSCF	3.0	2.7
	DDU	3.7	3.3
<b>Pound-rated Pieces, cents/lb &amp; cents/pc</b>			
	Pound Rate	64.3	64.3
<b>Per-piece Add Ons</b>			
	Basic ECR	4.0	7.2
	High Density ECR	0.7	4.5
	Saturation ECR	0.3	3.6
<b>Destination Entry Discounts, per pound</b>			
	DBMC	11.3	10.5
	DSCF	14.7	13.2
	DDU	17.7	16.6

1           These results confirm the expectation implied by considering the per-  
2 piece contributions. ECR rates are approximately 25 percent higher than they  
3 would be if no ECR subclass had been created. Using a modified set of  
4 passthroughs or avoidances would not change this conclusion. It is decidedly  
5 pronounced.

6 **5. Specific Consideration of the Non-cost Factors in the Act for ECR**  
7 **Mail.**

8           As discussed above, cost coverages for the subclasses should result from  
9 an independent application of the non-cost factors in the Act, within a breakeven  
10 framework. When the Commission did this for third class, before reclassification,  
11 it said: "Similarly, we have consistently found that third-class bulk regular,  
12 another subclass which is largely subject to the statutory monopoly, should also  
13 bear an approximately average markup." *Op. & Rec. Dec.*, Docket No. R90-1, p.  
14 IV-8, ¶ 4022. In short, the Commission laid the various characteristics of third  
15 class and its markets against the non-cost factors in the Act and reached a  
16 conclusion that its cost coverage should be 146.2 percent, which was a markup  
17 index of 0.927. *Ibid.*, App. G, Schedule 3, pp. 1-2.

18           It is important to note that this cost coverage of 146.2 percent was  
19 selected by focusing on the combination of what is now Commercial Regular and  
20 Commercial ECR, not including any influence from the nonprofit categories.  
21 Nonprofit third class at the time was a separate subclass and had a legislated

1 cost coverage approximating 100 percent, with its calculated contribution (to  
2 fixed costs) paid by Congress in the form of an appropriation. If lower rates for  
3 the then-nonprofit subclass had been financed in the same way that they are  
4 now, and the commercial categories were to have had the same implicit markup  
5 that they actually did (so as to leave them unaffected by the financing  
6 arrangement for nonprofit), the cost coverage for the joint (nonprofit and regular)  
7 third-class subclass would have had to be lower than 146.2 percent.

8         The important question becomes: If the application of the non-cost  
9 factors to the mail in Commercial Regular Standard and Commercial ECR  
10 Standard together led to a cost coverage of 146.2 percent, what coverages  
11 should a similar application of the non-cost factors yield when applied separately  
12 to Regular and ECR, allowing for the presence of the Nonprofit categories?<sup>23</sup>  
13 The decision to make ECR into a separate subclass, which by definition warrants  
14 an independent application of the non-cost factors, makes this the appropriate  
15 question, and one that must be answered.

---

<sup>23</sup> A similar question was asked by the Commission when it selected cost coverages for single piece and bulk third class in Docket No. R90-1, the two both being subclasses of third class. The Commission said: "Theoretically, there may be little reason to differentiate between single piece and bulk third class when establishing relative markups, however the rate design problems of single piece have effectively insulated it from being assessed a systematically developed contribution toward institutional costs." Op. & Rec. Dec., Docket No. R90-1, p. IV-31, ¶ 4101. This reasoning, to the extent to which it applies, suggests that the markups on Regular Standard and ECR Standard should be similar in magnitude.

1           Using X to stand for each of the non-cost factors,<sup>24</sup> this question can be  
2 stated another way. If non-cost factor X, when applied to the former third class,  
3 was part of a deliberation process that led to a cost coverage of 146.2 percent,  
4 what cost coverages are implied by applying factor X separately and  
5 independently to the now-Regular and the now-ECR subclasses, with the  
6 understanding that the average revenue-per-piece of the Nonprofit categories  
7 must be equal as nearly as practicable to 60 percent of that of their  
8 corresponding commercial categories? Since Congress made it clear that it did  
9 not intend for the burden of supporting the Nonprofit rates to fall on their host  
10 commercial categories only, but rather on the Postal Service overall,<sup>25</sup> it is clear  
11 that if the **implicit** coverages for the commercial categories of Regular and ECR  
12 were both to be 146.2 percent, the coverages on the joint (Commercial and  
13 Nonprofit) categories would necessarily be below 146.2 percent.

14           In addition to selecting cost coverages that do not place the burden of the  
15 Nonprofit rates on the host category, it needs also to be kept in mind that the

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<sup>24</sup> Note that factor No. 3 of section 3622, "the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type," is not a non-cost factor.

<sup>25</sup> Section 2 of S. 2686, which led to P.L. 106-384, 114 Stat. 1460, Oct. 2000, was a transitional provision that said: "In any proceeding in which rates are to be established under chapter 36 of title 39, United States Code, for mail matter under former sections 4452(b) and (c) of that title, pending as of the date of enactment of section 1 of this Act, the estimated reduction in postal revenue from such mail matter caused by the enactment of section 3626(a)(6)(A) of that title, if any, shall be treated as a reasonably assignable cost of the Postal Service under section 3622(b)(3) of that title."

1 resulting rate levels for the Nonprofit categories are determined just as much by  
2 these cost coverages as the rates of the accompanying commercial category.  
3 That is, since the per-piece revenue for the Nonprofits is fixed at 60 percent of  
4 the per-piece revenue for the corresponding commercial category, the higher the  
5 rates for the commercial categories, the higher the rates for the Nonprofit  
6 categories. Therefore, to elevate the coverages (and the rates) on the combined  
7 categories unnecessarily would be to elevate the implicit coverages (and the  
8 rates) on the Nonprofit categories. To do this would seem to negate the  
9 provision Congress made for the Nonprofits. The need to watch out for the  
10 Nonprofits, therefore, puts added pressure on the process of selecting  
11 coverages.

12 In the sections below, each non-cost factor will be discussed. Attention  
13 focuses on the proportionate (expressed as a percentage) cost coverage, which  
14 is directly related through the systemwide cost coverage to the markup index.<sup>26</sup>

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<sup>26</sup> The Commission has agreed that the cost coverages and the associated markup indexes are the appropriate focus. It has said: "We conclude that it continues to be most appropriate to distribute the relative burden of recovery of institutional costs on the basis of coincident application of the policy factors of the Act, with reference to the markup index." *Op. & Rec. Dec.*, Docket No. R90-1, p. IV-17, ¶ 4052. Also: "We measure relative burdens with a markup index, which compares the markup for each subclass with the systemwide average markup. . . . We find this measure particularly valuable because it allows us to compare relative burdens from case to case, while case to case comparisons of cost coverages or unit contributions are made misleading by variations in the amount of total attributable dollars involved." *Ibid.*, p. IV-4, ¶ 4011. Within the context of a given case, of course, there is no difference between relative cost coverages and relative markup indexes.

1 This is the appropriate focus, rather than some other measure such as the per-  
 2 piece contribution.<sup>27</sup>

3 **Non-Cost Factor No. 1:**  
 4 **The establishment and maintenance of a**  
 5 **fair and equitable schedule**

6 The question is: would any notion of fairness, when applied to ECR,  
 7 suggest in any direct way that its cost coverage should be higher than the 146.2  
 8 percent (or the associated markup index of 0.927) that was suited to third class  
 9 as a whole? Several observations may be made.

10 First, the fact that the reduced revenue from Nonprofit mail makes the  
 11 rates for the Commercial mail higher for any given cost coverage for the ECR  
 12 subclass suggests that the cost coverage for the subclass should be lower than  
 13 the 146.2-percent figure. If an influence in this direction were not allowed, it  
 14 would imply that the full burden of providing the lower Nonprofit rates should be  
 15 borne by the Commercial mailers, which, as discussed above, was not the intent  
 16 of Congress.

17 Fairness is often taken to mean that costs are recognized in appropriate  
 18 ways, lending support to attributable costs and markups as important reference

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<sup>27</sup> Another candidate measure is the markup fraction, which is the absolute per-piece markup relative to the rate. For example, if the rate is 8 cents and the cost is 5 cents, the per-piece markup is 3 cents and the markup fraction is  $3/8 = 0.375$ . This measure will always be equal to or less than 1.0. Its lack of use in Commission proceedings is probably because its relative levels are closely related to those of the more-common cost coverage.

1 points and to interests in what are often called **cost based rates**.<sup>28</sup> The  
2 Commission noted this and extended it in Docket No. MC95-1 when it said:

3           To be fair, rates should not only reflect direct and  
4           indirect attributable costs, but also the “noncost”  
5           factors set forth in the ratemaking section of the Act,  
6           § 3622. A major reason for establishing separate  
7           subclasses is to allow rates to be set to reflect  
8           significant distinctions in the applicability of one or  
9           more of the noncost statutory criteria. [*Op. & Rec.*  
10          *Dec.*, Docket No. MC95-1, p. III-22, ¶ 3056.]

11           In addition, national policy issues can be associated with fairness. The  
12 Postal Service has been established to provide services to mailers and the  
13 American people. The presumption is that by aggregating mail from all sources  
14 and having one carrier, a low-cost, highly efficient operation can be achieved,  
15 and these low costs can allow correspondingly low rates. Partly through the help  
16 of extensive preparation of mail by mailers, an issue discussed further under  
17 non-cost factor No. 6 below, low costs have been achieved in the ECR subclass  
18 to a considerable degree. ECR’s costs are low and the resources drawn from  
19 the nation to provide the service are minimal. Benefits from this achievement  
20 can be realized only if the low-cost mailstream is made available to mailers at  
21 reasonable rates. An excessive cost coverage subverts this process, unfairly,  
22 and prevents the benefits from being received.

---

<sup>28</sup> When rates are not cost based, it is often the case that inefficient signals are sent to mailers. One might argue, for example, that it is unfair to local mailers to maintain a uniform nationwide rate, as this would force them to help finance transportation for long-haul mailers that could arrange easily to print and enter their mail much closer to its destination. This is one of the reasons dropship discounts were introduced in third class in Docket No. R90-1.

1           Finally, as stated above, notions of fairness are often viewed as  
 2 reflections of the thought process of the beholder. For example, in Docket No.  
 3 R90-1, the Commission said: “The Commission is a collegial body with five  
 4 members, each of whom has a separate, distinct view of what is fair and what is  
 5 equitable. These five views become balanced as rate recommendations are  
 6 being developed.” *Op. & Rec. Dec.*, Docket No. R90-1, p. IV-39, ¶ 4124.

7           I find no basis for concluding that considerations of fairness and equity  
 8 argue for a cost coverage on ECR that is higher than the coverage on the former  
 9 third class, or even higher than the average for all mail. In the same docket,  
 10 quoting its own opinion in Docket No. MC78-2, the Commission said:

11                       it is our view that in the exercise of our classification  
 12                       responsibilities pursuant to § 3623, the requirement of  
 13                       a “fair and equitable classification system for all mail”  
 14                       compels us to strive for a classification structure  
 15                       which permits the establishment of cost-based rates.  
 16                       [*Ibid.*, p. V-56, ¶ 5124.]

17           One reason for creating ECR was to improve the cost-based nature of the  
 18 rates. That purpose should not be overridden by an excessive markup.

19                                       **Non-Cost Factor No. 2:**  
 20                                       **The value of the mail service actually provided each**  
 21                                       **class or type of mail service to both the sender and the**  
 22                                       **recipient, including but not limited to the collection,**  
 23                                       **mode of transportation, and priority of delivery**

24           Mailers receive value from using the mail. We know, for example, that a  
 25 mailer spending a million dollars on postage must be receiving more than a  
 26 million dollars of value, or he would not enter the mail. But as applied to the

1 question of how far to raise rates above costs, which is the question faced when  
2 cost coverages are selected, the question is how much value beyond the one  
3 million dollars is available to be drawn upon. Mailers spending a million dollars  
4 on postage could be getting, say, 8 or 9 million dollars in value. The realization  
5 of such high values is the hope when the service is provided. The nation is  
6 certainly better off when a value of 8 or 9 million dollars is received than when a  
7 value of, say, 1.5 million is received. On the other hand, mailers spending a  
8 million dollars on postage could be receiving a value of only 1.5 million dollars. A  
9 circumstance such as this would not suggest that the service should be  
10 withdrawn, but it would be clear that little value exists to draw on in increasing  
11 rates above costs.

12         If there is a substantial amount of value to draw on, the cost coverage can  
13 be elevated and volume will diminish only a little. If volume diminishes only a  
14 little, the reduction in value received will also be small, although more of the  
15 value will be paid out in postage. Alternatively, if only a small amount of value is  
16 available to be drawn on, then an elevation in the cost coverage will reduce the  
17 volume substantially, and the reduction in value received will also be substantial.  
18 The importance of recognizing value to mailers when selecting markups is to  
19 reduce the occurrence of the large losses in value that result from large volume  
20 reductions.

21         The measure of the sensitivity of volume to price increases, and therefore  
22 of value to price increases, is the own-price elasticity of quantity demanded.

1 Acknowledging this measure, the Commission said: "Large differences in own-  
2 price elasticities are clearly important evidence supporting separate treatment  
3 under § 3622(b)(2)." *Op. & Rec. Dec.*, Docket No. MC95-1, p. III-45, ¶ 3120.

4 Measures of elasticity are developed by the Postal Service as part of the  
5 volume forecasting process. In this docket, Postal Service witness Thress  
6 (USPS-T-7) estimates the own-price elasticity of Commercial ECR to be -1.093  
7 and of Commercial Regular to be -0.267, both of which categories were part of  
8 the former third class. USPS-T-7 at 9. This means that when rates for third  
9 class were increased, a substantial amount of value was lost by now-ECR  
10 mailers and a much smaller amount was lost by now-Regular mailers. In Docket  
11 No. R2001-1, these two elasticities were estimated to be, in order, -0.770 and -  
12 0.390. That is, the own-price elasticity of Commercial ECR is now estimated to  
13 be 41.9 percent **higher** than it was in the previous docket, and the corresponding  
14 own-price elasticity of Commercial Regular is now estimated to be 31.2 percent  
15 **lower**. See responses of witness Thress to VP/USPS-T7-1-2, Tr. 3/325-26. The  
16 importance of recognizing value has increased.

17 An elasticity of -1.093 is substantial. It means that if there is a rate  
18 increase of 10 percent, the volume will decline 10.93 percent, *ceteris paribus*,  
19 and therefore that total revenue will actually decrease. Total revenue less cost,  
20 however, which is the contribution obtained from the subclass, will increase as  
21 long as the elasticity, in absolute value, is less than the price divided by the per-  
22 piece markup. For Commercial ECR, this critical level (with its actual sign) is

1 about -1.88. Therefore, despite the volume loss, which is substantial, an  
2 increase in price will increase net revenue. But the amount by which net  
3 revenue will increase is not large and the elasticity is not so very far from the  
4 level where even this would not occur.

5 The elasticity measures vary among the subclasses of mail. In general,  
6 the elasticity of Commercial ECR (at -1.093) is relatively high (in terms of the  
7 response to a rate change) and the elasticity of Commercial Regular (at -0.267)  
8 is relatively low. The difference is due to a number of factors, including the  
9 importance attached to sending or receiving the piece, closeness of substitutes,  
10 preferences of the users, and response rates of recipients (the later applying  
11 primarily to advertising materials). The measure does reflect, then, the value to  
12 recipients.

13 In past proceedings, some attention has been focused on what are called  
14 **intrinsic** indicators of value. These relate to such things as deferability, speed  
15 of service, whether air transportation is used, whether delivery is guaranteed on  
16 a certain day, options available for acceptance or postage payment, whether the  
17 piece is sealed against inspection, and whether forwarding service is provided.  
18 For the most part, these are **characteristics of the product or service offered**.  
19 Whether and to what extent these characteristics are valued by senders or  
20 recipients is another matter. A product can have a long list of characteristics and

1 not be valued highly.<sup>29</sup> In the end, identifying a product's characteristics may  
2 highlight its features and facilitate clear thinking about the value mailers **might**  
3 place on the product, but the ultimate – and only relevant – question is whether  
4 the value is actually there. The test for this is the decisions users make in the  
5 market, which is reflected in the elasticity measures.

6         One reason for creating the ECR subclass was to facilitate recognition of  
7 its market characteristics. The measure of this that received primary attention  
8 was its high elasticity. It is apparent that the value available to draw on in the  
9 case of ECR Standard is considerably lower than the value available in the case  
10 of Regular Standard or of most other subclasses. To the extent that recognition  
11 is given to this low reservoir of value, a lower-than-average and lower-than-the-  
12 former-third-class cost coverage is suggested.

13         In the recognition of value, the Commission has noted that much of the  
14 inelasticity in First Class is due to restrictions against private carriage and to the

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<sup>29</sup> Suppose a product is defined by a certain list of **characteristics** and, accordingly, has a certain cost. Suppose further that the price is set equal to this cost and that, say, 5 billion pieces are purchased, for a total postage bill of \$1 billion. The fact that mailers are willing to spend \$1 billion on this product is certainly evidence that they find much value in it (in the sense that \$1 billion is a lot of money on any basis), and certainly the decision to purchase 5 billion pieces is a reflection of the product's characteristics. In fact, we know that the value being received must be something in excess of \$1 billion. But knowing this and understanding the product's characteristics tells us nothing about (i) how far the value being received is above \$1 billion, (ii) how rapidly the volume will drop off when the price is increased, and, accordingly (iii) how much value is available to draw on in increasing the price. If the volume falls off substantially when the price is increased, the attempt to obtain more revenue will largely fail due to the disappearance of the volume, and the value received by mailers from purchasing the product will decline substantially as well.

1 requirement that some materials, if mailed, **must** be sent First Class. It has  
2 considered it therefore somewhat unfair to elevate the markup of First Class on  
3 the basis of elasticity, even though it is clear that considerable value exists. In  
4 Docket No. R90-1, for example, the Commission said: "Specifically, we find that  
5 it would violate the principles of postal ratemaking as set forth in the Postal  
6 Reorganization Act to set First-Class rates to produce a markup index  
7 significantly higher than average." *Op. & Rec. Dec.*, Docket No. R90-1, p. IV-19,  
8 ¶ 4059. For related reasons, the Commission has declined to recommend a low  
9 markup to Standard mail, based on its low value. In the same docket, it said:  
10 "Similarly, we have consistently found that third-class bulk regular, another  
11 subclass which is largely subject to the statutory monopoly, should also bear an  
12 approximately average markup." *Ibid.*, p. IV-8, ¶ 4022.

13         Accepting the preference for not lowering the markup on third-class mail,  
14 and recognizing that Commercial ECR is more elastic than Commercial Regular,  
15 the question in regard to value should be whether the markup on Commercial  
16 ECR should be both lower than the systemwide average markup and lower than  
17 the markup on Commercial Regular. Even if this question is answered by a  
18 Commission preference for applying its "approximately average markup" to both  
19 ECR and Regular, the current markup on ECR, 226.4 percent in the test year at  
20 the proposed rates, is too high, by a wide margin. See USPS-LR-K-114, revised  
21 June 10, 2005. If the markup on ECR is not lowered, then ECR is thereby

1 prevented from having its market characteristics recognized appropriately, which  
2 was a primary purpose of making it a separate subclass.

3 **Non-Cost Factor No. 4:**

4 **The effect of rate increases upon the general public, business**  
5 **mail users, and enterprises in the private sector of the economy**  
6 **engaged in the delivery of mail matter other than letters**  
7

8 If a meritorious rate position has been identified and the rate increase  
9 required to get there is unusually large, concern over the **effect** of the rate  
10 increase might cause the coverage to be reduced, in order to ease the  
11 adjustment burden. Any such reduction, however, would normally be expected  
12 to be temporary. The Commission might decide to get to the desired rate  
13 position in two or three steps instead of one, but it would not reject the  
14 meritorious position. The concern here is over rate shock, not over rate level.

15 But in considering whether cost coverages are too high, a concern over  
16 the effect of rate **increases** does not arise. Instead, the question that arises is  
17 over the effect of rate **decreases**, which this non-cost factor does not expressly  
18 address.

19 Nevertheless, despite its specific focus on rate increases, this factor has  
20 sometimes been interpreted to raise the question of whether a rate is so low that  
21 it competes unfairly with "enterprises in the private sector of the economy  
22 engaged in the delivery of mail matter other than letters." Insofar as the  
23 restrictions on private carriage are concerned, letters are addressed pieces

1 having no more than 24 pages. Pieces without addresses can be carried  
2 privately, as can pieces with over 24 pages.

3         These definitions mean that addresses can be removed from saturation  
4 pieces and they can then be delivered by private enterprises, along with the  
5 over-24-page pieces. But private enterprises still cannot use the mailbox. That  
6 is, they are permitted to take the pieces to the delivery points, and leave them on  
7 door knobs or in front yards, but not in mailboxes. Under these conditions, I  
8 contend that it is not only unfair to mailers but also poor national policy to elevate  
9 ECR rates, for both Commercial and Nonprofit mailers, whether the pieces can  
10 be delivered privately or not, in order to attempt to make it profitable for private  
11 enterprises to be successful in attracting a portion of the ECR mailstream.

12         The situation faced by private delivery enterprises is perplexing at best.  
13 Delivery operations tend to have fixed costs as an inherent characteristic, which  
14 is another way of saying that their costs do not vary substantially with volume  
15 and that scale economies can be realized by attracting additional volume. To be  
16 effective, these operations need to attract substantial volumes per delivery point.  
17 But the situation they face is that only a portion of the ECR volume can be  
18 carried privately and, since many mailers and recipients would prefer the use of  
19 the mailbox, their method of delivery is considered inferior. Therefore, even  
20 under the best of circumstances, they have difficulty attracting volume. Many  
21 private delivery operators have said to me: If only I could use the mailbox, I  
22 could attract more volume and I would be running a successful operation.

1           Given this situation that they face, private operators tend to have relatively  
2 high costs, which might be overcome in some degree by payment of relatively  
3 low wages. On the other hand, mailers have available in the form of the Postal  
4 Service a low-cost delivery service that is able to use the mailbox and that should  
5 be able to meet their needs effectively. Under these conditions it is not  
6 appropriate to elevate the ECR rates to attempt to make the private operators  
7 successful anyhow. Doing this simply increases mailer costs, reduces volume,  
8 and accordingly reduces the value that mailers could receive. It also keeps the  
9 Postal Service from providing exactly the service that it was established to  
10 provide.

11           The Commission has taken the position many times that competition  
12 should be protected, but not competitors.<sup>30</sup> Placing an average markup on ECR,  
13 especially given that the wages (including fringe benefits) paid by the Postal  
14 Service are undoubtedly higher than those of private operators, would protect  
15 competition adequately. I contend that it is not good ratesetting to use an effect-  
16 on-competitor argument to elevate the coverage on ECR under these conditions.  
17 If there were interest in encouraging private competition, the mailbox rule could  
18 be changed instead.

---

<sup>30</sup> See Docket No. R2000-1, where the Commission said: "The Commission's role is to protect competition, not competitors. *Direct Marketing Association, Inc. v. United States Postal Service*, 778 F.2d 96, 106 (2<sup>nd</sup> Cir. 1985)." *Op. & Rec. Dec.*, *Ibid.*, p. 473, ¶ 5788.

1                                   **Non-Cost Factor No. 5:**  
2                                   **The available alternative means of sending and receiving**  
3                                   **letters and other mail matter at reasonable costs**

4           When this factor was applied to the former third class, it was in effect  
5 applied to ECR and Regular Standard jointly. Now that they are two separate  
6 subclasses, the factor must be applied separately, and the proportions of the  
7 included mail that can be carried privately differ.

8           As discussed above, some letters and other mail matter in ECR can be  
9 carried by private competitors if the addresses are removed or if the pieces have  
10 over 24 pages. Another alternative is to send materials privately under the  
11 urgent letter exception, which would not be expected for advertising matter. But  
12 most materials in ECR cannot be sent privately. The Private Express Statutes  
13 require that if they are sent, they must be sent through the Postal Service.  
14 Therefore, most ECR mailers have no alternatives. This conclusion applies with  
15 even more force to Nonprofit mailers.

16           In the case of Regular Standard, however, the mail tends to be targeted  
17 and removing the addresses is not an option. Therefore, it may be that Regular  
18 mailers have fewer options than ECR mailers, or at least that a smaller  
19 proportion of the included volume has a private delivery option. For this reason,  
20 one could argue that an appropriate markup on ECR might be somewhat higher  
21 than the markup on Regular. This position, however, is based on averages and  
22 not on any notion of fairness to the mailers in ECR who have no options. In any

1 case, it is difficult to see that this factor would contribute to the markup on ECR  
2 being **substantially** higher than the markup on Regular.

3 Considerations rooted in this factor are often expanded to include  
4 **alternatives** to sending and receiving physically, such as when information  
5 equivalent to that contained in letters and other mail matter is transmitted  
6 electronically, despite the fact that this non-cost factor refers specifically to  
7 "sending and receiving letters and other mail matter." For example, a mailer  
8 sending advertising or other promotional material in one of the Standard  
9 subclasses could consider a similar promotion using television, radio,  
10 newspapers, or the Internet.<sup>31</sup> Viewed in this way, it is clear that Standard  
11 mailers do have alternatives. And, since ECR mailers are more likely to be  
12 interested in reaching broad geographic areas, and thus are more likely to find  
13 some of the broader media like television suitable, one could argue that ECR  
14 mailers might have more alternatives than Regular mailers, perhaps contributing  
15 to the higher elasticity and lower value of service of the former relative to the  
16 latter.

17 If ECR mailers have more alternatives than mailers in other subclasses or  
18 than Regular mailers, the position could be taken that an elevation in their rates  
19 would not leave them in the lurch, despite the lower value available to be drawn

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<sup>31</sup> As another example, one restaurant that I frequent sends me coupons by e-mail. It is clear beyond question that my propensity to eat there again is influenced by the coupons received. In fact, if I fail to use the coupons, my wife takes the position that I have wasted money.

1 on through increased rates. And, at the same time, it is important to compete  
2 fairly with these other media. But it is also important not to disadvantage the  
3 mail option. The Postal Service exists to serve mailer needs effectively and a  
4 high rate prevents that from occurring, thereby limiting the value and benefits  
5 that are achievable.

6 On balance, arguments relating to the availability of alternatives, exclusive  
7 of considerations relating to value, and arguments about how to compete fairly  
8 with providers of alternatives, could be taken to suggest a markup at or near the  
9 average level, and perhaps a slightly higher markup for ECR than for Regular,  
10 but would not support, even apart from the influence of other factors, the  
11 exceedingly high markup on ECR that would exist under the Postal Service's  
12 proposal.

13 **Non-Cost Factor No. 6:**  
14 **The degree of preparation of mail for delivery into the**  
15 **postal system performed by the mailer and its effect**  
16 **upon reducing costs to the Postal Service**

17 An important element of an effective postal system involves mailers and  
18 the Postal Service working together. Sometimes this is done through rate  
19 arrangements commonly referred to as involving worksharing, with an associated  
20 outcome of achieving technical efficiency in the mailstream and lowest combined  
21 costs, and sometimes through an elementary process of deaveraging and  
22 recognizing costs in rates, which can increase the competitiveness of the Postal  
23 Service in fair ways, while allowing mailer needs to be met. Mailer responses to

1 signals sent through rates aligned with notions of worksharing and appropriate  
2 cost recognition often result in additional preparation of the mail, an activity that  
3 this non-cost factor suggests should be recognized in rates.

4 ECR mailers engage in preparation activities in greater degree than any  
5 other subclass. They presort, they barcode, they prepare mail in line-of-travel  
6 sequence, and they dropship. In addition, some practices that are a natural part  
7 of their operations tend to result in low postal costs, such as container usage,  
8 acceptance processes, and postage payment procedures. Also important is that  
9 their density, which may be thought of as the number of pieces per carrier route,  
10 and their bulk nature helps to translate their activities into low costs. As a result,  
11 the Postal Service's costs for ECR mail are notably low – especially saturation  
12 mail.

13 When costs are low, a normal outcome of the competitive process is low  
14 rates. This allows benefits of the low costs to be realized. It makes no sense at  
15 all for the presence of low costs to be used as a basis for elevating rates to an  
16 extreme degree. Such a practice removes from mailers the reasonable option to  
17 use a low-cost mailstream that is a prime example of the kind of service that a  
18 national postal service should provide. Also, an elevation of rates on this basis  
19 runs counter to this non-cost factor, which requires that preparation activities be  
20 recognized. This factor, even on a *ceteris paribus* basis, cannot be used as a  
21 basis supporting a markup on ECR at anywhere near the current level. At the  
22 most, it should support a markup at or below the median, at least as far as

1 In regard to the reclassification proposals of the Postal Service and factor  
2 No. 9, the Commission said:

3 No other factor involved in the process of allocating  
4 institutional costs requires separate mention.  
5 Consideration of the eight specific factors leads to the  
6 conclusion that only one of the subclasses proposed  
7 by the Postal Service will improve the ability of rates  
8 to reflect the statutory ratemaking criteria. [*Op. &*  
9 *Rec. Dec.*, Docket No. MC95-1, p. III-53, ¶ 3141.]

10 In the same docket, the Commission mentioned the “other factors”  
11 provision in section 3623(c)(6), saying: “The major ‘other factor’ which the  
12 Commission has taken into consideration in this docket is whether the proposed  
13 subclass structure will facilitate the application of the statutory ratemaking  
14 criteria.” *Ibid.*, p. III-41, ¶ 3110. It concluded that it did for ECR.

15 Finally, in Docket No. R94-1, another case filed as ATB, the Commission  
16 said:

17 In evaluating all of the arguments for and against the  
18 proposed across-the-board rate increase, the  
19 Commission has focused on its obligations under the  
20 Act. The Postal Service suggests that section  
21 3622(b)(9) allows the Commission to determine that  
22 the importance of facilitating [the] reclassification  
23 [case to come] outweighs the considerations codified  
24 in other statutory criteria. The Commission has  
25 carefully considered this proposition, but before  
26 accepting it the Commission must judge whether  
27 there is sufficient evidence to support the conclusion  
28 that an across-the-board approach will actually tend  
29 to further reclassification. Although a number of  
30 parties support the Postal Service’s request, there is  
31 no empirical evidence in the record to suggest that  
32 mailers will be less receptive to reforms of product  
33 lines if rate increases for existing subclasses are not

1 identical. [*Op. & Rec. Dec.*, Docket No. R94-1, pp. 1-  
2 4-5, ¶ 1015, footnote omitted.]

3  
4 Other parts of my testimony deal with whether a justification has been  
5 presented for an AtB approach, under or apart from non-cost factor No. 9. But I  
6 have found no basis for non-cost factor No. 9 being used to influence the markup  
7 of the former third class or of ECR.

8 **6. The Legacy of ECP Should Not Be Continued in High Markups.**

9 Many differences among rates within subclasses have been set according  
10 to the efficient component pricing (“ECP”) rule. The Commission explains:

11 The theory [the ECP rule] requires the discount to be  
12 100 percent of the cost savings. The Commission  
13 tries to achieve 100 percent passthrough of the  
14 worksharing savings, but again it frequently may  
15 depart from this standard for a variety of reasons.  
16 [*Op. & Rec. Dec.*, Docket No. R2000-1, p. 390, ¶  
17 5535.]

18 When the rule is followed, pieces moving from one rate category to another tend  
19 to keep their same absolute per-piece contributions to fixed costs; and to the  
20 extent to which all important cost differences among mailings are recognized in  
21 rates, all pieces within the subclass tend to have the same per-piece  
22 contribution. When the per-piece contributions are equal, the percentage  
23 contributions are not. Specifically, workshared pieces will tend to have much  
24 higher percentage contributions than non-workshared pieces. This phenomenon  
25 is well recognized in rate proceedings. Examples are easy to construct.

1           Suppose a subclass is composed of equal volumes of two kinds of pieces,  
2 presorted and not presorted. Suppose further that the presorted pieces cost 6  
3 cents to process and deliver, and the non-presorted pieces cost 10 cents. If the  
4 rate difference is set equal to the 4-cent cost difference, the presort rate might be  
5 11 cents and the non-presort rate might be 15 cents. Under these conditions,  
6 the average per-piece revenue is 13 cents and the average per-piece cost is 8  
7 cents. The cost coverage of the subclass, then, is  $13/8 = 162.5$  percent. Each  
8 of the pieces, presort and non-presort, make a per-piece contribution of 5 cents  
9 ( $11 - 6$  and  $15 - 10$ ). But the implicit percentage markup of the presorted pieces  
10 is 11 divided by 6, which is 183.3 percent. This result does not imply an error in  
11 any of the ratesetting steps.

12           Prior to reclassification, third class fit this example. The implicit  
13 percentage cost coverage of the most highly workshared pieces, taken category  
14 by category or as a group, was much higher than the percentage cost coverage  
15 of the subclass as a whole; and since ECR is composed of the most highly  
16 workshared pieces, the implicit coverage of ECR was very high.

17           Actual figures show exactly such relationships. Coming out of  
18 reclassification, which was contribution neutral, the coverage of Regular  
19 Standard was estimated to be 134.6 percent and the coverage of ECR Standard

1 to be 218.1 percent. The joint coverage, however, was 159.9 percent.<sup>32</sup> *Op. &*  
2 *Rec. Dec.*, Docket No. MC95-1, App. F.

3         These relationships and relative levels were consistent with what would be  
4 expected under the efficient component pricing rule for recognizing worksharing  
5 **within a subclass**. But the outcome of the reclassification case was to separate  
6 third class into two subclasses, which would warrant an independent application  
7 of the non-cost factors to obtain cost coverages. The ECP rule does not apply  
8 between subclasses. The appropriate way to recognize costs in rates was quite  
9 different after reclassification. Reclassification recognized that different markets  
10 and different mailers were involved. In effect, Regular Standard and ECR  
11 Standard became separate products.

12         Under these conditions, there is no justification for continuing the relative  
13 cost coverages of Regular and ECR, case after case after case, much as though  
14 they were worksharing categories. In response to the possibility of doing just  
15 that for the proposed split of Regular into two subclasses, the Commission said:

16                 The alternative of creating separate subclasses and  
17                 considering the issue of lowest combined cost when  
18                 selecting the associated markups is not a rational  
19                 alternative. Selecting the markups in such a  
20                 constrained way provides rates that are no different  
21                 from those that result from offering worksharing  
22                 discounts through rate categories. . . . One has to  
23                 question the logic of creating subclasses and then

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<sup>32</sup>         These figures do not include the Nonprofit subclasses, which were the subject of a separate reclassification proceeding. As explained earlier in the text, the inclusion of the Nonprofit categories should have caused the cost coverages to decline.

1                   constraining the outcome in accordance with a result  
2                   that would be obtained without creating the  
3                   subclasses. [*Op. & Rec. Dec.*, Docket No. MC95-1,  
4                   pp. V-161-62, ¶ 5388.]

5                   The pattern must be broken. The link between the two subclasses is  
6                   gone. It is time to apply the non-cost factors in the Act separately. When this is  
7                   done, as explained herein, it becomes clear that the appropriate coverage for  
8                   ECR should be much lower than it is. The position is not taken that the required  
9                   reduction should necessarily be made in one step, but it should be undertaken  
10                  and it should begin now. Ten years have now passed. That is too long.

1 **IV. SPECIFIC RATE DESIGN PROPOSALS**

2 As explained further by Valpak witness Haldi (VP-T-2), the costs of record  
3 in this case raise a number of questions and leave much to be desired. A case  
4 in point is the Commission version of the delivery costs, which appears to be little  
5 more than a rote reproduction of earlier spreadsheets and which depends on  
6 inputs that have now been changed. It is not clear that any principle or  
7 preference expressed by the Commission in the past argues against making a  
8 range of updates and improvements in these costs. See Postal Service  
9 responses to VP/USPS-2 (Tr. 8/\_\_\_\_) and VP/USPS-7 (Tr. 8/\_\_\_\_).

10 It is important to note that the problems with these costs, and others, go  
11 to their basic structure and not just to a need for updates, which might do little  
12 more than change their general level. Consider, for example, the delivery cost  
13 for flats tendered to the Postal Service in 3/5-digit Regular bundles compared to  
14 the delivery cost for flats tendered in basic ECR bundles. The Postal Service  
15 agrees that any delivery cost difference between these two categories does not  
16 lie in street costs, obviously because the street costing system does not  
17 distinguish between them, so that the cost difference must be due to in-office  
18 activities. Response of witness Kelley to VP/USPS-T-16-6 (Tr. 7/2857-59).

19 When carriers receive these flats and begin the in-office casing activity,  
20 the 3/5-digit Regular flats are in groups prepared by the Postal Service in flats  
21 sorting operations and the basic ECR flats are in bundles prepared by the  
22 mailers. Aside from issues relating to piece uniformity, the only known difference

1 between receiving the flats in one way instead of the other is that the ECR flats  
 2 are in line-of-travel ("LOT") sequence and the Regular flats are not. A study  
 3 done by the Postal Service in Docket No. R2000-1 showed that LOT preparation  
 4 saves about 0.74 cents per flat, due to faster casing, a figure that may need  
 5 updating for inflation. See Docket No. R2000-1, USPS-LR-I-307. Yet under  
 6 Commission costing, the carrier cost for the 3/5-digit Regular flat is 11.184 cents  
 7 (up 32.51 percent from Docket No. R2001-1) and for the basic ECR flat is 5.923  
 8 cents (down 6.99 percent from Docket No. R2001-1). See June 17, 2005  
 9 revision to USPS-LR-K-101 and Docket No. R2001-1, PRC-LR-7.

10 Corrected for LOT, the difference between these two costs, 4.521 cents,  
 11 is far too large to be explained by any difference in the uniformity of the pieces.<sup>33</sup>  
 12 When asked about this cost difference during oral cross examination, witness  
 13 Kelley replied: "I just reiterate my response to 40(a). I just haven't studied the  
 14 issue and the different casing rates." Tr. 7/2989, ll. 22-24. Just as disturbing as  
 15 the difference between these two costs is the fact that one of them (the cost for  
 16 3/5-digit-entered flats) **increased** 32.5 percent from Docket No. R2001-1 and the  
 17 other (the cost for basic-ECR-entered flats) **decreased** 6.99 percent. These

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<sup>33</sup> To place this cost difference in perspective, it can be converted to seconds of time. If it is assumed for present purposes that the average wage of carriers is \$40,000 per year and that the average piggyback factor on carrier costs is 1.25, the cost difference of 4.521 cents equates to 6.77 seconds. The comparison then is that it takes a carrier 6.77 seconds **longer** to case a 3/5-digit Regular flat than it does a basic ECR flat. This kind of difference is quite beyond the pale. It is essentially equal to the 6.9 seconds of credit that rural carriers are allowed in toto for handling **either** the 3/5-digit flat or the carrier-route flat. See response of witness Lewis to VP/USPS-T-30-29, Tr. 6/2388.

1 changes are anomalous. Given the strong similarity in the processing received  
2 by the two pieces, one would expect the percentage increases to be similar in  
3 magnitude, whatever their absolute level and in whatever costing system they  
4 are developed. There is no excuse for not studying these issues and trying to  
5 figure out what is wrong.

6       If **Postal Service** versions of these same delivery costs are compared,  
7 the findings are somewhat less disturbing, but not out of the woods. The carrier  
8 cost for the Regular flats is 9.290 cents (up 11.77 percent from Docket No.  
9 R2001-1) and for the ECR flats is 6.143 cents (up 1.20 percent from Docket No.  
10 R2001-1). See response of the Postal Service to VP/USPS-T28-50, redirected  
11 from witness Taufique (Tr. 8/\_\_\_\_), for Docket No. R2005-1 costs, and response  
12 of the Postal Service to VP/USPS-T-28-48 (Tr. 8/\_\_\_\_), redirected from witness  
13 Taufique, for Docket No. R2001-1 costs. Even if one argued that the Postal  
14 Service version of these costs is an improved rendition, the difference in cost  
15 between the two categories (Regular and ECR) is suggestive of a serious  
16 problem, just as is the fact that the proportionate increase in one (at 11.77  
17 percent) is approximately ten times the proportionate increase in the other (at  
18 1.20 percent). Accordingly, the costs accepted by the Commission at the end of  
19 this case will undoubtedly be different from any available now.

20       Under these circumstances, I can make certain proposals concerning how  
21 ECR rates should be developed, but, lacking reliable costs, am not able to  
22 propose specific rates. These proposals are outlined in the following four

1 sections. The first two, dealing with cost coverage and the rate differential  
2 between letters and flats, are **critical**. They deal with key issues in rate design  
3 that I believe are out of line with accepted ratemaking principles. The second  
4 two deal with related issues, the most important being to move toward full  
5 recognition of a range of cost differences for the categories of the ECR subclass.

6 **1. Cost Coverage.**

7 For the reasons developed and explained in Section III, the cost coverage  
8 of ECR Standard should be reduced. I propose a reduction of 10 percentage  
9 points in this case, relative to the coverage proposed by the Postal Service, and  
10 10 additional points of coverage in each of the next two cases. At that time, cost  
11 coverage levels should be considered further.

12 A reduction of 10 percentage points in this case would give ECR mailers  
13 little if any rate increase. Accordingly, my recommendation would be to leave  
14 ECR rates unchanged. However, if the Commission finds that the record allows  
15 meaningful estimates of the costs of the rate categories in ECR, a new set of  
16 rates consistent with the 10-percentage-point reduction in coverage and the  
17 guidelines outlined below should be developed by the Commission.

1 **2. Letter/Flat Rate Differential.**

2 A key element in the development of ECR rates is the selection of a  
3 letter/flat rate differential.<sup>34</sup> At Commission costs, as presented by the Postal  
4 Service in this case, the cost difference on which this rate differential would be  
5 based is -0.540 cents, the negative sign suggesting that letters cost more to  
6 process and deliver than flats. See Cell G30 of 'Sheet 3' of file  
7 Cost\_Interrogatory-USPS2\_checked.xls, filed by the Postal Service as an  
8 attachment to its response to VP/USPS-T28-49, redirected from witness  
9 Taufique (Tr. 8/\_\_\_\_). As the presort-tree diagram in that response makes clear,  
10 all ECR rates depend in a critical way on the letter/flat rate differential selected.  
11 The fact that the difference is negative as presented is clearly anomalous,  
12 pointing again to the need for cost adjustments.<sup>35</sup>

13 In developing the rates that became those of the settlement of Docket No.  
14 R2001-1, the Postal Service's workpapers show a letter/flat cost difference of  
15 +0.251 cents, but a passthrough of zero percent. See response of the Postal  
16 Service to VP/USPS-T28-48, redirected from witness Taufique (Tr. 8/\_\_\_\_). It  
17 selected this passthrough for reasons associated with an interest in achieving a

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<sup>34</sup> The rates for pieces that do not qualify as letters or flats depend on both the letter/flat differential and the residual shape surcharge.

<sup>35</sup> The Postal Service response to VP/USPS-T28-49 (Tr. 8/\_\_\_\_) was not updated to reflect cost revisions provided in a June 17, 2005 errata to USPS-LR-K-101, which would change the cost in cell H28 to be 9.146 cents, which makes the cost difference equal to -1.909 cents, even more anomalous than before. Note that the revisions in the June 17 errata were not reflected in the Postal Service response to Question No. 3c of POIR No. 3, which has not been revised.

1 specific alignment of the basic ECR letter rate with the 5-digit automation letter  
2 rate in Regular, and that passthrough resulted in basic ECR letters having the  
3 same rates as basic ECR flats. Specifically, the letter and flat rate came out to  
4 be 19.4 cents, which compares with a rate for 5-digit automation letters in  
5 Regular of 19.0 cents, for a rate difference between them of 0.4 cents. A 100  
6 percent passthrough, given the cost difference of +0.251 cents, would have  
7 yielded a rate for basic ECR letters of 19.2 cents, still 0.2 cents above the rate  
8 for the 5-digit automation letters in Regular.

9 It is argued below that the rate for basic ECR letters should be decoupled  
10 from the rate for 5-digit automation letters in Regular. This should be done  
11 regardless of whether the basic ECR letter rates overlap with the 5-digit  
12 automation letter rates. Then, the passthrough on the letter flat cost difference  
13 should be set to a level of at least 100 percent.

14 The processing streams for letters and flats are generally separate, and  
15 are becoming even more so with the shift to delivery point sequencing. To a  
16 considerable extent, they are separate products. A shift by mailers from one to  
17 the other has cost implications, but it is not a matter of worksharing.<sup>36</sup> The Postal

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<sup>36</sup> The absence of a worksharing distinction between letters and flats was recognized early on by the Commission when it referred to the rate difference as being "one based primarily on physical characteristics of the mail and not on traditional worksharing concepts." *Op. & Rec. Dec.*, Docket No. R90-1, p. V-230, ¶ 5941. It also said: "We . . . note that the letter discounts we are recommending are not worksharing discounts in the sense this term is used on the record; however, our recognition of shape at the saturation level introduces the possibility that some mailers may decide to convert their mailings." *Ibid.*, p. V-305, ¶ 6076. Mailers should not be restricted from

(continued...)

1 Service does not avoid any piece of work when a mailer shifts from a flat to a  
2 letter. Similarly, there is no piece of postal work that the mailer does if a flat is  
3 sent instead of a letter. Therefore, getting the lowest cost entity to do the work is  
4 not an issue. The mailer may look at rates to help decide which product to  
5 purchase, but this is exactly the kind of market decision made regularly among  
6 all products.

7 In the case of two separate products, costs need to be recognized and the  
8 markups need to be selected. No theory or body of analytical guidance suggests  
9 that two products, even though related, should have the same per-piece  
10 markups, and there is no reason why the rate differential should equal the cost  
11 difference. In fact, if a default solution exists, it would probably be one of equal  
12 percentage markups, although economic theory would suggest that this solution  
13 should be tempered if the cross elasticities are high. Accordingly, I believe the  
14 passthrough of the letter/flat cost difference should be over 100 percent, but  
15 certainly at least 100 percent.

16 Whether the passthrough of the letter/flat cost difference has an upper  
17 limit is open to question. If the elasticity of letters is higher than that of flats,  
18 which is not known to be the case, notions of economic efficiency would suggest  
19 that the passthrough could be greater than the subclass cost coverage, *i.e.*, the  
20 passthrough of the letter/flat cost difference could be over 156 percent for a

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<sup>36</sup> (...continued)  
choosing the products that suit them best, given appropriate rate differences.

1 subclass with a cost coverage of 156 percent. On the other hand, establishing  
2 equal implicit cost coverages on letters and flats would suggest a passthrough  
3 equal to the coverage of the subclass. This is an issue that should be  
4 considered further. But the upper-limit question does not need to be answered  
5 to know that the passthrough should be at least 100 percent. Simply put, no  
6 justification exists for requiring low-cost letters to bear the heavy per-piece  
7 contribution burden that is associated with low passthroughs.<sup>37</sup> Similarly, no  
8 justification exists for elevating the rates for letters so that the rates for flats can  
9 be lower.

10 **3. Decoupling the ECR Basic Letter Rate and the 5-digit Automation**  
11 **Letter Rate.**

12 In recent rate cases, the Postal Service has argued that to encourage an  
13 automated mailstream and to support its automation program, the rate for basic  
14 letters in ECR Standard should be higher than the rate for the 5-digit automation  
15 letters in Regular Standard. The concern seems to be that if the rate for basic  
16 letters in ECR is lower, automation mailers might move from Regular into ECR,  
17 and leave the barcode off. Alternatively, there could be an interest in giving ECR  
18 basic mailers an incentive to apply barcodes.

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<sup>37</sup> In Docket No. R90-1, the letter/flat differential was introduced with a passthrough of 50 percent. There was every expectation at the time that this would be increased further. The zero percent passthrough of Docket No. R2001-1 is at the wrong end of the spectrum.

1           On practical grounds, neither of these possibilities should be given weight.  
2 Regular mailers by their very nature cannot move to ECR. That is, Regular  
3 mailers must have at least 10 pieces per 5-digit area and ECR mailers must  
4 have at least 10 pieces per carrier route. The second requirement is an order of  
5 magnitude greater than the first. The essence of the reclassification case,  
6 Docket No. MC95-1, was that: (i) the 5-digit mailers are different in kind from the  
7 ECR mailers; (ii) the cross elasticity between the two is low;<sup>38</sup> (iii) the value of the  
8 service received by the two groups is different; and (iv) that the nature of the  
9 mailings is different. And, if one is interested in giving basic letters in ECR an  
10 incentive to barcode, it should be done in the ECR subclass, not by establishing  
11 a restrictive link to another subclass.

12           The problems with the linkage as it now exists are, however, even more  
13 fundamental than this. Regular Standard and ECR Standard are separate  
14 subclasses of mail. Their rates should be set through an independent  
15 application of the non-cost factors in the Act, along with accepted and defensible  
16 rate design procedures. If these steps, because of lower value of service, lower  
17 costs, recognition of mail preparation, or recognition of market characteristics,  
18 yield rates for basic letters in ECR that are lower than those for 5-digit  
19 automation letters in Regular, then the basic letters in ECR should be allowed to

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<sup>38</sup> See the Commission's discussion of Postal Service witness Tolley's conclusion that the cross elasticities between the two are low, *Op. & Rec. Dec.*, Docket No. MC95-1, pp. V-179-80, ¶ 5437.

1 have those rates. To elevate the rates for these letters artificially is to say to  
2 them: We understand that you would like your market characteristics and your  
3 low costs recognized in your rates, but we would rather give you higher rates  
4 (which, incidentally, will allow us to provide lower rates to flats) and thereby  
5 encourage you to abandon your subclass altogether and join a prebarcoded  
6 group of a different subclass. No justification exists for sending such a message.

7 Another difficulty, and an important one, is caused by the means used to  
8 keep the rate for the basic letters in ECR above the rate for the 5-digit  
9 automation letters in Regular. Specifically, zero percent of the cost difference  
10 between basic letters and basic flats in ECR is passed through into a rate  
11 differential. In other words, the rate for basic letters and basic flats in ECR are  
12 the same, even though their costs differ. The additional difficulty caused by this  
13 fix, as the presort tree makes clear, is that it not only elevates artificially the rate  
14 for basic letters in ECR, it also elevates artificially the rates for the high density  
15 letters and the saturation letters, as their rates are directly dependent on cost  
16 differences and discounts from the basic letter rate. This is decidedly unfair,  
17 particularly since both of these categories, high density and saturation, are  
18 required to apply barcodes and meet automation requirements.<sup>39</sup>

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<sup>39</sup> One other issue relating to the linkage with the 5-digit automation rate should be noted. The 5-digit automation discount in Regular Standard is based on a cost difference that relates not only to the placement of a barcode on the piece and meeting associated automation requirements but also to mailers changing their pieces from a non-machinable format to a machinable format. This change in format is not a worksharing change, but rather is related to the mailer choosing to purchase what is  
(continued...)

1 **4. Other Rate Design Proposals.**

2 Completing rate design for ECR requires attention to a number of  
3 additional issues. The following recommendations are made. (1) Once costs  
4 are developed, passthroughs of 100 percent should be selected, unless good  
5 reason exists to do otherwise.<sup>40</sup> (2) Increase (or decrease) the residual shape  
6 surcharge ("RSS"), the barcode discount for RSS pieces, and the pound rates by  
7 the same proportion as any increase (or decrease) in the rates of the subclass  
8 as a whole, much as in the Postal Service's proposal. (3) Update the dropship  
9 cost avoidances and apply the same passthroughs as those recommended in  
10 Docket No. R2001-1. Test year avoidances are provided in the testimony of  
11 Postal Service witness Mayes, USPS-T-25. (4) Within limits allowed by normal  
12 rounding procedures, set the Nonprofit rates so that their average per-piece level  
13 is 60 percent of the corresponding per-piece level of their host category, as  
14 required by law, before the recognition of fees. This is easy to do and no reason  
15 has been offered to do otherwise. My experience has been that phrases like "as

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<sup>39</sup> (...continued)

essentially a different product. The cost avoidance recognized for the discount should be much smaller. When this is done, the rate for 5-digit automation letters will increase, making it even more apparent that a tie between the two rate categories is disruptive.

<sup>40</sup> Passthroughs of 100 percent are aligned with general Commission preferences. In Docket No. R90-1, for example, the Commission referred to: "align[ing] presort passthroughs with our longstanding cost and policy preferences [which] generally means that for established presort discount categories, we recommend full passthrough of associated savings." *Op. & Rec. Dec., Ibid.*, p. V-159, ¶ 5806.

- 1 nearly as practicable” are always meant to allow the practicalities of rounding to
- 2 be accommodated, and nothing more.<sup>41</sup>

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<sup>41</sup> Whatever is done with rates, a small error in witness Taufique’s (USPS-T-28) revenue calculations should be corrected. The postage for automation letters weighing between 3.3 and 3.5 ounces (heavy letters) is calculated by applying the pound rates and the piece-rate-add-ons for pound-rated non-letters, and then subtracting the letter/flat rate differential. In other words, these rates are calculated from other rates. Witness Taufique developed his revenues by applying to the heavy-letter volumes a per-piece revenue figure developed by applying the 5.4 percent increase to the current per-piece revenue, and then rounding, which in some cases gives a different per-piece revenue than the postage that will actually be paid. See response to VP/USPS-T28-29, Tr. 3/659-60, the response to which seems to argue that the correction required is a small one.

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

5                   THE WITNESS: Yes, I have.

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

10                  THE WITNESS: Yes, they would, and I would  
11 like to note that Valpak filed two erratum about two  
12 days ago. We have inserted those two erratum into  
13 this package so that they are up-to-date.

14                  CHAIRMAN OMAS: Are there any corrections or  
15 additions that you would like to make to the answers  
16 you have provided?

17                  THE WITNESS: No.

18                  CHAIRMAN OMAS: Counsel, would you please  
19 provide two copies of the corrected designated written  
20 cross-examination of Witness Mitchell to the reporter?  
21 That material is received into evidence and is to be  
22 transcribed into the record.

23                  //

24                  //

25                  //

1 (The document referred to,  
2 previously identified as  
3 Exhibit No. VP-T-1, was  
4 received in evidence.)

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BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

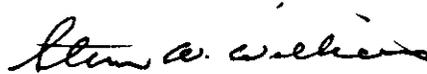
Request of the United States Postal  
Service for a Recommended Decision on  
Changes in Rates of Postage and Fees for  
Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION  
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION INC.  
WITNESS ROBERT MITCHELL  
(VP-T-1)

<u>Party</u>	<u>Interrogatories</u>
Advo, Inc.	ADVO/VP-T1-1-5, 6a, 7-14
Direct Marketing Association, Inc.	DMA/VP-T1-1-9

Respectfully submitted,



Steven W. Williams  
Secretary

INTERROGATORY RESPONSES OF  
VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK  
DEALERS' ASSOCIATION INC.  
WITNESS ROBERT MITCHELL (T-1)  
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
ADVO/VP-T1-1	Advo
ADVO/VP-T1-2	Advo
ADVO/VP-T1-3	Advo
ADVO/VP-T1-4	Advo
ADVO/VP-T1-5	Advo
ADVO/VP-T1-6a	Advo
ADVO/VP-T1-7	Advo
ADVO/VP-T1-8	Advo
ADVO/VP-T1-9	Advo
ADVO/VP-T1-10	Advo
ADVO/VP-T1-11	Advo
ADVO/VP-T1-12	Advo
ADVO/VP-T1-13	Advo
ADVO/VP-T1-14	Advo
DMA/VP-T1-1	DMA
DMA/VP-T1-2	DMA
DMA/VP-T1-3	DMA
DMA/VP-T1-4	DMA
DMA/VP-T1-5	DMA
DMA/VP-T1-6	DMA
DMA/VP-T1-7	DMA
DMA/VP-T1-8	DMA
DMA/VP-T1-9	DMA

**Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.**

**ADVO/VP-T1-1.**

Please provide the workpapers used to develop the results presented in Figure 3 on page 51 of your testimony.

**RESPONSE:**

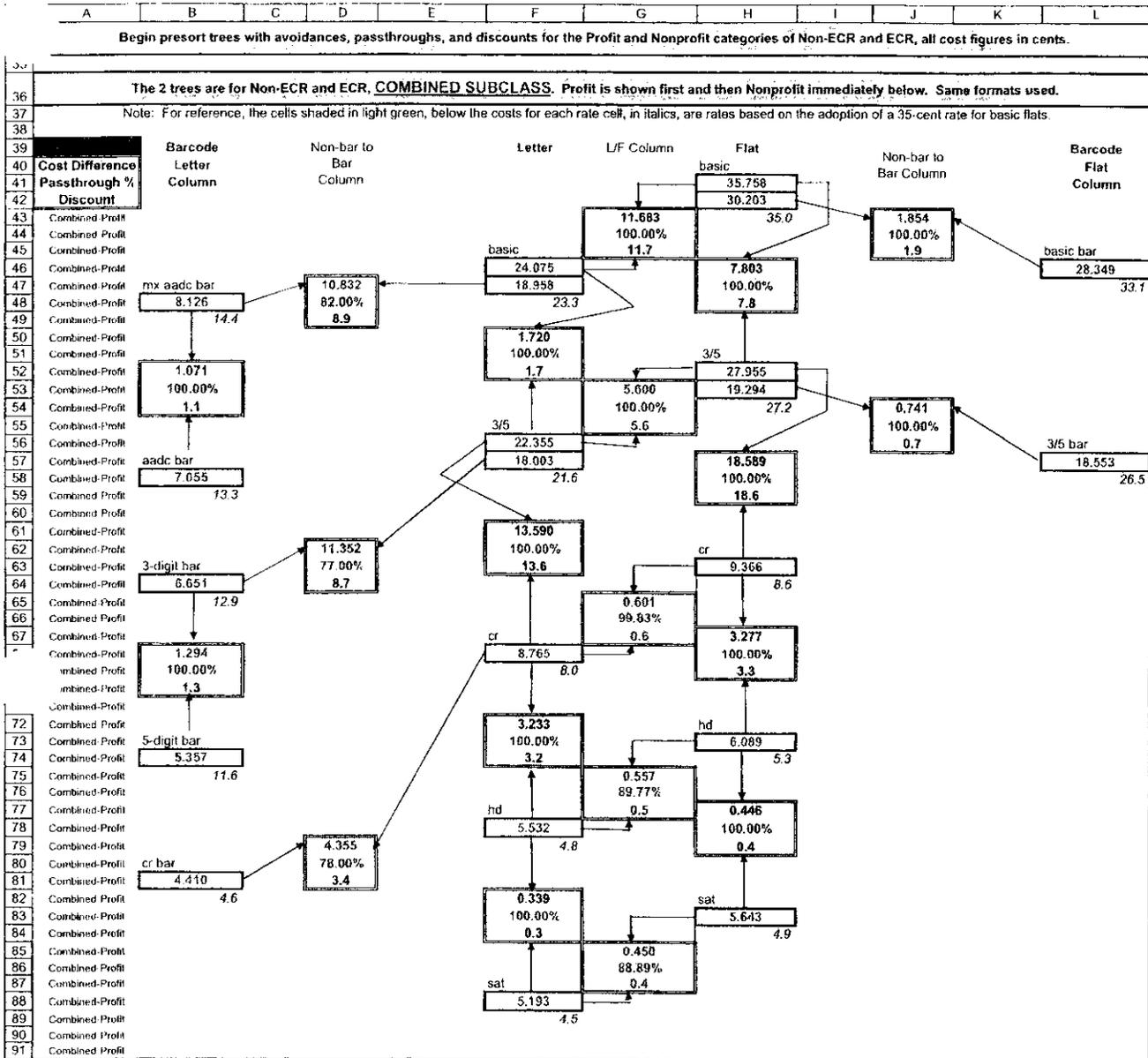
The workpapers are provided as an attachment to this response, and are identified as VP-T1-Workpapers.xls. Decision inputs are on the 'Inputs' sheet. Figure 3 is on the 'Schedule' sheet, beginning at line 67.

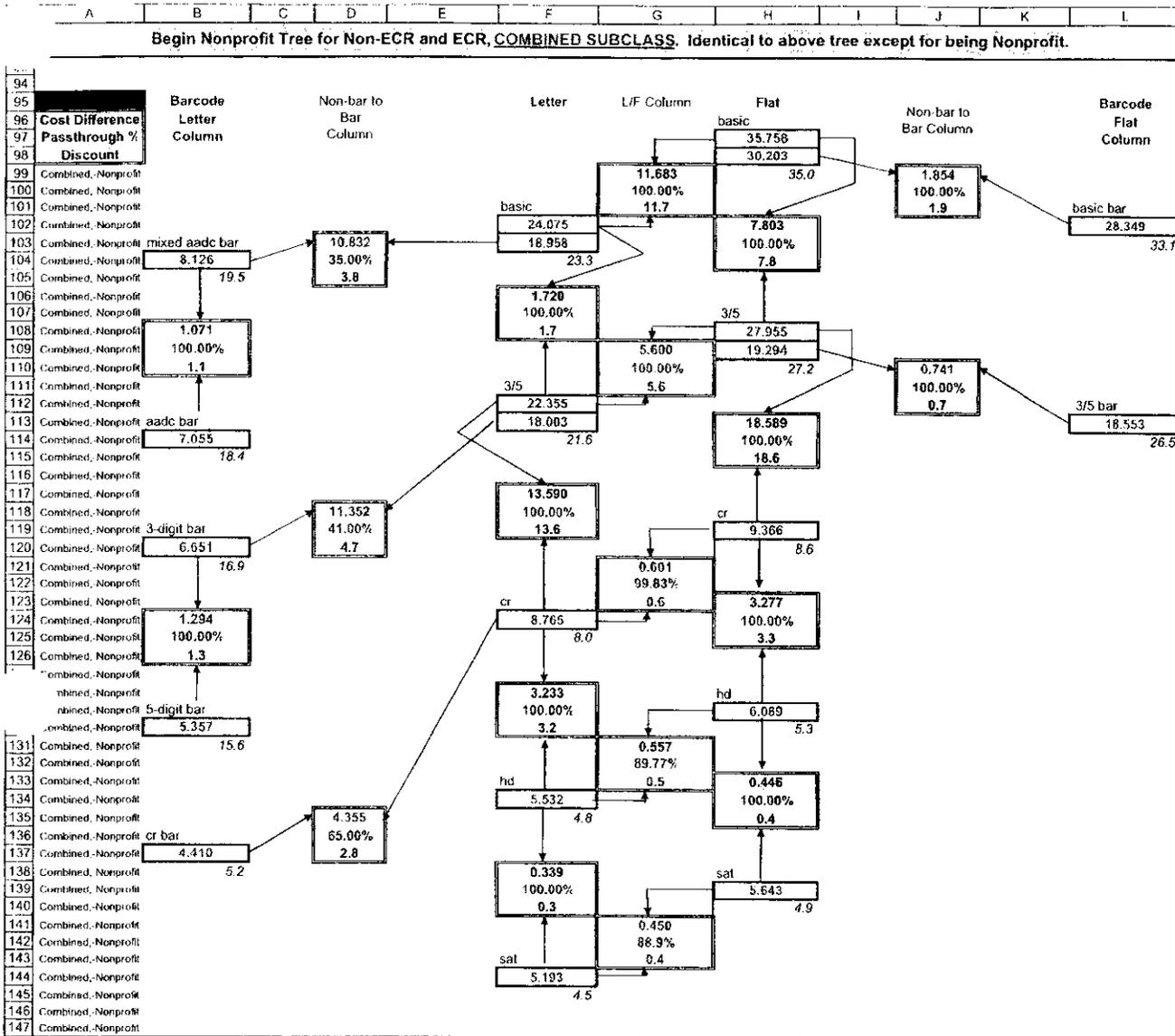


	A	B	C	D	E	F	G	H	I	J	K	L
1	These volume ratios are developed from BY2000 and Tolley volumes and are used to inflate the BY BD sheet to obtain TYBR and TYAR											
2												
3												
4												
5		Volume factors					BY/BY	Volume	Volume	lybr/by	Volume	lyar/by
6		Non-ECR-Profit						BY2000	TYBR	Factor	TYAR	Factor
7		Letters-Non-Barcoded										
8		Basic					1.000000	793,501,993	817,754,459	1.030564	809,733,939	1.020456
9		3/5					1.000000	1,065,186,190	757,568,118	0.711207	697,778,977	0.655077
10		Flats-Non-Barcoded										
11		Basic					1.000000	479,656,633	448,826,802	0.935725	443,471,958	0.924561
12		3/5					1.000000	1,052,913,950	953,252,266	0.905347	925,540,123	0.879027
13		Barcoded Letters										
14		MxAADC					1.000000	1,950,273,409	2,236,058,034	1.146536	2,217,147,820	1.136839
15		AADC					1.000000	2,201,484,140	2,517,616,648	1.143600	2,496,325,308	1.133928
16		3-digit					1.000000	15,819,321,120	18,153,833,425	1.147573	17,989,964,663	1.137215
17		5-digit					1.000000	18,402,050,918	19,382,990,228	1.181742	19,265,167,056	1.174558
18		Barcoded Flats										
19		Basic					1.000000	354,820,302	416,977,922	1.175181	414,714,247	1.168801
20		3/5					1.000000	10,657,027,136	11,300,895,211	1.060417	11,218,794,042	1.052713
21		Non-ECR-Nonprofit										
22		Letters-Non-Barcoded										
23		Basic					1.000000	548,859,122	501,801,091	0.914262	498,835,390	0.908859
24		3/5					1.000000	1,086,840,563	878,426,094	0.808238	841,502,420	0.774265
25		Flats-Non-Barcoded										
26		Basic					1.000000	107,099,998	104,807,102	0.978591	104,231,688	0.973218
27		3/5					1.000000	225,485,758	218,999,256	0.971233	217,372,336	0.964018
28		Barcoded Letters										
29		MxAADC					1.000000	807,738,620	865,098,392	1.071013	860,675,813	1.065538
30		AADC					1.000000	789,437,381	836,145,931	1.059167	831,871,364	1.053752
31		3-digit					1.000000	3,916,956,217	4,065,787,333	1.037997	4,058,439,104	1.036121
32		5-digit					1.000000	2,644,008,338	3,083,280,956	1.166139	3,084,411,839	1.166567
33		Barcoded Flats										
34		Basic					1.000000	86,736,469	95,806,496	1.104570	95,321,155	1.098974
35		3/5					1.000000	1,578,421,702	1,705,401,731	1.080447	1,696,807,639	1.075003
36		ECR Profit										
37		Letters-Non-Barcoded										
38		Carrier Route					1.000000	2,144,903,041	2,279,214,850	1.062619	2,204,590,228	1.027827
39		High-density					1.000000	481,876,440	505,000,459	1.047987	487,031,862	1.010699
40		Saturation					1.000000	2,783,103,074	3,131,007,735	1.125006	3,023,502,885	1.086378
41		Letters-Barcoded										
42		Carrier Route					1.000000	1,914,433,081	2,077,658,300	1.085260	2,008,138,417	1.048947
43		Non-Letters Non-Barcoded										
44		Carrier Route					1.000000	11,396,910,120	12,648,693,997	1.109835	12,224,335,151	1.072601
45		High-density					1.000000	1,744,328,033	1,875,030,801	1.074930	1,812,943,000	1.039336
46		Saturation					1.000000	9,879,894,649	10,812,299,961	1.094374	10,426,558,187	1.055331
47		ECR-Nonprofit										
48		Letters-Non-Barcoded										
49		Carrier Route					1.000000	265,916,432	350,739,545	1.318984	348,711,796	1.311359
50		High-density					1.000000	67,510,392	73,226,700	1.084673	72,743,668	1.077518
51		Saturation					1.000000	661,059,108	667,651,626	1.009973	663,796,603	1.004141
52		Letters-Barcoded										
53		Carrier Route					1.000000	202,104,310	210,036,111	1.039246	208,868,516	1.033469
54		Non-Letters Non-Barcoded										
55		Carrier Route					1.000000	964,685,063	1,301,548,575	1.349195	1,294,109,919	1.341484
56		High-density					1.000000	32,813,668	57,252,160	1.744766	56,923,016	1.734735
57		Saturation					1.000000	456,163,561	486,719,822	1.066985	483,703,911	1.060374
58												
59												
60												
61												
62		More Check Lines										
63		Non-ECR Profit						50,776,235,791	56,985,773,113		56,478,638,134	
64		Non-ECR Nonprofit						11,791,584,168	12,355,554,381		12,289,468,746	
65		ECR Profit						30,345,448,438	33,328,906,103		32,187,099,731	
66		ECR Nonprofit						2,650,252,534	3,147,174,541		3,128,857,428	
67		Total						95,563,520,931	105,817,408,138		104,084,064,039	
68												
69												
70										TYAR/TYBR Regular=	0.991733	
71												
72										Same ECR	0.968195	











**Sheet Calculates Rates using data from other sheets, for combined subclasse, tybr basis.**

Variables and special subtotals used	Regular		ECR		Combined		Reg		ECR	
	Regular	ECR	Regular	ECR	Reg	ECR	Reg	ECR	Reg	ECR
Total piece volume, Commercial	56,985,773,113	33,328,906,103	56,985,773,113	33,328,906,103						
Total piece volume, Nonprofit	12,355,554,381	3,147,174,541	12,355,554,381	3,147,174,541						
Pieces paying min/pc rate, Commercial	50,205,510,054	21,992,810,397	50,205,510,054	21,992,810,397						
Pieces paying min/pc rate, Nonprofit	11,721,328,922	2,860,871,713	11,721,328,922	2,860,871,713						
Pieces paying pound rate, Commercial	6,780,263,059	11,336,095,706	6,780,263,059	11,336,095,706						
Pieces paying pound rate, Nonprofit	634,225,459	286,302,828	634,225,459	286,302,828						
Pounds paying pound rate, Commercial	2,524,474,543	3,624,232,795	2,524,474,543	3,624,232,795						
Pounds paying pound rate, Nonprofit	212,394,350	87,117,656	212,394,350	87,117,656						
Leakages, Commercial			11,757,985,239	10,887,419,097						
Leakages, Nonprofit		Not Used	2,097,981,662	145,429,354						
Cost, tybr	9,586,215,578	2,753,033,152	12,339,248,730							
Coverage	152.79%	226.37%	169.21%							
Total Revenue less fees & other adj	14,581,801,390	6,205,877,499	20,778,552,407							

Rounded Key Rates	
Reg	ECR
Reference min/pc rate, Profit, key rate	0.437
Piece rate intercept for reference pound rate, Profit	0.283
Total revenue, Commercial	
Total revenue, Nonprofit	
Reference min/pc rate, Nonprofit, key rate	0.313
Piece rate intercept for reference pound rate, NP	0.186
Revenue per piece, Commercial w/o fees	0.127
Revenue per piece, Nonprofit w/o fees	0.047

Sub values for solving combined

Phi 1	0.1538625	
Phi 2	0.13261875	
Phi 3	0.12705	
Phi 4	0.0804375	
Phi 5	0.130090937	
Phi 6	0.056656667	
Phi 7	-9874727230	
Phi 8	-1967146742	
Phi 9	-8357037410	
Phi 10	-111453468.3	
k	0.20625	
Theta	0.6	
R1	0.437035929	
R1 Nonprofit Alpha	0.31300018	
R1 Nonprofit Beta	0.127441818	Rounded
Differential for Nonprofit Alpha	0.124035749	0.124
Differential for Nonprofit Beta	0.309594111	0.310

Intercepts

Profit Alpha	0.283173429
Profit Beta	0.304417179
Nonprofit Alpha	0.18595018
Nonprofit Beta	0.047004318

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	
3	<b>COMBINED SUBCLASS</b>															
4																
5																
6	<b>Commercial</b>							Proposed Taufique	<b>Nonprofit</b>							Proposed Taufique
7																
8	Letter Size	Piece Rates			Rates				Letter Size	Piece Rates			Rates			
9		Basic			0.320		0.282		Basic				0.196		0.174	
10		Mix aadc Bar			0.231		0.231		Mix aadc Bar				0.158		0.152	
11		aadc Bar			0.220		0.223		aadc Bar				0.147		0.143	
12		3/5			0.303		0.261		3/5				0.179		0.161	
13		3-d Bar			0.216		0.214		3-d Bar				0.132		0.136	
14		5-d Bar			0.203		0.200		5-d Bar				0.119		0.120	
15		Destination Entry Discounts, per piece							Destination Entry Discounts, per piece							
17		DBMC			0.023		0.022		DBMC				0.023		0.022	
18		DSCF			0.030		0.027		DSCF				0.030		0.027	
19																
20	Non Letter Size	Piece rates							Non-Letter Size	Piece rates						
21		Basic			0.437		0.363		Basic				0.313		0.242	
22		Basic Bar			0.418		0.316		Basic Bar				0.294		0.199	
23		3/5			0.359		0.304		3/5				0.235		0.193	
24		3/5 Bar			0.352		0.275		3/5 Bar				0.228		0.175	
25		Destination Entry Discounts, same as above							Destination Entry Discounts, same as above							
26																
27	<b>Begin Pound Rates</b>															
28	Non-Letter	Basic Pound Rate < cr			0.746			0.746	Non-Letter	Basic Pound Rate < cr			0.616			0.616
29		Per-piece add ons:								Per-piece add ons:						
30		Basic			0.283		0.209		Basic				0.186		0.116	
31		Basic Bar			0.264		0.182		Basic Bar				0.167		0.073	
32		3/5			0.205		0.150		3/5				0.108		0.066	
33		3/5 Bar			0.198		0.121		3/5 Bar				0.101		0.048	
34		Destination Entry Discounts, per-pound							Destination Entry Discounts, per-pound							
36		DBMC			0.113		0.105		DBMC				0.113		0.105	
37		DSCF			0.147		0.132		DSCF				0.147		0.132	
38																
39	<b>Begin Categories now in ECR</b>				<b>Hypothetical</b>		<b>USPS</b>		<b>Begin Categories now in ECR</b>							
40	<b>Rates in Dollars</b>				<b>Combined</b>		<b>Proposed</b>		<b>Rates in Dollars</b>							
41	Letter	Piece Rates			<b>Subclass</b>		<b>Rates</b>		Letter	Piece Rates						
42		Basic CR			0.167		0.204		Basic CR				0.121		0.133	
43		CR Bar			0.133		0.180		CR Bar				0.093		0.117	
44		High density			0.135		0.173		High density				0.089		0.108	
45		Saturation			0.132		0.160		Saturation				0.086		0.100	
46	Non-Letter	piece rates							Non-Letter	piece rates						
47		Basic CR			0.173		0.204		Basic CR				0.127		0.133	
48		High density			0.140		0.178		High density				0.094		0.116	
49		Saturation			0.136		0.169		Saturation				0.090		0.110	
50		Destination Entry Discounts, per piece							Destination Entry Discounts, per piece							
51		DBMC			0.023		0.022		DBMC				0.023		0.022	
52		DSCF			0.030		0.027		DSCF				0.030		0.027	
53		DDU			0.037		0.033		DDU				0.037		0.033	
54	<b>Begin Pound Rates</b>															
55	Pound Rate, cr & finer				0.643			0.643	Pound Rate, cr & finer				0.390			0.390
56		Per-piece Add Ons								Per-piece Add Ons						
57		Basic CR			0.040		0.072		Basic CR				0.047		0.053	
58		High Density			0.007		0.045		High Density				0.014		0.036	
59		Saturation			0.003		0.036		Saturation				0.010		0.030	
60		Destination Entry Discounts, per-pound							Destination Entry Discounts, per-pound							
61		DBMC			0.113		0.105		DBMC				0.113		0.105	
62		DSCF			0.147		0.132		DSCF				0.147		0.132	
63		DDU			0.177		0.166		DDU				0.177		0.166	



**Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.**

**ADVO/VP-T1-2.**

Please provide the workpapers used to develop the estimate on page 80 of your testimony that a reduction of 10 percentage points (of cost coverage) would give ECR mailers little if any rate increase.

**RESPONSE:**

No workpapers are required to reach the conclusion you cite, and I relied on none. The reasoning is straightforward. USPS-LR-K-115, file USPST28Aspreadsheets.xls, sheet '2006 BR' shows the TYBR revenue of ECR to be \$5,931,918,263, including fees. USPS-LR-K-95, folder R2005\_RollFwd\_Model2\_ForFiling, folder R2005OutputRpt, folder PRC\_R2005\_Filing\_Output, file R2005,FY2006BRC\_DRpt.PRC.AMX.xls, sheet 'DReport' shows the cost of Standard ECR mail to be \$2,753,033,152, including a contingency of zero. This implies a cost coverage of 215.47 percent. To keep things easy, it is convenient to think in terms of a cost of \$100 and a revenue of \$215.47. With a 5.4 percent increase, this revenue becomes \$227.10 (*i.e.*,  $1.054 * \$215.47$ ), which is a coverage of 227.10 percent. The volume effect can be neglected since in going from TYBR to TYAR the volumes and costs move together, or very nearly so. If 10 percentage points of cost coverage were removed, which means removing 10 percent of \$100, or \$10, the revenue would be \$217.10, which is a coverage of 217.10 percent. Since 217.10 percent is not far above 215.47 percent, I said little if any rate increase (p. 80, l. 13).

Part of my reasoning for the phrase "little if any rate increase" is that, in the end, the Commission will be working with actual numbers. It will therefore have to deal with rounding effects, mix effects in the volume forecast (which depend on the mix of rates selected), any extent to which the percentage change in cost in going to TYAR is not exactly equal to the

**Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.**

percentage change in volume, with the fees recommended, and with whether any rate increase is to be measured by the change in average per-piece revenue or with a fixed-weight index. I was not able to deal with some of these matters. But since all of the associated effects are small, I felt comfortable with the phrase I used.

**Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.**

**ADVO/VP-T1-3.**

Referring to the letter-flat cost differential discussed on page 81 of your testimony, please confirm that you mean the differential between ECR Basic letters and Basic flats. If not, please explain.

**RESPONSE:**

Confirmed. Rate differences, cost differences, and, therefore, passthroughs exist at the high density and saturation levels as well, of course, and the passthroughs at those levels might be called implicit. Calling them implicit, however, does not make them any less real. When all of the passthroughs in the presort tree are 100 percent, it makes no difference which levels are specified and which are implicit. If the letter-flat passthrough at the basic level is not 100 percent, but the passthroughs between the adjacent letter categories and between the adjacent flat categories are 100 percent, the implicit letter-flat passthroughs will be different from the passthrough at the basic level, although it is not possible to say in general whether they will be above or below it.

**Response of Valpak Witness Robert W. Mitchell  
to Interrogatory of Advo, Inc.**

Revised 8/22/05

**ADVO/VP-T1-4.**

At page 82 of your testimony in footnote 36, you refer to the Commission's Docket R90-1 decision concerning implementation of a saturation letter-flat rate differential and state:

[The Commission] also said "We . . . note that the letter discounts we are recommending are not worksharing discounts in the sense this term is used on the record; however, our recognition of shape at the saturation level introduces the possibility that some mailers may decide to convert their mailings." *Ibid.*, p. V-305, ¶ 6076. Mailers should not be restricted from choosing the products that suit them best, given appropriate rate differences.

- (a) Are you aware of any ECR saturation flat mailers that, since the Commission's decision in Docket R90-1, have converted their mailings to letter size? If so, please identify them.
- (b) Do you have any knowledge or information on the percentage of total ECR saturation flat volume (if any) that, since the Commission's R90-1 decision, has converted to letter size? If so, please provide it, including all sources.
- (c) Please confirm that the last sentence in your footnote 36, quoted above, is your statement and not the Commission's.
- (d) Is it your contention that, absent a 100 percent or greater passthrough of the ECR saturation letter-flat cost differential, saturation mailers are "restricted from choosing the products that suit them best"? If so, please identify the saturation mailers, or types of saturation mail programs, that are so "restricted" from choosing the products that suit them best, and explain how they are restricted.
- (e) Based on your knowledge of the ECR saturation mail industry, is it your belief that the choice of saturation shopper publications and shared mailers to utilize a flat-size format is influenced in any respect by the magnitude of the letter-flat cost passthrough (i.e., that a change in the passthrough might cause them to switch from a flat-size to a letter-size format)? If so, please explain the basis for your belief.
- (f) Based on your knowledge of the ECR saturation mail industry, please list the factors, in order of importance, that you believe influence the choice of ECR

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saturation shopper publications and shared mailers to utilize a flat-size format,  
rather than a letter-size format.

**RESPONSE:**

(a) No.

(b) Using the workpapers presented by the Postal Service in Docket No. R90-1 and the current billing determinants, certain aggregate comparisons could be made, but it would not be possible to infer how much of the growth (or decline) in a category (such as saturation letters or saturation flats) has been due to the inherent growth (or decline) in that category and how much has been due to mailers shifting from one category to another. We do know, of course, that prior to Docket No. R90-1, the rates were the same for letters and flats, so mailers had no reason to consider postage in their decisions on shape. It also should be noted that even if the relative sizes of two categories remained the same, it would be possible that some mailers moved one way and some the other.

(c) Confirmed, since the sentence to which you refer is not enclosed in quotation marks and comes after the citation for the quote. I do not see any ambiguity. However, I would note that the formatting of your question could lead some readers to suspect that my introduction to the quotes from the Commission, the actual quotes themselves, and the "last sentence" at issue are together in my text as a single-spaced, double-indented quotation, which is not the case. Footnote 36 in its entirety is ordinary text. (Also, the question omits a colon after the word "said.")

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(d) No. I know of no restrictions on mailers' freedom to choose, except obvious ones such as that flats must pay the rates for flats and that letters must be the size of letters. The sentence you cite might be clearer if it said that mailers, when choosing the products that suit them best, should be presented with appropriate rate differences. Alternatively, one could say that mailers should not be put into the position of having to, or being allowed to, select from among products that have inappropriate rate differences.

(e) It would be a strong statement to say that mailers of the kind you reference are not influenced "in any respect" by the rate alternatives they face, and I would not make such a statement, not even for rate differences in the neighborhood of the current ones. To say this would imply a cross elasticity of absolutely zero. I have learned to expect some sensitivity at the margin between such related product categories. Letter-size pieces can be as large as 6 1/8 inches high and 11 1/2 inches wide, and one way to achieve such pieces is to fold a flat. I do not view such pieces as being small or uninteresting. But the importance of setting appropriate rates for these categories depends only partially on the possibility of some mailers switching. For example, consider how it would sound for the Postal Service to make the following statement to letter mailers: "We know you believe it would be fair for your costs to be recognized in your rates and that you would like a not-unreasonable markup over those costs, but we have found that holding your rate down does not cause flats to convert to letters, so we are going to elevate your rate and use the revenue to help hold down the rate for flats, thereby giving them a smaller percentage markup than you."

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(f) Actually, my guess is that different mailers would identify different influential factors, that the descriptions of these factors would differ, and that there would be differences in their order of importance. I doubt if anyone can present such a list “in order of importance,” not even if it were agreed that the levels of any relevant variables were not to stray far from their current levels. That is, paper prices might not be influential now but might be very influential at twice their current level. I have no analysis available that would allow me to answer this question.

As a practical matter, I believe “shopper publications and shared mailers” pursue a product concept that they believe makes business sense, and that they have an understanding of the information (and its form) that they wish to provide, the associated production and handling costs, the postage, the markets in which they will sell their services, and, importantly, recipient response rates. This does not preclude the possibility that lower costs and a slightly lower response rate could lead to higher profits. Considering a run-of-press product would be different from considering one that accepts inserts provided by the advertiser. The preferences and interests of customers (including potential customers) are always important. Early on, providers of advertising services might have more than one product concept in mind. Once a concept is selected and found to work, they would need to have a pretty good reason to alter it.

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**ADVO/VP-T1-5.**

- (a) Do you have any knowledge or understanding of any differences in the typical frequency of mailing (e.g., weekly, monthly, less-than-monthly) between ECR saturation letter mailings and ECR saturation flat mailings? If so, please state your understanding and provide sources.
- (b) Are you aware of any ECR saturation letter mail programs that are mailed in a market on a regular weekly basis? If so, please identify the mailers and the markets, and quantify the volumes of such weekly-frequency saturation letter mail.
- (c) Are you aware of any ECR saturation letter mail programs that are mailed in a market on a more-frequently-than-monthly basis, i.e., more than 12 times per year? If so,
  - (i) please identify the mailers and the markets, and quantify the volumes of such saturation letter mail;
  - (ii) please state whether distribution more frequently than monthly is either commonplace, the exception, or nonexistent for saturation letter mail.
- (d) To the extent you believe there are differences in the typical frequency of mailing between ECR saturation letter mailings and saturation flat mailings, please describe the factors that you believe may account for the differences.

**RESPONSE:**

(a) Other than that many frequencies exist, and that mailers sometimes change their frequency, I have no basis for saying what is typical, including the proportion of users of particular rate categories that have one frequency or another. I am aware that a number of saturation flat mailings are weekly, but I receive some at my house that are less frequent. I also am aware that a number of saturation letter mailings are less frequent than weekly, but I have not studied the distribution of their frequencies.

(b) No.

(c) No.

(i) Not applicable.

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(ii) Not applicable.

(d) I would be surprised if a study did not show differences in typical frequency. It seems likely that many saturation flat mailers have a basic business model that is different from that of many saturation letter mailers. Most classifications of mail seem to have many different kinds of users. At the same time, it is not uncommon for one or two types of users to account for a large portion of the volume of a subclass or category.

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**ADVO/VP-T1-6.**

At page 67 of your testimony, you state that “most materials in ECR cannot be sent privately.”

- (a) Please confirm that saturation letters could be sent privately if unaddressed.
- (b) Are any of Val-Pak’s letter-size enveloped coupons distributed by private delivery, not mail? If so, please provide the following:
  - (i) the total volume of such privately-delivered pieces in 2004 and an estimate for 2005;
  - (ii) the percentage of Val-Pak’s total enveloped coupon volume that is delivered privately; and
  - (iii) identify the markets where private delivery is used, and for each market identify the private delivery company used.

**RESPONSE:**

(a) Confirmed. However, note that my understanding of this issue is rather general and does not rise to the level of a legal opinion.

(b) Redirected to Valpak.

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**ADVO/VP-T1-7.**

At pages 83-84 of your testimony, you advocate that the passthrough of the letter-flat cost differential “should be over 100 percent, but certainly at least 100 percent.” Do you believe that the passthroughs of the Automation-Basic Letters, Basic-High Density, and High Density-Saturation total cost differences (for both letters and non-letters) should also be a minimum of 100 percent? If not, explain why not.

**RESPONSE:**

It may be that the passthrough of the cost difference for automation-basic letters in ECR, which are viewed as workshared mail, should be well under 100 percent, because the cost difference of record goes far beyond that appropriate for any concept of worksharing. Passthroughs for the other categories referenced in your question are usually based on a review of a range of considerations. My preference for 100 percent is stated on page 87 of my testimony, lines 3 through 5.

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**ADVO/VP-T1-8.**

At page 83 of your testimony, you take the position that the passthrough of the letter/flat cost difference “should be over 100 percent ...” Please explain why, and under what circumstances, a passthrough greater than 100 percent would be appropriate.

**RESPONSE:**

Section IV-2 of my testimony, pages 81-84, discusses the passthrough of the letter/flat cost difference with some care. The answer to your question is that a passthrough greater than 100 percent would always be appropriate. Factors that could argue for the over-100-percent (default) passthrough to move downward toward 100 percent would be: (a) a high cross elasticity between letters and flats; (b) the difference between letters and flats being considered a matter of worksharing, coupled with an interest in getting the lowest cost entity to do the work; (c) evidence of a considerably higher own-price elasticity for flats than for letters; (d) significant differences in the applicability of the monopoly statutes to letters and flats; and (e) a national policy position to give preferred treatment to flats relative to letters, in which case a position might be taken that the additional charge for flats relative to letters should reflect only the additional cost of flats, and no additional contribution. None of these apply in the situation at hand.

Taken together, the following interrogatories (ADVO/VP-T1-9 through ADVO/VP-T1-14) imply erroneously that I believe that (i) the cross elasticity between letters and flats is high, and that (ii) many mailers of flats could easily shift to a letter format. I do not argue that mailers of flats do not have reasons for using the flat format, nor do I argue that they are on the edge of converting to letters. Also, I do not argue that mailers of flats **should** convert to

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letters, and it is certainly not the case that the Postal Service should have a preference for one versus the other. When I say that mailers should be presented with appropriate rates and allowed to choose which product they wish to purchase, I mean just that, but I do not mean that any particular mailer, or group of mailers, is on the edge.

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**ADVO/VP-T1-9.**

At page 83 of your testimony, discussing the letter-flat rate differential, you state: "The mailer may look at rates to help decide which product to purchase, but this is exactly the kind of market decision made regularly among all products."

- (a) Is it your belief that saturation shopper publications and shared mailers that compete with newspapers for distribution of preprinted advertising circulars "look at the letter-flat differential" to decide whether to mail their product as a letter or a flat? If so, explain the basis for your belief.
- (b) Is it your belief that such mailers could switch to a letter-size format and still remain competitive for distribution of preprinted advertising circulars? If so, explain the basis for your belief.

**RESPONSE:**

- a. I am not an authority on what "saturation shopper publications and shared mailers" look at to formulate their business plans. Presumably, all of them are to some degree aware that postal rates must be paid and that there are many rate alternatives in Standard mail. This does not mean that they are on the edge of switching from one rate alternative to another. I have learned, however, that there is usually some cross elasticity between products, especially related products, even if small. See also my response to ADVO/VP-T1-4(f).
- b. Other than as discussed in my response to part a of this question, I hold no such belief.

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**ADVO/VP-T1-10.**

The following relate to your statement at page 83 that mailers may look at rates to help decide which postal products to purchase.

- (a) Please confirm that the maximum allowable dimensions of a “letter” are 11-1/2 inches length, 6-1/8 inches height, and 1/4 inch thickness.
- (b) Do you agree that most multi-page preprinted advertising circulars that are distributed as inserts inside newspapers exceed the maximum dimensions of a “letter?” If not, please explain your understanding of the typical dimensions of most such circulars, and the basis for your understanding. If you do not know, please so state.
- (c) Please confirm that the maximum allowable dimensions of an ECR “flat” are 14 inches length, 11-3/4 inches height, and 3/4 inch thickness.
- (d) Please confirm that these maximum allowable dimensions were increased to their current size in 1987 (Docket MC87-1) in order to allow newspapers to mail their total market coverage advertising programs at Third Class carrier route presort rates without having to fold their customers’ preprint advertising inserts. If you cannot confirm, please state your understanding of the purpose of the size changes in Docket MC87-1.

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**RESPONSE:**

- a. That is my understanding. Interestingly, I have not found a definition for letters in section 300 (applicable to Standard mail) of the Domestic Mail Classification Schedule ("DMCS"), so I would assume section 230 applies.
- b. For most of the ones I have seen, I agree.
- c. Confirmed. The dimensions that are cited are found in section 331 of the DMCS.
- d. I recollect very generally the matter described, but have not researched the matter.

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**ADVO/VP-T1-11.**

The following relate to your discussion at pages 82-83 about the influence of the letter-flat rate differential on mailer decisions concerning the format of their mailings.

- (a) Please confirm that the typical multi-page preprint advertising circular of the format currently carried as inserts inside newspapers, saturation shopper publications, and saturation shared mail programs would have to be folded at least once to fit within the dimensions of a "letter." If you cannot confirm, please explain why not and state your understanding of the dimensions of such preprint advertising circulars. If your answer is that you do not know, please so state, and assume for purposes of the following parts that such circulars would have to be folded to fit within letter-size dimensions.
- (b) If a preprint advertising circular had to be folded in order to fit within the length and height restrictions on letter-size pieces, please confirm that the folding would double the thickness of the circular.
- (c) For a saturation shopper publication or shared mail program mailing that is nearly 1/4 inch thick, please confirm that the folding of the preprint inserts to fit within the letter-size length and height restrictions would likely cause the mailing to exceed the 1/4 inch thickness restriction on letters, so that it could not in any event qualify as a "letter."
- (d) For a saturation shopper publication or shared mail program mailing with preprint inserts that currently exceeds 1/4 inch thickness, please explain how the mailer could modify its mailing to qualify as a "letter."

**RESPONSE:**

- a. I have no reason to believe that what is stated is not the case, but I should not be considered an authority on whatever folding alternatives mailers may have.
- b. I have no reason to believe that what is stated is not the case, if it were folded once.
- c. It could.
- d. I know of no way the mailer could make the transformation that is stated.

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**ADVO/VP-T1-12.**

In addition on the dimensional restrictions on a letter-size mail piece, please confirm that to qualify for the saturation letter rate, the mail piece cannot exceed 3.5 ounces.

- (a) For a saturation shopper publication or shared mail program mailing that currently exceeds 3.5 ounces, please explain how, or whether, you believe the mailer could reformat its mailing in some manner to qualify for the saturation letter rate.
- (b) If you believe that such a mailing could be reformatted in some manner to qualify for the letter rate, please explain whether you believe the reformatting would have an adverse impact on the preprint advertiser's choice to use the mail rather than newspapers for its preprint distribution.

**RESPONSE:**

Standard pieces weighing 3.3 to 3.5 ounces can qualify as letters if they are automation letters. Since all saturation letters are required to be automation qualified, I believe what is stated to be the case.

- a. Apart from removing pieces from the package, I see no easy way to make such a conversion.
- b. Not applicable.

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**ADVO/VP-T1-13.**

Do you agree that the great majority of multi-page preprinted advertising circulars currently can be distributed either as inserts in newspapers, or as inserts in shopper publications or shared mail programs, without any change to the format of the preprint. If you disagree, please explain your understanding of the format and characteristics of such circulars, and how they differ between newspapers and mail.

**RESPONSE:**

I have no reason to disagree with what is stated, although I should add that not every address receives a newspaper. However, I am not an authority on processes and programs involving the shifting of advertising circulars between newspapers and shopper publications or shared mail programs.

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**ADVO/VP-T1-14.**

Please confirm that newspapers do not require their preprint advertising circular customers to fold their preprints to “letter” size in order to be inserted in the newspaper. If you cannot confirm, please explain your understanding of typical newspaper practices and requirements concerning the maximum size of preprinted inserts. If you do not know, please so state, and assume for purposes of the following that newspapers do not require preprints to be folded to “letter” size.

- (a) Are you aware that “quarterfolding” of preprint advertising circulars involves an additional operation and cost that must be borne either by the advertiser or the distributor?
- (b) Would you agree that an additional folding operation, whether done by the advertiser’s printer or by the mailer, would lengthen the “lead time” between the printing operation and the mailing date (i.e., the preprint would have to be printed further in advance of the mailing date to allow for the additional folding operation than if no folding were done).
- (c) If a saturation shopper publication or shared mailer were to require its preprint customers to fold their preprints to “letter” size, whereas newspapers did not, do you agree this would have a negative impact on the advertiser’s choice to use mail distribution rather than newspapers? If you disagree, please explain why, including your understanding of the factors that affect preprint advertisers’ choice of distribution medium.

**RESPONSE:**

I am not an authority on “typical newspaper practices and requirements concerning the maximum size of preprinted inserts.” I have no reason to believe that what is stated is not the case.

- a. I would be surprised if that were not the case.
- b. I have discussed lead time issues with mailers and understand that they are sometimes important factors to be considered in making decisions. I am not an authority on the speed or timing of folding operations or on the conditions under

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which an additional fold might be integrated into an existing production processes.

- c. I do not have a specific “understanding of the factors that affect preprint advertisers’ choice of distribution medium,” and neither do I know the cost of a folding operation, or who could do it most efficiently. Under some conditions, your conclusion seems plausible, but decisions on distribution medium would be expected to involve considerations that go beyond whether or not a sheet must be folded, and that also include such things as cost and reach and response rates.

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**DMA/VP-T1-1.**

Please refer to page 10, lines 2 - 9, of your testimony.

- a) Would you agree that the Commission (with the approval of the courts) has implemented the requirements of 39 U.S.C. 3622(b)(3) (i.e., that each class or subclass of mail service bear its “direct and indirect attributable” costs) by determining causal relationships between each class or subclass and various amounts of USPS costs, including operating costs? Please explain in as much detail as possible any negative answer.
  
- b) Would you agree, further, that, in determining these causal relationships, the Commission (with the approval of the courts) has used a form of logical analysis known as “but for causation,” i.e., if certain costs would not have been incurred but for the need to provide service to a certain volume of mail (a single additional piece in the case of marginal cost analysis, or a small incremental volume in the case of incremental cost analysis) with certain characteristics, it can be concluded that these costs were caused by the provision of service to such mail (and are therefore “attributable” to such mail under section 3622(b)(3))? Please explain in as much detail as possible any negative answer.

**RESPONSE:**

(a) In substantial part, yes, as explained further below. I do not understand any distinction you may intend between “various amounts of USPS costs” and “operating costs.” It may be that your reference in its entirety is simply to what section 3621 calls “total estimated expenses,” which it explains further include “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.” These costs are discussed on pages 6 through 9 of my testimony.

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I would agree that the Commission's implementation of section 3622(b)(3) has been causal, inasmuch as it has been pursuant to principles of marginal cost, volume variability, or specific fixed costs. However, I do not agree that appropriate costs automatically flow from just any principle of causation. Using mere causation as a guide can lead to cost estimates that have really bad economic characteristics or that are meaningless. For example, one could argue that transportation costs are caused by our cities being so far apart, rather than by the volume of mail, and therefore that they should not be attributed. This would not make economic sense, but it is arguably causal. Similarly, fully distributed costing ("FDC") techniques are generally presented as being causal, yet their bad economic characteristics and harmful consequences have been explained by economists and business consultants for over 50 years, and were so recognized by the Kappel Commission. In fact, the need for improved product costing was one reason for passage of the Postal Reorganization Act of 1970.

Also, a distinction must be made between costs that are used for pricing and costs that are incremental to a subclass. Marginal costs and volume variable costs focus on the behavior of costs in response to small volume changes and thus relate directly to the resource implications of one rate alternative instead of another. On the other hand, incremental costs, which are certainly causal, are usually defined as the change in total cost when the entire volume of a subclass is withdrawn, and thus relate to the largest possible volume reduction. They are not developed to have a relation to the cost effects of rate alternatives. Accordingly, they do not relate to decisions about pricing. A fundamental reason for engaging in costing exercises is to facilitate attention to the effects of rate alternatives.

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(b) I believe the choice of terms in your question poses difficulties that could lead to confusion. As discussed in my response to part a of this question, economists often refer to the incremental cost of a subclass, defining it as the amount by which costs would decline if the entire volume of the subclass were withdrawn. This is a very large volume change — indeed, as large a volume change in the downward direction as possible. Your question describes incremental cost analysis as involving instead a small volume increment. Nothing is wrong with talking about the cost effects of small increments to volume, so long as the result is identified clearly and used appropriately.

As a practical matter, I do not see any difference between marginal cost analysis and the small-increment cost analysis you reference. In fact, an increment of non-negligible size is suggested by the economic prescription that rate alternatives should be evaluated by looking, possibly among other things, at the effects of one rate instead of another. Changing a rate by a small amount does cause a non-negligible change in volume in almost all cases.

As explained further in my response to part a of this question, I believe the Commission's cost attribution has been causal but that more guidance is needed to do good costing than principles of causation. Said in a different way, just passing some causal test is not enough. I believe it would be more accurate and more helpful to say that, predominantly, the Commission has used a form of volume variability analysis, and has found it to meet high standards of causation.

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to Interrogatory of Direct Marketing Association**

**DMA/VP-T1-2.**

Please refer to page 10, lines 11 - 12 of your testimony, where you state, "But one cannot say that the responsibility for the deficit lies in a certain place." Please refer also to page 11, lines 8 - 11 of your testimony, where you state, "No logical basis supports a conclusion that the deficit projected for FY 2006 is caused more by the escrow payment than by any other expense component, and any relation between their sizes is purely coincidental."

- a) Please confirm that, according to the Postal Service's chief policy witness, PMG John Potter, the additional revenues being sought by the Postal Service in this case would not have been needed, and this case would not have been filed, but for the escrow requirements established by Congress in P.L. 108-18?
- b) Do you have any reason to question the Postal Service's identification of the moneys required to be paid by the Postal Service into the escrow as "institutional costs?" See USPS-T-10, Exhibit USPS-10H, page C-24. Please explain in as much detail as possible any affirmative answer.
- c) Assuming that you answered the preceding question in the negative, would you agree that the estimated \$3.1 billion (of operating costs) required by P.L. 108-18 to be paid into the escrow are not attributable to any class or subclass of mail, but rather are caused by a specific act of Congress. Please explain in as much detail as possible any negative answer.
- d) Are you aware of any other omnibus rate case under the Postal Reorganization Act where the entire amount of the additional revenues being sought by the Postal Service was caused by a single factor?
- e) Are you aware of any other omnibus rate case under the Postal Reorganization Act where the entire amount of the additional revenues being sought by the Postal Service was caused by an act of Congress?

**RESPONSE:**

(a) The Postmaster General's statements are a matter of record, and speak for themselves. My interpretation of what he said is: (i) absent the projection of a deficit for FY 2006, this case would not have been filed, and (ii) a reduction of approximately \$3.1 billion in any cost component or any cost category or any group of costs, including the escrow payment

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(as it just happens to be the right size), would bring about a no-deficit projection. The “but for” test to which you refer is passed equally well by all of these possible reductions.

Therefore, if the test is used as an indicator of causation, the deficit must be viewed as having a very large number of causes, as many as the number of ways the costs can be assembled into \$3.1-billion pools. Note that I do not interpret his statements to mean that factors other than cost reductions (such as an increase in volume that is accommodated without much cost increase) could not also have brought about, or helped to bring about, a no-deficit projection.

This case is based on a contention that the escrow requirement stands out as a kind of Congressional influence that is different from any other Congressional influence, and that therefore the financial burden of it should be borne in a way that is different from other financial burdens, even though Congress declared that the escrow requirement should be considered an operating expense of the Postal Service (as discussed on pages 6 through 8 of my testimony). But even if Congress had not so declared, it would still be clear that the normal ratesetting scheme in the Act is the appropriate way to fund the escrow and that the escrow requirement falls within a continuum of Congressional influence, both positive and negative.

(b) I agree that the escrow costs are not volume variable and should not be attributed. Institutional costs, however, are a residual. Therefore, one “identifies” the level of attributable costs, and finds the institutional costs as the difference between total estimated costs and those attributed. One does not identify and then add up costs that appear to be institutional (although that can sometimes be done). This is a critical difference. To see how the reasoning works, consider a simple firm with two cost pools and three products. The first

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cost pool involves a fixed payment of \$20 million and the second is an operating pool of \$80 million. The total costs of the firm are \$100 million. Suppose the cost elasticity of the \$20-million pool is zero for all three products, much like the escrow. That is, for a 10 percent increase in the volume of Product A, a 10 percent increase in the volume of Product B, or a 10 percent increase in the volume of Product C, taken individually, one at a time, *ceteris paribus*, the percent change in the number of dollars in the \$20-million pool is zero. Now suppose the cost elasticity of the \$80-million pool is 0.3 for Product A, 0.5 for Product B, and 0.4 for Product C. This means that the attributable cost of Product A is \$24 million ( $0.3 * \$80$  million), of Product B is \$40 million ( $0.5 * \$80$  million), and of Product C is \$32 million ( $0.4 * \$80$  million).<sup>1</sup> Total attributable cost is \$96 million. Institutional cost can now be calculated as \$4 million ( $\$100$  million - \$96 million). It is true that if the \$20-million pool were to be removed as a cost burden, institutional cost would be \$20 million lower, going in this case to a level of negative \$16 million, but it is not true that the \$20-million expense resides as an identifiable element in the institutional cost of the firm. Furthermore, although seeking to understand why costs have the variabilities that they do is a laudable undertaking, exercises that focus on the causes of institutional costs are the stock-in-trade of advocates of fully distributed costing. Accordingly, extreme care must be taken in discussing the causes of institutional costs. You may object that the sum of a set of cost elasticities ( $0.3 + 0.5 + 0.4 = 1.2$ , in this case) would not normally be expected to exceed 1.0, at least if the firm is

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<sup>1</sup> Note that upon analyzing Product A and finding that \$24 million of the \$80-million cost pool is attributable to it, one cannot jump to a conclusion that \$56 million ( $\$80$  million - \$24 million) of the pool is institutional.

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experiencing scale economies, and I would agree. A theory of costing, however, must be general enough to accommodate all possible outcomes, and the situation posited in this example is both possible and understandable.

(c) As indicated in my response to part b of this question, I agree that the escrow costs are an operating expense (so classified by Congress), do not vary with volume, and should not be attributed. But I take issue with the phrase “but rather are caused by.” The fact that costs may be viewed as caused by something other than volume, such as Congressional concern over the funding of health care costs for retirees, or anything else, does not imply that they are unusual or that they are not volume variable. The sum of the costs caused by a set of perfectly sensible causes can easily be greater than the cost itself. As an example, consider carrier costs. We know that all carrier costs are caused by the need to deliver the mail. But one could argue as well that they are caused, at least in substantial part, by a universal service obligation (“USO”) and by a decision on how many days a week to deliver and by the weather and by decisions Congress made on the guidelines for collective bargaining. The sum of the costs caused by all of these causes is probably much larger than the total of all carrier costs. In other words, costs cannot necessarily be distributed to their causes, and they can have more than one cause.

(d) Assuming but not agreeing that there is a logical basis for saying that the need for additional revenue (*i.e.*, the deficit) is caused more by one factor than another, I am not aware of any other such rate cases, possibly because I have not examined previous omnibus cases and searched for coincidences between factor sizes and projected deficits. A situation like the

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present one, even though brought about in substantial part by the unusual decision to propose a contingency of zero, is probably rare. An alignment of the stars is required for an obvious cost pool to be just the right size. If the Postal Service's recent cost reduction efforts were less successful than they actually were, and the deficit projected for FY 2006 were \$5 billion instead of \$3 billion, the temptation to assert a link between the escrow and the deficit would be weaker.

(e) Coincidences aside, I don't view the amount of additional revenue being sought in this case as caused any more by an act of Congress than by any other expense that must be paid. All Congress did was to say that payments made in the past would be continued as before, but would now be put into a separate fund, the purpose of which will be designated at some future date. This does not qualify as an overt act that changed financial trends. But let's assume that Congress suddenly and unexpectedly said that all addresses would begin immediately to receive three deliveries per day. Assuming breakeven otherwise, if a rate case were to be filed because of this new requirement, it would be an ordinary rate case. The fact that Congress, in some sense, caused it would be irrelevant. See also my response to other parts of this question.

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**DMA/VP-T1-3.**

Please refer, further, to page 11, lines 8 - 11 of your testimony, where you state, "No logical basis supports a conclusion that the deficit projected for FY 2006 is caused more by the escrow payment than by any other expense component, and any relation between their sizes is purely coincidental."

- a) Would you agree that a deficit (any deficit) is by definition the result of aggregate calculations, i.e., total expenses being larger than total revenues? Please explain in as much detail as possible any negative answer.
- b) Is it your assertion that, in the context of a business with multiple sources of revenues and expenses, it is logically impossible to identify a causal relationship between a subset of these sources and an overall financial deficit (or an overall financial profit, for that matter)? Please explain in as much detail as possible any affirmative answer.
- c) Would you agree that conclusions concerning the causes of, or the responsibility for, any specific deficit (or profit) depend on an analysis of the circumstances of that particular situation? Please explain in as much detail as possible any negative answer.

**RESPONSE:**

(a) Yes. I discuss the residual nature of deficits on pages 10 and 11 of my testimony.

(b) As a practical matter, I would not in all cases so assert, but the logic may not be as unambiguous as you suggest. That is to say, as I discuss in my response to DMA/VP-T1-2(a) and 2(c), a deficit can be said to have multiple causes, at least according to the "but for" reasoning of that interrogatory, and there may not be a way to narrow it down to one cause. The sentence beginning on page 10, line 2 of my testimony says only: "Generally, one would not expect any logical basis for assigning responsibility for a deficit."

I agree that situations exist where the man on the street would view it as logical to say that a deficit was caused by some event. For example, suppose at a time of a balanced budget

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and smooth economic sailing, an earthquake destroyed the 12 bridges that were central to a city's economic functioning, and damaged some buildings as well. A deficit in the city's budget could occur. If it did, I am sure everyone would argue that it was caused by the earthquake. However, since the escrow payment is not something that occurred suddenly and unexpectedly, it is not clear that this example applies. All Congress did was say that payments made in the past would continue to be made, but would be put into a different pot, for a purpose to be designated. And even if the earthquake example were taken to apply, the question of the most appropriate way to cover the deficit would still have to be asked.

Things can be placed into better perspective by recognizing, as your question seems to, that deficits are nothing more than negative profits. It might be found that a certain event (possibly a complex development or maybe just a cost that is extraordinary) led to a decrease in profits. For example, suppose an event reduced profits by \$400 million, meaning that profits are \$400 million lower than they would have been otherwise. The event could have lowered profits from, say, \$700 million to \$300 million, or from \$200 million to negative \$200 million, or from negative \$100 million to negative \$500 million. If the event were sudden and unexpected, and if it just happened to lower profits from zero to negative \$400 million, one might be tempted to argue that the event caused the \$400 million deficit. But even here, the "but for" form of logic would suggest that the deficit had other causes as well.

(c) Yes, but the analysis required is fraught with difficulties and it should not be presumed that well-defined causes will be identifiable.

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**DMA/VP-T1-4.**

With further reference to your testimony at pages 10 - 11, please assume, hypothetically, that an airline has experienced only modest variations in revenues (including passenger miles) and costs for the past three years, and that this airline has had a modest profit in each of those years. Assume, further, that in the most recent year it experienced a substantial increase in fuel costs and that it also experienced a significant deficit in that year.

- a) Is it your position that management of the airline would be illogical in identifying the increase in fuel costs as the "cause" of the current deficit, as opposed, e.g., to a failure to attract more passengers? Please explain fully.
- b) Is it your position that management of the airline would be misleading the public if it asserted that its recent deficit was "caused" by the recent increase in fuel costs? Please explain fully.
- c) Assuming that the airline has limited financial reserves and that it would take at least six months to conduct a detailed market study in order to determine the relative demand and other competitive factors affecting each of its routes, is it your opinion that management would be acting irrationally to impose an across-the-board "fuel surcharge" to all its fares in order to avoid a deficit? Please explain fully.
- d) In your opinion, would it be more economically rational for management to impose surcharges in identical dollar amounts to each ticket sold, or to impose surcharges of an identical percentage on the cost of each ticket sold? Could you identify a third alternative that would be more economically rational than either of these two possible surcharges? Please explain fully.

**RESPONSE:**

(a) Not inherently, but note should be made that your example involves horizontal trends consistent with a modest profit, and then the occurrence of a sudden and unexpected event.

(b) No, but public relations statements are generally not as carefully scrutinized as representations which have rate consequences.

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(c) Not necessarily, in part because you have ruled out alternatives. But your airline could face consequences for not being able to achieve a solution that is better aligned with its costs and the competition it faces. A critical difference between the Postal Service and the airline, however, is that when the airline does decide to move to a well-thought-out position, it can go directly there, even if it involves something as draconian as withdrawing altogether from certain unprofitable routes (an option unavailable to the Postal Service), and it does not need to consider the proximity of the new position to the surcharged-rate position you created for it. When it comes to watching out for the welfare of its customers and the effects on them, the Postal Service is held to a higher standard than are private firms.

(d) Unless I had concerns about whether some of the existing rates were out of line with important guidelines, such as current costs, I believe most notions of economic rationality would be taken to suggest the percentage approach. I have read in recent years, however, about fixed per-ticket charges to cover certain costs. These may have been to cover costs that did not vary with distance. I have not explored alternatives to the approach you suggest and do not consider myself enough a student of airline pricing for sensible alternatives to come easily to mind. One obvious one could include honoring some kind of markup index.

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**DMA/VP-T1-5.**

Please refer to page 16, lines 1 - 2 of your testimony, where you state, in reference to PMG Potter's second justification for the AtB proposal, ". . . increasing the likelihood of achieving a settlement is not one of the non-cost factors in the Act."

- a) Would you agree that expediting receipt by the Postal Service of needed additional revenues is a valid goal of the Postal Service and of the Act, and that the Commission has the authority to recognize this goal as an "other factor" under section 3622(b)(9)? Please explain fully.
- b) Would you agree that a streamlined request, designed to avoid as much as possible controversies concerning complex costing, classification and rate design issues, such as the Postal Service has filed in this case, is a valid means toward the end of expediting receipt by the Postal Service of needed additional revenues? Please explain fully.

**RESPONSE:**

(a) My review of previous cases found that the Commission has relied rarely on section 3622(b)(9). See pages 72-73 of my testimony. Nevertheless, aside from the record developed in the case at issue, its own judgment, and the other policies of the Act, I know of no limits on what other factors this section might allow the Commission to consider. However, there may be a reason why expedition is not one of the non-cost factors of the Act, at least not one expressly identified. If needing additional revenue soon trumped other considerations, there would be no ratesetting process at all. That is to say, expedition conflicts with and weakens the review contemplated by the Act. Whether expedition is a valid goal for the Postal Service must be viewed in the context of shortchanging the ratesetting process and the role of the Commission. Viewed in this way, Postal Service steps to expedite may not be a good thing. As explained on lines 6 and 7 of page 16 of my testimony: "Borrowing options are available

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to allow flexibility and to smooth things out over time.” In the scheme of things, I do not view the financial consequences of one rate case schedule or another to be troublesome or unmanageable.

(b) Certain observations on the question of validity were made in my response to part a above. I agree that the Postal Service has the option of handling things in such a way that the processing time needed at the Commission is likely to be shorter. Whether doing so is a good thing is another question. The nation and its mailers could be the losers if rates are based perpetually on costs that are out of date and if improvements in the efficiency of rates are not made. But whatever decisions the Postal Service makes, I have a hard time imagining Congress putting in a non-cost factor that says: “If, at the time of filing, the Postal Service indicates that it is in a hurry to begin receiving additional revenues, it is OK to jettison all rate improvements, neglect all current costs, and give reduced weight to all of the other ratesetting policies contained herein.” A provision like this would not be consistent with good ratesetting by an expert commission, nor would it be fair to mailers.

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**DMA/VP-T1-6.**

Please refer to pages 17 - 18 of your testimony, where you refer to witness Robinson comparing the escrow burden to a "tax."

- a) On page 18, lines 6 - 8, you allege that the Postal Service "has not presented any plan to remove the ATB increase . . . [and] it is clear without question that no such plan is feasible and that if the ATB increase is implemented, the next rate increase will be built on top of the ATB rates." Is it not the case that the Postal Service has stated that it plans to file another omnibus postal rate case (referred to hereinafter as "R2006-1") soon after the conclusion of this case and that R2006-1 will involve a complete consideration of the full panoply of postal costing, pricing and rate design issues? Please explain fully.
- b) Further, you state on page 18, line 13 through page 19, line 1, that ". . . future rates built on an ATB platform would be different from future rates built on a more traditional platform." Beyond the differences in test-year-before-rates revenues (which clearly will be higher if the ATB rates are implemented in the interim), on what grounds do you believe that rates implemented following the R2006-1 case will be different depending on whether ATB rates are in place during the base year of such a case. Please explain fully.
- c) Do you believe that, if the rates for Standard ECR mail implemented following this case reflect an increase of less than 5.4%, there will be a substantial chance that the rates for Standard ECR mail implemented following R2006-1 will be lower than if the rates for Standard ECR mail implemented following this case reflect an increase of 5.4%, as proposed by the Postal Service? In what ways would the arguments made by representatives of Standard ECR mail in the former situation be stronger than the arguments that they would be able to make in the latter situation? Please explain fully.

**RESPONSE:**

(a) Yes, it is true that the Postal Service has stated plans to file a case you refer to as R2006-1. But whether that case is actually filed, and when it is filed, may not be so certain. For example, no one expected the settlement rates of Docket No. R2001-1 to stay in effect for 3 1/2 years. Also, postal reform legislation may affect the next case.

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(b) This issue is discussed in Sections II-6 and II-7 of my testimony, beginning on pages 22 and 24, respectively. For the case you call R2006-1, in the unlikely event that neither the Commission nor the Postal Service, nor any parties presenting evidence or writing briefs, give any attention or weight to rate shock or other effects of the rate increases on mailers, then the rates recommended in R2006-1 would not depend on the rates recommended in the current docket. It bears noting in this regard, however, that the option to neglect the effects of rate increases on mailers is of questionable legality; section 3622(b)(4) of the Act requires attention to effects. Incidentally, FY 2006 is not likely to be the base year for R2006-1.

(c) My response to the first part of your question is yes. In regard to the second part, it is not that the arguments would be stronger *per se*, but rather that they may be less effective. As discussed in my response to part b of this question and extensively in my testimony, section 3622(b)(4) of the Act requires that the Commission consider the effects on mailers of any rate increases recommended, and my experience has been that the Commission does this. When this is done, it is quite often the case that new rate positions are reached in several steps instead of one step. I believe this case should be the first step. It has been 10 years since ECR was created as a subclass. Further delay in responding to what you call "the arguments made by representatives of Standard ECR mail" is not an attractive alternative. It is time to begin making some changes.

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**DMA/VP-T1-7.**

Please refer to your testimony at page 23, lines 2 - 6 and at page 30, lines 3 - 5.

- a) Please explain what you mean by a “meritorious” rate position.
- b) Is it a correct interpretation of these portions of your testimony that, unless some rate relief is granted to Standard ECR mailers in this case, it will be more difficult for the Commission in the next case to give Standard ECR mailers the rate relief they would like to have, because such rate relief would involve a shift of revenues from Standard ECR mail to other mail so substantial that it would cause “rate shock” to the mailers of other mail to such an extent that the Commission would be reluctant to recommend such a shift? Please explain fully.
- c) Is this what you mean when you state, on page 30, lines 3 - 4, “. . . an ATB case . . . can result in disruptive rate patterns and excess effects on mailers in future cases.”? Please explain fully.

**RESPONSE:**

(a) In context, the reference to a meritorious rate position means a preferred set of rates, selected by the Commission, based on the Act, the record, and its judgment, without giving any weight to non-cost factor No. 4 (that being the factor relating to the effects of rate increases on mailers).

(b) The sections of my testimony to which you refer are general and relate to patterns of rate adjustments over time. Focusing only on this case and the next one, your question is whether “rate relief” for ECR mailers can be provided more easily in two small steps (as in a relatively small increase in both this case and the next one) than in one large step (as in an average increase in this case and no increase in the next one). My answer is yes.

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(c) Yes, in part, as explained further in my response to parts a and b of this question and in the section you quote. Note that problems can occur not only between subclasses but also within subclasses.

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**DMA/VP-T1-8.**

Please refer to your testimony beginning on page 24 at line 4 and continuing to page 30, line 5.

- a) Is the essence of your testimony that the Postal Service should have presented a full-blown case in this proceeding?
- b) Is it your position that the Postal Service violated some applicable principle or principles of law by filing the case that it did? Please explain fully, specifically identifying each principle of law that, in your opinion, was violated by the USPS filing.
- c) Is it your position that the Postal Service violated some applicable economic principle or principles by filing the case that it did? Please explain fully, specifically identifying each economic principle that, in your opinion, was violated by the USPS filing.
- d) Please explain as completely as possible the ways in which the violations, if any, identified in your responses to the preceding questions should impact the Commission's consideration of this case.

**RESPONSE:**

(a) Of the section you cite, yes.

(b) Nothing in the section of my testimony you cite argues that any specific principle of law has been violated. However, it is my view that the case does not appropriately honor the regulatory scheme that has evolved under the Act and that I believe to be encompassed by the Act. For example, I believe it is better to use current costs than historic costs to set rates, a view the Commission has expressed in the past. *See* Docket No. R94-1, *Op. & Rec. Dec.*, p. I-5, ¶ 1017.

(c) Yes. This is explained in considerable detail in my testimony (*see especially* Sections II-2 through II-8, pp. 10-33), and a summary might not do it justice. I believe one of

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the most fundamental principles of fairness is that costs should be current and should be recognized in appropriate and defensible ways. This case virtually neglects costs and proposes rates based on the costs of Docket No. R2001-1. I also believe that efficient rates are desirable and that this case, instead of improving efficiency, makes it worse. In addition, this case makes no improvements in rates or in the signals sent to mailers, and improvements are needed. And it is not just a matter of the nation having to endure a year or two of rates that are out of kilter, it is a matter as well that the effects of this case will be around for a much longer period.

(d) The Commission should recognize current costs and other current conditions, in a detailed way, and recommend rates in accordance with the policies in the Act, its rules, and its judgment, consistent with the regulatory scheme it has helped develop.

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**DMA/VP-T1-9.**

Please refer to your testimony beginning on page 35, line 21, where you state, "The ATB approach fails also as a special assessment, because no procedure exists for withdrawing it when the need has been met."

- a) Would you agree that the ATB approach would qualify as a special assessment if a plan did exist for withdrawing it when the need for it has been met? Please explain fully.
- b) Other than the absence of such an "exit strategy", are there any other reasons why, in your opinion, the ATB approach would not qualify as a valid special assessment? Please explain fully, describing each such reason, if any, in as much detail as possible.

**RESPONSE:**

(a) Basically, yes, but a special assessment still might not be the best way to cover the deficit. Aside from the concern that it might be possible during the next year or two to have a better set of rates, the problem is that I don't think there is a way to withdraw it. At the time the next omnibus rate case is filed, there appears to be no choice but for mailers to be paying the rates that come out of this case. Therefore, the effects of the rate increases of that case will be considered relative to those rates. We can't really change the fact that section 3622(b)(4) of the Act says to consider the effects of rate increases (from the current rates) on mailers.

(b) In context, I suppose it would qualify as a special assessment, but there would still be the question of whether a special assessment is the best approach, and if so, whether this one is the best special assessment that could be designed. The Act outlines a range of factors that are important to consider when additional revenue is needed and, except in a perfunctory way, the Postal Service proposal considers none of them.

1                   CHAIRMAN OMAS: This brings us to oral  
2 cross-examination. Three parties have requested oral  
3 examination, Advo, Direct Marketing Association and  
4 the United States Postal Service.

5                   Mr. McLaughlin for Advo, would you identify  
6 yourself for the record, please?

7                   MR. MCLAUGHLIN: My name is Tom McLaughlin  
8 representing Advo. Thank you, Mr. Chairman. I guess  
9 we have to share microphones today here at this table,  
10 so we may be passing it back and forth.

11                  CHAIRMAN OMAS: Mr. Olson can pull the one  
12 down up there.

13                                   CROSS-EXAMINATION

14                   BY MR. MCLAUGHLIN:

15                  Q     Mr. Mitchell, I hope I don't call you Bob.  
16 If I do, I apologize.

17                  A     No problem.

18                  Q     I'd like to start just by asking you in  
19 general the extent to which you have knowledge of what  
20 I will call the coupon envelope, saturation coupon  
21 envelope market.

22                  A     I have limited knowledge of the market.

23                  Q     And Valpak is a competitor in that market?  
24 Is that right?

25                  A     Yes.

1           Q     That is its product, a saturation coupon  
2 envelope?

3           A     Yes.

4           Q     Do you know if Valpak is the largest of the  
5 coupon envelope distributors?

6           A     I'm sure they're a candidate for the top  
7 group, but I can't say with certainty that they're the  
8 largest.

9           Q     You just don't know?

10          A     I don't know for sure. I would not be  
11 surprised if they are the largest.

12          Q     What other companies are in that top group  
13 that you're aware of?

14          A     Well, I recall at my home, and this is  
15 anecdotal. I recall at my home getting packages from  
16 Mercury Coupons. I remember sometime in the past  
17 getting coupons from Carol Wright. I don't know that  
18 I'm still receiving those. I can't think of any  
19 others off the top of my head.

20          Q     And you wouldn't know how any of those  
21 companies would compare in terms of size among them?

22          A     You say how they prepare their --

23          Q     How they compare in size. Who's the  
24 largest? Who's second? You wouldn't know that?

25          A     I think I said that I'm not really

1 certain --

2 Q Okay.

3 A -- who's the largest.

4 Q Now I'd like to turn to your testimony at  
5 page 83. This is where you're talking about the  
6 letter/flat cost differential and how that should be  
7 marked up to get a rate differential. Is that  
8 correct?

9 A Yes.

10 Q At Lines 11 and 12 you seem to suggest that  
11 the default solution should be that whatever the  
12 letter/flat cost differential is that that  
13 differential should be marked up by an amount equal to  
14 the subclass cost coverage.

15 A Yes. I have called that the default  
16 solution.

17 Q Okay. Approximately what is the cost  
18 coverage for the ECR subclass?

19 A I reviewed that in one of your  
20 interrogatories and calculated it before rates. It  
21 seems to me like it was in the neighborhood of 215 or  
22 217 percent.

23 Q If we just use 200 percent for the purpose  
24 of the question that would mean that your optimal  
25 solution would be that if the letter/flat cost

1 differential is a penny that the rate differential  
2 should be doubled and be two cents by applying a 200  
3 percent cost coverage?

4 A That's true. That's the result of applying  
5 that percentage.

6 Q Now, how does that differ in terms of the  
7 application of a cost coverage from subclass pricing?

8 A I'm not sure that I understood exactly what  
9 you asked.

10 Q How does applying a cost coverage markup to  
11 the letter/flat differential differ from subclass  
12 pricing as if they were treated as separate  
13 subclasses?

14 A As a general matter it doesn't. Whether or  
15 not there's some secondary effects having to do with  
16 things like fees I'm not sure, but in general it  
17 doesn't differ.

18 Q So the approach you're talking about would  
19 produce in your view the same view as if letters and  
20 flats were separate subclasses having the same cost  
21 coverage?

22 A I think that's basically the case, yes.

23 Q How are cost coverages calculated for a  
24 subclass?

25 A How are they calculated?

1 Q Yes.

2 A I think they're usually given. I don't know  
3 that they're calculated.

4 Q Okay.

5 A Do you mean to take the revenue and divide  
6 by the cost?

7 Q Yes. Isn't it total revenues for the  
8 subclass divided by the total cost?

9 A Yes.

10 Q So working it the other way, if you had  
11 total costs for the subclass you apply a cost coverage  
12 to get the targeted total revenues. Is that right?

13 A Yes. It usually includes fees, but yes.

14 Q Right. Putting aside fees, it's basically  
15 total costs producing through cost coverage total  
16 revenues. Is that right?

17 A Yes.

18 Q Would your approach do that?

19 A You're drawing me into some exact statements  
20 here involving some comparisons, but I think that in  
21 other words once you apply the letter/flat  
22 differential you still have to put in the  
23 differentials between basic and high density and  
24 saturation.

25 Before I make a series of all-inclusive

1 statements, I usually run some numbers and check it  
2 and see if there's anything going on that I don't see,  
3 but I think what you're saying is correct.

4 Q Does the letter/flat cost differential  
5 include the effects of not just piece handling cost  
6 differentials, but also weight-related cost  
7 differentials?

8 A I think that weight-related cost  
9 differentials are not included in the letter/flat  
10 differential that we've been discussing.

11 Q What's your basis for saying that?

12 A Well, we have drop ship discounts, for  
13 example, and presumably the drop ship discounts  
14 consider weight-related costs.

15 We also have a pound rate, and there should  
16 be a relationship between the pound rate and the  
17 transportation-related costs. Normally --

18 Q Excuse me. When the letter/flat cost  
19 differential is calculated is there an adjustment made  
20 to factor out weight-related costs?

21 A Yes.

22 Q What is it?

23 A If you look at the Postal Service's cost  
24 studies they make a drop ship adjustment to their cost  
25 studies.

1           Q     Let's say for example a 12-ounce piece costs  
2 more to handle than a two-ounce piece in terms of  
3 either casing or in-office operations or on the  
4 street. Are those differences picked up in the  
5 letter/flat cost differential?

6           A     The letter/flat cost differential is based  
7 on delivery costs and mail processing costs.

8           Q     Correct.

9           A     Those costs are drop ship adjusted. Those  
10 costs are generally viewed as not terribly sensitive  
11 to weight, at least within the range that we're  
12 talking about, but if those costs were sensitive to  
13 weight there would be a question here.

14          Q     Yes, there would be, wouldn't there. Why  
15 wouldn't they be sensitive? Why wouldn't those cost  
16 differences reflect weight-related differences in  
17 casing, weight-related differences in bulk handling in  
18 office or weight-related differences in carrier street  
19 time to the extent that there are weight-related  
20 differences?

21          A     I guess the question goes to whether the  
22 cost studies that generate those figures are sensitive  
23 to the weight of the pieces. If a carrier cased heavy  
24 pieces more slowly than lightweight pieces then I  
25 think there would be some sensitivity.

1           Q     Under your approach, in your view you would  
2 agree that there very well could be weight-related  
3 cost differences that are reflected in the letter/flat  
4 cost differential? Do you have any reason to doubt  
5 that?

6           A     I grant you that that's a fair question. I  
7 have relied on the Postal Service's cost studies,  
8 which have also been used by the Commission in  
9 previous rates, so I'm not prepared to go into a  
10 detailed discussion of exactly what those cost results  
11 mean. I have used them in the same way that they've  
12 been used in the past.

13          Q     To the extent that the letter/flat cost  
14 differential includes the effect of weight-related  
15 costs would you agree that marking up that cost  
16 differential by a 200 percent cost coverage and then  
17 also charging a pound rate on top of that might create  
18 a problem?

19          A     I'm not sure I want to give a clear yes or  
20 no until I've explored this further. This is not an  
21 issue that I've spent a lot of time trying to map out  
22 in my mind, and my reaction is it's not an issue  
23 that's received a lot of attention in previous cost  
24 working cases.

25          Q     You don't believe this issue has been raised

1 by issues in prior proceedings? Is that your  
2 understanding? It has not been raised?

3 A I'm not making a statement that it hasn't  
4 been raised. I said in my mind I'm not aware of how  
5 the issue has been treated. I don't have a  
6 recollection of exactly how the issue has been  
7 handled.

8 Q I'd like to ask you a couple questions about  
9 private delivery. You do discuss private delivery in  
10 your testimony a little bit.

11 By the way, are you aware that there are a  
12 number of saturation shopper publications that are  
13 delivered privately?

14 A That are delivered privately?

15 Q Yes.

16 A Yes. When I attended a convention once of  
17 those providers the rule of thumb seemed to be that  
18 about half of them were delivered privately and half  
19 of them through the mail.

20 Q I think that's my understanding as well. I  
21 think that's a fairly common understanding.

22 And you are aware that there are at least  
23 some saturation shared mailers that use private  
24 delivery for portions of their distribution?

25 A Yes.

1 Q Valpak does not?

2 A My understanding is that they do not.

3 Q What factors do you think would contribute  
4 to the higher usage of private delivery by saturation  
5 flats than by saturation letters?

6 A Well, I think one issue is the pound rate  
7 that you've been discussing. When a piece is  
8 relatively heavy the postage goes up rather rapidly,  
9 and the private firms find that they can carry them  
10 and can compete more effectively.

11 Q And then how about at the level of the  
12 letter/flat rate differential, a surcharge for flats  
13 in essence over letters? Does that have an influence  
14 on greater usage of private delivery by flats than by  
15 letters?

16 MR. OLSON: Mr. Chairman, is counsel  
17 representing there is a surcharge on flats at this  
18 point?

19 MR. MCLAUGHLIN: Well, excuse me. Excuse  
20 me. Perhaps poor usage of words.

21 BY MR. MCLAUGHLIN:

22 Q There is a higher charge for flats than for  
23 letters based on the letter/flat rate differential,  
24 right? Is that correct?

25 A Yes. Higher than it would have been.

1           Q     Could that contribute to higher usage of  
2 private delivery by flats than by letters?

3           A     Well, I'm not sure, but it's awkward to say  
4 it that way. I think you arrive at a fair rate for a  
5 flat and a fair rate for a letter, and those become  
6 rates just like the rates for any other product.  
7 People who want to compete look at those rates.

8           Q     That wasn't my question. My question  
9 related to private --

10           MR. OLSON: Mr. Chairman, I'm not sure the  
11 witness was done responding. This has come up a  
12 couple of times. That's the only reason I'm asking.

13           BY MR. MCLAUGHLIN:

14           Q     Had you finished?

15           A     Well, in this particular case I think I was  
16 pretty close. I think taking a step to look at one  
17 end of a particular rate from saying that the  
18 competitor looks at the rate to see what it is when he  
19 competes.

20           Q     I think my question related to private  
21 delivery. I'll restate the question.

22                     Do you think that the fact that there is a  
23 letter/flat rate differential so that flats pay higher  
24 rates than letters, do you believe that that would be  
25 a contributing factor to the higher usage of private

1 delivery by flats than by letters? That was the  
2 question I asked.

3 A Do I believe that the fact that there is a  
4 differential would contribute?

5 Q Yes.

6 A A differential makes the flat rate higher  
7 than it would have been otherwise, and that would be a  
8 rate that a competitor would look at.

9 I mean, I'm having a little trouble with the  
10 causation and the order in which you're saying it.  
11 It's altogether clear that there's a market price and  
12 that the market price is developed in a certain way  
13 for flats.

14 Q Well, maybe I'm not being clear enough  
15 myself. I'm looking now at a saturation letter mailer  
16 versus a saturation flat mailer considering whether or  
17 not private delivery makes sense for them.

18 Do you believe that the fact that the  
19 saturation flat mailer has to pay a higher postage  
20 rate because of the level of the letter/flat rate  
21 differential would create a greater incentive for them  
22 to use private delivery compared to the letter mailer?

23 A I'm still having the same trouble with the  
24 logic flow here. If you want to present two  
25 alternatives and say if we had a low pass-through of

1 the letter/flat differential would that give a lower  
2 flat rate than if you had a high pass-through I would  
3 say yes. If you want to say would a competitor look  
4 at that higher rate when he's competing I would say  
5 yes.

6 Q Well, I'm not sure that we're communicating  
7 here, and I think I'll just go on to something else at  
8 this point.

9 There are of course many saturation flat  
10 mailers that mail on a weekly frequency, for example.  
11 Are you aware of that?

12 A There are flat mailers with a weekly  
13 frequency. Yes, I'm aware of that.

14 Q I believe we've had in fact some  
15 interrogatories concerning letter mailers. Are you  
16 aware of any letter mailers, saturation letter  
17 mailers, that mail weekly or even monthly?

18 A I always have a little trouble  
19 characterizing something as monthly versus every four  
20 weeks because if weekends are important then every  
21 four weeks would be a lot better than monthly.

22 Q Take your pick.

23 A You want to know if I'm aware of any  
24 saturation letter mailers that are weekly?

25 Q Yes.

1           A     I can't name any.

2           Q     Do you think that having a regular weekly  
3     distribution would make it more feasible to consider  
4     starting up your own private delivery operation using  
5     private delivery than if you mailed six or eight times  
6     a year?  If you don't know, you can just say you don't  
7     know.

8           A     I guess my reaction is that the private  
9     delivery operations are set up in a number of  
10    different ways, sometimes using part-time people,  
11    sometimes people that do one thing one time and one  
12    time another.

13                    I don't really know enough about setting up  
14    that kind of operation to know, you know, the pros and  
15    cons of one versus the other.

16           Q     So your answer is you really don't know?

17           A     The answer is I'm really not sure that I can  
18    respond to it effectively.

19                    MR. MCLAUGHLIN:  I have no further  
20    questions.

21                    CHAIRMAN OMAS:  Thank you, Mr. McLaughlin.  
22    Mr. Ackerly, would you identify yourself?

23                                    CROSS-EXAMINATION

24                    BY MR. ACKERLY:

25           Q     Good morning, Mr. Mitchell.  I'm Todd

1 Ackerly, counsel for Direct Marketing Association.

2 A Good morning.

3 Q Could I ask you first to turn to page 7 of  
4 your testimony, please? That's the portion of your  
5 testimony where you discuss the characterization of  
6 the escrow, the \$3.1 billion, as an operating expense.  
7 Do you see that?

8 A Yes, I do.

9 Q Beginning at Line 16 of your testimony you  
10 state, and I quote, "I am not aware of any basis under  
11 the Act for treating this operating expense as any  
12 different from any other operating expense."

13 That's still your testimony, isn't it?

14 A Yes.

15 Q Is it your understanding that under the  
16 traditional ratemaking approaches utilized by this  
17 Commission operating expenses are in fact divided into  
18 several different kinds of costs such as attributable  
19 costs, institutional costs, specific fixed costs?  
20 That is your understanding, isn't it?

21 A We find a level of attributable costs. We  
22 find institutional costs as a residual. I don't know  
23 whether that can always be done by simply separating  
24 the costs into categories, but my statement here was  
25 at a little higher level than how the Commission deals

1 with costing for rate purposes.

2 Q If you would then turn to page 9 of your  
3 testimony? You state that, and I quote beginning at  
4 Line 15, "The deficit must be addressed and addressed  
5 according to the requirements of the Act."

6 Is that still your testimony?

7 A Yes.

8 Q My question is does the fact that the  
9 deficit is an operating expense entail necessarily any  
10 particular methodology for allocating those costs to  
11 specific classes of mail?

12 A You started out by saying that the deficit  
13 is an operating expense. I don't think of the deficit  
14 as being an operating expense. I'm sorry. I got off  
15 on the wrong foot at the first part of your question.

16 Q Well, perhaps I misunderstood your  
17 testimony. If we go back to page 7, you were talking  
18 about something being an operating expense. To what  
19 were you referring when you identified certain costs  
20 as operating expenses?

21 A Well, Congress said that the escrow payment  
22 would be handled as an operating expense. That's on  
23 the cost side of the ledger.

24 You started out your question asking about a  
25 deficit, which is a residual which compares both the

1 revenue side and the cost side, so when you started in  
2 your first line talking about a deficit I had a little  
3 bit of trouble getting back to the rest of your  
4 question.

5 Q I see. So the distinction that you're  
6 making is between the deficit and the escrow  
7 requirement.

8 If I were to change the question and say  
9 does the fact that the escrow requirement is an  
10 operating expense entail in your judgment any  
11 necessary conclusion that the Commission ought to draw  
12 for purposes of rate making?

13 A No.

14 Q Fine.

15 A It should analyze that cost just like all  
16 other costs and cover it just like all other costs.

17 Q Now if you could turn to your answer to our  
18 Interrogatory 2(b), please? You state there, and I  
19 quote again, "I agree that the escrow costs are not  
20 volume variable and should not be attributed."

21 Is it your testimony then that the escrow  
22 costs should be treated as institutional?

23 A I don't treat the specific costs as  
24 institutional. What I do, as I explain further in  
25 this example, is that I analyze costs to see if they

1 are attributable.

2 After I get through with that process I  
3 subtract the attributable costs from the total and I  
4 have institutional, but I don't get institutional  
5 costs by going around and identifying pools of costs  
6 that are institutional and adding them up.

7 Q Okay. Perhaps I was talking in a  
8 shorthanded way then. If the escrow costs are not  
9 attributed, should not be attributed, doesn't it  
10 follow according to the ratemaking process that the  
11 Commission uses that those dollars will end up being  
12 institutional costs?

13 A In a general sort of way, yes, but in my  
14 answer to the question that you're referring to I  
15 provided a situation which was very plausible where  
16 the total of institutional costs could be less than  
17 the residual.

18 I'm sorry. Where the total of institutional  
19 costs could be less than the size of the escrow pool  
20 that we're talking about so in general I'm very, very  
21 careful about saying that I can identify certain costs  
22 as institutional and attempt to transfer them into the  
23 institutional pool and keep their identity.

24 Q Well, I will confess to you, Mr. Mitchell,  
25 that the calculations you made towards the end of your

1 answer to our Question 2(b) I couldn't follow, but  
2 perhaps people smarter than I can.

3 In any event, assuming that the escrow costs  
4 end up being treated by the Commission as  
5 institutional costs is it not your understanding of  
6 the Commission's ratemaking procedures that they would  
7 be distributed among the classes in accordance with  
8 what is generally known as the pricing process and  
9 that that process entails a large amount of judgment  
10 by the Commission?

11 A I'd like to take two steps. Number one,  
12 just to save your own face I don't think that whether  
13 or not you understand my answer that you just referred  
14 to, I don't think it has anything to do with  
15 intelligence. It has a little bit to do with whether  
16 or not you spent time studying some of these issues;  
17 nothing to do with intelligence.

18 The rest of my answer is that yes, the  
19 institutional costs as a whole are distributed to the  
20 categories of mail according to the factors in the Act  
21 and the Commission's judgment.

22 I think the end of your question was whether  
23 or not that process requires some judgment. I would  
24 say yes, it does require some judgment. We have a  
25 Commission that exercises that judgment and explains

1 the result when they issue an opinion.

2 Q Mr. Mitchell, would you now please turn to  
3 page 10 of your testimony? The heading of that  
4 portion of your testimony is, and I quote, As A Matter  
5 of Logic Identifiable Causes For Deficits Do Not  
6 Exist.

7 In that context would you turn please to  
8 your answer to our Interrogatory 1(a), the second  
9 page?

10 A Okay.

11 Q You state there beginning on the fourth  
12 line, and I quote, "Using mere causation as a guide  
13 can lead to cost estimates that have really bad  
14 economic characteristics or that are meaningless.

15 "For example, one could argue that  
16 transportation costs are caused by our cities being so  
17 far apart rather than by the volume of mail and,  
18 therefore, that they should not be attributed. This  
19 would not make economic sense, but it is arguably  
20 causal.

21 "Similarly, fully distributed costing  
22 techniques are generally presented as being causal,  
23 yet their bad economic characteristics and harmful  
24 consequences have been explained by economists and  
25 business consults for over 50 years and were so

1 recognized by the capital Commission."

2 The whole subject of causation is addressed  
3 also in your answer to our Interrogatory 2, and just  
4 to get everything out in the record before I begin  
5 asking you questions about it I'd also like to address  
6 your attention to the second page of your answer to  
7 Question 2(a) where you state:

8 "The but for test to which you refer is  
9 passed equally well by all of these possible  
10 reductions. Therefore, if the test is used as an  
11 indicator of causation the deficit must be viewed as  
12 having a very large number of causes."

13 My question, Mr. Mitchell, is this. To  
14 summarize what you're saying here would it be a  
15 correct summarization to say that causation is a  
16 tricky issue and that identifying a cause of something  
17 depends on all the facts and in particular an  
18 understanding of why you want to know?

19 A I would say it requires an understanding and  
20 a theory in your mind of the situation that you're  
21 dealing with, which is very close to what you said.

22 Q I know you're not a lawyer. I don't know  
23 whether you've had any legal training or not, but are  
24 you familiar with a term that lawyers use called  
25 proximate cause? Are you familiar with that term at

1 all?

2 A If you ask me whether I've heard it, yes.  
3 Am I comfortable with it? Do I understand it? No.

4 (The document referred to was  
5 marked for identification as  
6 DMA-XE-1.)

7 BY MR. ACKERLY:

8 Q Mr. Mitchell, I am handing you a document  
9 that has been identified as DMA-XE-1. It has three  
10 pages, and I will state for the record that the first  
11 page is from a copy of Black's Law Dictionary that was  
12 published in the late 1960s. It is in fact the very  
13 same copy of Black's Law Dictionary that I had when I  
14 was a law student.

15 Pages 2 and 3 are copied from the most  
16 current version of Black's Law Dictionary that I  
17 located recently in the Covington & Burling law  
18 library.

19 I would like to discuss with you a  
20 hypothetical and then ask you about it in reference to  
21 the pages that I have just handed to you.

22 MR. OLSON: Mr. Chairman, before we get into  
23 that can I just first of all ask if counsel has a use  
24 that Mr. Mitchell made of the term proximate cause  
25 that is causing him to bring this term into the

1 hearing? If so, if you could identify that for the  
2 record I'd appreciate it.

3 MR. ACKERLY: The witness has opened up the  
4 entire issue of causality beginning at page 10 of his  
5 testimony, and I would like to explore the whole issue  
6 of the meaning of causality, especially since the main  
7 topic of what he has said is as a matter of logic  
8 identifiable causes for deficits do not exist. I  
9 would like to explore that topic with the witness.

10 MR. OLSON: Just to clarify --

11 CHAIRMAN OMAS: I'll allow the question.

12 MR. OLSON: If I could just clarify then,  
13 the term proximate cause is not in the testimony nor  
14 the responses to the DMA interrogatories?

15 MR. ACKERLY: To the best of my knowledge,  
16 that's correct.

17 MR. OLSON: Mr. Chairman, just for the  
18 record I'll say that we're getting into an area that  
19 you spend months on at law school having to do with  
20 tort law mainly. I'm not sure of the nexus to  
21 ratemaking, but I'm sure we'll find out.

22 CHAIRMAN OMAS: Mr. Mitchell, would you  
23 answer the question, please?

24 MR. ACKERLY: Mr. Chairman, I don't believe  
25 there's a question pending, but what I would like to

1 do is now that I've shown the witness these pages, to  
2 which I will refer in a minute, I would like to  
3 describe a hypothetical fact situation, and that will  
4 be the basis for discussing the whole question of  
5 causality, so bear with me please.

6 BY MR. ACKERLY:

7 Q Envision the mother of a school child who at  
8 the grocery store one evening has her car hit by a  
9 negligent man. We'll call him Mr. A. The car is  
10 damaged enough so that it needs repair the next day.  
11 It's clear that Mr. A has been negligent.

12 As a result, she tells her son that he must  
13 ride his bike to school the next day instead of being  
14 taken to school in her car, which would be the normal  
15 process. He does that, and in school the next day a  
16 boy -- we'll call him Boy B -- intentionally hurts the  
17 bike, makes it impossible for the bike to be ridden  
18 home, so the boy has no alternative but to walk home  
19 from school.

20 On the way home from school he is about to  
21 cross a bridge that crosses over a dry streambed, and  
22 the policeman -- we'll call him C -- tells him that he  
23 should not walk across the bridge because it's too  
24 dangerous with all the car traffic, even though there  
25 is a sidewalk there, but he should take a footbridge

1 that is built with ropes right next to the vehicular  
2 bridge.

3 As he is walking across the bridge, Man D  
4 takes an axe and cuts the ropes that hold the bridge  
5 up, and the boy falls into the streambed and is  
6 injured.

7 The boy and his parents want to get  
8 compensated for his injuries, and they sue all four  
9 people -- the man who hit the car who was negligent;  
10 the boy who hurt the bike, and he did that  
11 intentionally; the policeman who was probably  
12 negligent in directing the boy across a footbridge;  
13 and Man D who took an axe and intentionally caused the  
14 boy to be injured.

15 Now, would you agree that as a matter of  
16 logic all four people would be causes of the injury in  
17 the but for sense? In other words, were it not for  
18 their acts, the boy would not have been injured.  
19 That's my question, my first question.

20 A I think what my testimony says is that the  
21 but for scheme leads you to all kinds of different  
22 things. This is clearly one of them. Whether or not  
23 I would extend that to say that this is the conclusion  
24 of causation I'm not sure. I think that causation is  
25 often a conclusion that results from mental

1 constructs.

2           If we start out with your car situation  
3 we've got a car parked in the parking lot. We come  
4 back to the parking lot, and we see that it's damaged.  
5 We are wondering if we can determine the cause of that  
6 damage. We start looking around, and we have a mental  
7 construct which tells us what the car should look  
8 like, and we have a mental construct that says if it's  
9 parked here nobody should hit it and other cars should  
10 be going up and down the aisle.

11           We have a theory in our mind about what the  
12 car should look like when we come back. We look at  
13 the car, and we see some damage. We suddenly get the  
14 idea that somebody hit it. At that point we have  
15 identified an event. We line up that event, and we  
16 try to trace the effects of that event. We find that  
17 the effects of that event were that it damaged the  
18 car. At some point we begin feeling comfortable  
19 saying that that car running into it is the cause of  
20 all the damages.

21           In this case it was something that was  
22 unexpected. It was something that happened suddenly.  
23 I think there are a lot of cases where sudden,  
24 unexpected things happen. We can identify the event.  
25 We can trace through the effects of that event, and in

1 many of them we might be able to say okay, we have  
2 looked at this effect and we think that this is the  
3 cause of it.

4 I don't know. I mean, your story is  
5 interesting, and if I had a lot of years left, you  
6 know, I might want to study some of these things. I'm  
7 sure very smart people work hard at figuring them out.

8 I think that the situation that we're facing  
9 here is not all that difficult. We don't have a  
10 sudden event. We don't have an unexpected event. We  
11 can certainly trace through very easily the effects on  
12 revenue and cost of an escrow requirement. We can  
13 understand them clearly. We can know what that event  
14 caused. There's no problem there.

15 The problem was when we looked at a residual  
16 like the deficit which was connected with all  
17 different kinds of things and we tried to say aha,  
18 here's the cause of it. That's where we started  
19 having all kinds of trouble.

20 Q Mr. Mitchell, the reason for my showing you  
21 these three pages in DMA Cross-Examination Exhibit No.  
22 1 is to point out something that I discovered that was  
23 really quite interesting, and that is having been  
24 through law school, and counsel is quite right that in  
25 torts class one does discuss at some length in law

1 school the meaning of proximate cause.

2 The definition that was given in the version  
3 in the late 1960s is, and I quote, "That which in a  
4 natural and continuous sequence unbroken by any  
5 efficient intervening cause produces the injury and  
6 without which the result would not have occurred."

7 Could you now turn to pages 2 and 3? You  
8 see that the definition has changed substantially in  
9 the short space of roughly 30 plus years. Here the  
10 definition of proximate cause is, and there are  
11 actually two of them. The first is a cause, and I  
12 quote, "that is legally sufficient to result in  
13 liability." The second one is, and again I quote, "A  
14 cause that directly produces an event and without  
15 which the event would not have occurred."

16 The notion of proximate cause I will assert  
17 to you is the notion of the person or the entity or  
18 the thing that is the proximate cause is the one that  
19 is responsible.

20 Now to go back to my example, if you were  
21 sitting on the jury and had to determine which of  
22 those individuals, if any, was the proximate cause of  
23 the boy's injury what would your judgment be, your  
24 individual judgment?

25 A I can't say at this point what my judgment

1 would be without thinking about the situation and  
2 studying it at some length.

3 I think we're getting a little bit far here  
4 from the question at hand. The question was whether  
5 or not the deficit was caused by the escrow, and I  
6 said the escrow wasn't a sudden thing. It wasn't a  
7 surprising thing. It was an event that we can trace  
8 very clearly. We can understand the effects of it.  
9 There's no question about that.

10 We know that it has origin back in a CRS  
11 payment. We know that way back at that time it was  
12 built into the revenue stream. There was money there  
13 to cover it. We know that at a later time it  
14 continued. We used that same revenue stream to pay  
15 off debt. We know that the same revenue stream now is  
16 being used to pay into an escrow.

17 I think it's already been covered, and now  
18 we come in with a separate case and say we're going to  
19 cover it again. I assume if we came in in R2006 and  
20 we had a \$3.1 billion deficit and the escrow was still  
21 there somebody would say that that deficit was caused  
22 by the escrow too, and we should build it in again.

23 I'm saying at this point we've got the  
24 escrow built into the rate at least three times. You  
25 know, it's okay to say we know the cost that this

1 causes. We know how that cost gets accommodated in  
2 the income statement. We see the result in terms of  
3 the deficit.

4 We understand the Postal Service's need for  
5 revenue. We know that when the Postal Service has a  
6 need for revenue the Act tells us how to get it. I  
7 don't see that there's anything missing here.

8 Q Here's my point. Your claim that on page 10  
9 that as a matter of logic identifiable causes for  
10 deficits do not exist doesn't get to the heart of the  
11 question, does it, because what you really need to  
12 know is as a matter of judgment whether or not there  
13 are causes for deficits that can be identified as  
14 being responsible for the deficits. Isn't that the  
15 correct issue here?

16 A Was it one of your examples where it talked  
17 about the city with 12 bridges and we had an  
18 earthquake?

19 Q Yes, it was.

20 A I mean, in that situation I would think  
21 everybody would agree that the deficit situation was  
22 caused by the earthquake, but I don't see that that  
23 situation applies at all to what we're dealing with in  
24 this rate case.

25 Q Okay. Let's turn then to your answer to our

1 Interrogatory 2(e) because I do think that this gets  
2 to the heart of your testimony whether we're dealing  
3 with logic or whether we're dealing with judgment.

4 A Okay. Two?

5 Q (e) as in Edward.

6 A Okay. (e) as in Edward. Okay.

7 Q You state there, and I quote, "I don't view  
8 the amount of additional revenue being sought in this  
9 case as caused any more by an act of Congress than by  
10 any other expense that must be paid."

11 You then continue, "But let's assume that  
12 Congress suddenly and unexpectedly said that all  
13 addresses would begin immediately to receive three  
14 deliveries per day assuming break even. Otherwise if  
15 a rate case were to be filed because of this new  
16 requirement it would be an ordinary rate case. The  
17 fact that Congress in some sense caused it would be  
18 irrelevant."

19 That's the guts of your testimony, isn't it?  
20 The causation of this deficit, these escrow costs,  
21 whichever you want to identify, is irrelevant for  
22 purposes of the Commission's ratemaking decisions,  
23 recommended decisions and its fulfillment of its  
24 responsibilities?

25 A That's a very important point in my

1 testimony.

2 Q At the same time, the whole notion of  
3 causality is critical to the ratemaking process, isn't  
4 it?

5 We discussed but for causality in one sense.  
6 Another sense that causality becomes important is in  
7 the identification of attributable costs. Would you  
8 agree with that statement?

9 A I understand that we do discuss causality in  
10 the cost attribution process, but the beginning of  
11 your sentence was that causality I think was a central  
12 issue in the rate process.

13 I don't recall anything in the rate process  
14 ever where someone tried to explain what caused a  
15 deficit and why it is we need this rate increase. I  
16 mean, it was altogether clear that the Postal Service  
17 had these costs, that they'd made an honest projection  
18 into a test year, that there was a shortage of  
19 revenue.

20 Except for the honest, efficient and  
21 economical management issue, which has never been used  
22 to make any adjustments so far, I don't know that  
23 there's ever been any discussion of why it is that  
24 they have this deficit and need this money.

25 Q Mr. Mitchell, maybe I've phrased the

1 question in a way which was not particularly  
2 articulate. I wasn't talking about causation of  
3 deficits. I was talking about the role of causation  
4 generally in the ratemaking process.

5 If for example you read the Supreme Court  
6 decision of 1983, and for those who are interested  
7 it's at 462 U.S. 833. The discussion by the Supreme  
8 Court of the two tier ratemaking process identifies in  
9 the first tier costs, and I quote, "that could be  
10 identified in the view of the expert rate Commission  
11 as causally linked to a class of Postal Service."

12 I'm not asking you to verify whether that's  
13 an accurate quotation or not. I'm just asking whether  
14 it is your understanding that the notion of causality  
15 plays an important role in the ratemaking process  
16 overall.

17 A Well, it turns out that I have read that  
18 decision at some time in the past, and I'm aware of  
19 the fact that cause has been adopted as a very  
20 important term, but I think you need a lot more than  
21 causation to do costing.

22 If you look back at R71-1 and you look at  
23 R74-1 and you look at R76-1 and you look at hundreds  
24 and hundreds of pages of good economic testimony and  
25 you read the recommended decision of the Commission

1 and you see that they looked to people who knew  
2 something about costing and they looked to the  
3 economics profession and they looked to rate issues  
4 and regulatory theory and said what kind of costs are  
5 important for setting rates and they established a  
6 reliance on volume variability and marginal costs much  
7 like economists advocate and they began to use these,  
8 now at some point this wound up in Court, and the  
9 Court in trying to be helpful, and this is just my  
10 opinion.

11 The Court, in trying to be helpful, threw in  
12 the word cause and said that we should ask whether or  
13 not these costs are causal. I think we looked at the  
14 costs that we had been using, and we said yes, they  
15 are causal. They need a very high standard of  
16 causation.

17 I don't think this means that you can just  
18 adopt the word cause and go anywhere it leads because  
19 you can wind up in some very bad places.

20 Q Mr. Mitchell, I wasn't suggesting that you  
21 take cause beyond where you think it properly leads  
22 you.

23 A Wow.

24 Q You are the person who talked about the lack  
25 of a cause of deficits on page 10 of your testimony.

1           My point was simply that the Supreme Court,  
2           in determining how the Commission should apply Section  
3           3622(b)(3) of the Act, interpreted the intent of  
4           Congress and made the statement that I just quoted,  
5           which means as I interpret it that causation is a  
6           central feature of the first tier of the costing  
7           process, which we all know as attributable costs.

8           Wouldn't you agree with me to that extent  
9           that causation is important to that extent?

10          A     I would agree that we spent a lot of time  
11          talking about causation and the costing process. I  
12          mean, we're getting into a legal argument here, and  
13          I'm sure that if I sat around a table with a bunch of  
14          lawyers they would all have a feeling about exactly  
15          how this thing should be played out.

16          At this point I'm not sure whether the  
17          Supreme Court makes law or whether the Supreme Court  
18          helps interpret law, but I have an idea it's the  
19          latter so I think the Commission goes back to the law  
20          and tries to apply it. The Supreme Court has probably  
21          been helpful in that regard.

22          We're getting into a series of exchanges  
23          here that appears to me to be very legal in nature.  
24          I'm not sure how far I'm going to be able to go with  
25          it. I think I've been able to deal with the situation

1 that I addressed in my testimony, but whether or not I  
2 can deal effectively with all the issues that you're  
3 bringing up I'm not quite sure.

4 Q Okay. Let me move on. In your answer to  
5 Interrogatory 3(b), and this is the answer where you  
6 talk about the 12 bridges and identification of a  
7 cause of a deficit. You state on the second page, and  
8 I quote, "Even if the earthquake example were taken to  
9 apply, the question of the most appropriate way to  
10 cover the deficit would still have to be asked."

11 Do I understand your statement to mean that  
12 the Commission would still have to exercise its  
13 judgment? It would have to go through a pricing  
14 analysis in consideration of all relevant factors to  
15 come to a recommended decision as to how to deal with  
16 the deficit?

17 A Yes. I think it does that in every case.

18 Q Could you turn now to your answer to our  
19 Interrogatory 4(d) as in dog?

20 A Okay.

21 Q This is the interrogatory where we discussed  
22 the example of airlines and increases in fuel costs  
23 and the possibility that airlines would cover their  
24 increased fuel costs through a fuel surcharge.

25 In your answer to 4(d) you state, and I

1 quote, "Unless I had concerns about whether some of  
2 the existing rates were out of line with important  
3 guidelines such as current costs, I believe most  
4 notions of economic rationality would be taken to  
5 suggest the percentage approach."

6 Do I understand your testimony to be that as  
7 long as the rates that were in existence before the  
8 increase in fuel charge -- increase in fuel costs;  
9 pardon me -- met appropriate standards that a  
10 percentage fuel charge would be appropriate?

11 A No, I don't think so. I think that I was  
12 trying to respond to the situation that you painted  
13 and that you described, and the situation was would it  
14 be rational for management to impose this kind of  
15 surcharge.

16 I said unless they had specific concerns  
17 about, you know, current levels of cost and how they  
18 should be recognized, unless they had guidelines that  
19 they followed, ruling all that out, which I think that  
20 your question does, would it be economically rational  
21 to use the percentage approach.

22 My answer is that, you know, it might be  
23 economically rational. It's certainly a candidate for  
24 consideration. It's certainly easy, but it's not the  
25 only way. I don't know that -- you know, it's been

1 three and a half years or more since we recognized  
2 Postal Service costs and rates. I don't know whether  
3 this airlines got rates built on costs that are four  
4 years out of date.

5 Q Mr. Mitchell, if I may interrupt? My  
6 question was intended to make it clear that the  
7 existing rates, the rates that were in effect before  
8 the increase in the fuel costs, complied, were in line  
9 with whatever the existing rate principles were and  
10 that, therefore, there's no problem with the existing  
11 rates at the time that the fuel costs go up.

12 If that is the case, is it your testimony  
13 here that a percentage approach would be economically  
14 rational?

15 A I think there are situations similar to what  
16 you described where that could occur. In fact, I  
17 think I said in my testimony that one could  
18 hypothesize certain situations and say if these  
19 situations were met then the natural outcome of a  
20 normal rate process might be an across-the-board  
21 increase, but I don't think those conditions have been  
22 met.

23 Q That's the crux of the problem that you have  
24 with this case, isn't it, that the current rates are  
25 not appropriate? They are out of line with costs and

1 that this is the case where the Commission ought to  
2 take at least a first step in fixing that disparity?

3 A Well, I certainly talked about the case in  
4 terms of cost. The first part of your question was  
5 about costs. I don't think one can make the case that  
6 Postal Service costs haven't changed in the last three  
7 or four years.

8 I think we have every reason to believe that  
9 all kinds of changes have occurred. All kinds of  
10 adjustments have been made. Technology has been put  
11 in place. Equipment has been put in place. Mail  
12 practices have been changed.

13 There's been a lot going on, and if you look  
14 at the Postal Service's cost presentation in this  
15 case, you know, you see some costs that went up 30  
16 percent and some went down 10 percent and some went up  
17 six percent and so it paints a picture of massive  
18 change, massive adjustment, massive differences from  
19 what we've seen in the past.

20 None of these were recognized in rate  
21 design. There wasn't one rate design spreadsheet in  
22 the whole case that gave us a presort tree or anything  
23 like that and said, you know, here's what this cost is  
24 now and here's what it was in the past and here's how  
25 we should recognize it in a pass-through. These

1 things weren't even calculated after-the-fact.

2 Yes, I think that one could say gee, if  
3 nothing has changed, no relative costs are different,  
4 no market conditions are different, it's altogether  
5 possible that a perfectly reasonable rate process if  
6 nothing was brought into the record which was  
7 different from the record before this, one could say  
8 gee, the outcome of that would probably be  
9 approximately the same percentage increase for  
10 everybody. That hasn't been examined, and I don't  
11 think that situation applies.

12 Q Let me ask you to turn to your answer to our  
13 Interrogatory 8(c).

14 A Eight?

15 Q 8(c) as in Charlie.

16 A Okay.

17 Q If I understand your testimony correctly,  
18 Mr. Mitchell, this answer again gets to the crux, at  
19 least one of the important parts of your testimony.  
20 You state there, and it carries over from the first  
21 page to the second, "I believe one of the most  
22 fundamental principles of fairness is that costs  
23 should be current and should be recognized in  
24 appropriate and defensible ways."

25 You then continue on, and I quote, "And it

1 is not just a matter of the nation having to endure a  
2 year or two of rates that are out of kilter. It is a  
3 matter as well that the effects of this case will be  
4 around for a much longer period."

5           You're making two points as I understand it.  
6 First of all that it's not fair. It's not fair for  
7 rates which you believe to be out of kilter with costs  
8 are going to be carried forward without the  
9 disparities being corrected at least in part, and  
10 you're also pointing out that these rates may be  
11 carried forward for a substantial period of time and  
12 perhaps not something limited to a year or two. Is  
13 that the guts of what you're saying there?

14           A     Yes.

15           Q     Would you think that other mailers would  
16 think that it was not fair if the disparities that you  
17 have identified are corrected even partially by the  
18 Commission when the disparities that affect them  
19 directly are not?

20           A     I'm sorry. Does that mean that if we  
21 corrected these disparities and brought them up-to-  
22 date that some rates would go up a little more than  
23 others and that the mailers whose rates went up more  
24 than average would be unhappy?

25           Q     Let's assume that there are other mailers

1 who feel that their rates are higher than they should  
2 be if their rates were based upon current, accurate  
3 costs.

4 A Were higher than they should be? This isn't  
5 100 percent clear yet.

6 Q Is it not the case that you are testifying  
7 on behalf of a client whose basic position is that the  
8 rates of mail that they pay at the moment are not  
9 based on current costs and that the rates that they  
10 are likely to be paying if the across-the-board  
11 increase were implemented would also be out of line  
12 and that they are too high? I mean, isn't that what  
13 this is all about?

14 A I think that's an outcome of the situation  
15 that we have here.

16 Q Right. What if other groups of mailers felt  
17 the same way? Would you think it was fair for the  
18 Commission to give you some relief without giving  
19 other mailers relief as well?

20 A Well, I'll tell you what I tell my client,  
21 and that is that if you have to hang your hat  
22 somewhere you better hang it on good rates and good  
23 costing because if you hang it on something else  
24 you're going to lose, and you won't be able to find a  
25 witness that will go in and testify for you.

1           At some point there's a fairness associated  
2 with having your costs recognized in your rates. You  
3 have to be willing to accept them and so you support  
4 good costing. I think that's what we've done here is  
5 supported good costing and good rate design.

6           I know that if you adjust rates that some  
7 rates will go up more than others. I know that the  
8 mailers that have to pay those rates will be unhappy  
9 about it. They might even say that it's unfair, which  
10 I think is what was in your question.

11           If somebody is going to say it's unfair they  
12 have to say why, and I have to say what's unfair about  
13 having your costs recognized in your rates? I think  
14 that's pretty hard to answer.

15           Q     We have agreed I think, Mr. Mitchell, that  
16 the matter of addressing the escrow costs is a pricing  
17 issue that the Commission needs to determine on the  
18 basis of its judgment, taking into account the factors  
19 that are enumerated in the Act and that the issue  
20 cannot be resolved on the basis of causality.

21           Would you agree with me that the Pandora's  
22 box effect of granting you -- granting Valpak --  
23 accepting your testimony, the consequences, the  
24 ultimately consequence of that is a factor the  
25 Commission should take into account when making a

1 judgment as to whether or not to adopt or to reject  
2 the across-the-board proposal that the Postal Service  
3 has made?

4 A That was a long question, and I have to say  
5 that I was a little uncomfortable with most of the  
6 introduction and the way you summarized the case, but  
7 let's go to the end of your question.

8 I present my testimony is my opinion on good  
9 rate design and how things should be done. The  
10 Commission has to evaluate the record and my  
11 testimony, and it has to make some decisions on what  
12 it wants to do.

13 If it should make a decision to agree with  
14 me and our rates come out a little lower than they  
15 would otherwise, and I'm not even 100 percent sure  
16 that the costs, when you do good costing and you come  
17 to a final result, I'm not 100 percent sure that all  
18 the costs will come out in a way that will favor my  
19 client, but let's assume that the Commission did agree  
20 with me and did find some costs and did lower the  
21 coverage and did come out with some rates that I would  
22 find attractive or at least that my client would find  
23 attractive, and let's assume that some other rates  
24 went up a little more than average.

25 The Commission would then have to evaluate

1 that situation and say is that the right thing to do?  
2 Have we considered the effects of these changes that  
3 we're making? Have we recognized costs properly?  
4 Have we gone in the direction of setting appropriate  
5 rates? Have we honored the record? Have we honored  
6 our concepts of fairness? Have we honored the past in  
7 the way we set rates?

8 The Commission would certainly have to go  
9 through this process and decide what it wants to  
10 recommend. It has gone through this process before.  
11 I pointed out in my testimony particularly with  
12 respect to periodicals that there have been a number  
13 of cases in the past where the Commission has made  
14 adjustments to the way the rates have been set. They  
15 thought that they were adjustments that were  
16 defensible. They were in line with the Act. They  
17 were the right thing to do.

18 They caused some rates to go up quite a bit  
19 and some rates to go down quite a bit. There were  
20 some mailers that were affected, but they said gee,  
21 and R90 was a good example of this. It doesn't have  
22 to be periodicals.

23 People often think of me as a periodicals  
24 person, but in R90 I was associated with all the  
25 changes where we put in a letter/flat differential in

1 third class, where we put in drop ship discounts,  
2 where we put in saturation rates. We also put in some  
3 bar code discounts in R90.

4 I think all these changes were very  
5 important. I think they were the right changes to  
6 make. I think they increased efficiency to the  
7 subclass. The Commission agreed with them. They had  
8 some big effects. Some rates didn't go up at all, and  
9 some people saw their rates go up 30 or 40 percent. I  
10 think there were some 50 percent rate increases in  
11 non-profit categories in R90. I think one of them was  
12 52 percent.

13 The answer is yes, there are going to be  
14 some effects when you make some changes, and the  
15 Commission has to look at these effects and decide if  
16 they're the right thing to do.

17 MR. ACKERLY: Thank you. Mr. Chairman, I  
18 have no further questions.

19 I would, however, in the interest of clarity  
20 of the record ask that my cross-examination exhibit be  
21 transcribed into the record. I don't think it's  
22 necessary to admit it into evidence, but if it could  
23 be transcribed in the record I think that would aid  
24 everybody's understanding of the cross-examination.

25 CHAIRMAN OMAS: Without objection. So

1 ordered. Thank you.

2 (The document referred to,  
3 previously identified as  
4 DMA-XE-1, was transcribed  
5 into the record.)

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## PROVOST — PROXY

**PROVOST.** The principal magistrate of a royal burgh in Scotland. A governing officer of certain universities or colleges. The chief dignitary of a cathedral or collegiate church.

In France, this title was formerly given to some presiding judges.

**PROVOST-MARSHAL.** In English law, an officer of the royal navy who had the charge of prisoners taken at sea, and sometimes also on land.

In military law, the officer acting as the head of the military police of any post, camp, city or other place in military occupation, or district under the reign of martial law. He or his assistants may, at any time, arrest and detain for trial, persons subject to military law committing offenses, and may carry into execution any punishments to be inflicted in pursuance of a court martial.

**PROXENETA.** Lat. In the civil law. A broker; one who negotiated or arranged the terms of a contract between two parties, as between buyer and seller; one who negotiated a marriage; a match-maker. Calvin; Dig. 50, 14, 3.

**PROXIMATE.** Immediate; nearest; direct, next in order. In its legal sense, closest in causal connection. Menger v. Laur, 55 N.J.L. 205, 26 A. 180, 20 L.R.A. 61. Poore v. Edgar Bros. Co., 33 Cal. App.2d 6, 90 P.2d 808, 810. Next in relation to cause and effect. Godfrey v. Vinson, 215 Ala. 166, 110 So. 13, 16.

**PROXIMATE CAUSE.** That which, in a natural and continuous sequence, unbroken by any efficient intervening cause, produces the injury, and without which the result would not have occurred. Swayne v. Connecticut Co., 86 Conn. 439, 85 A. 634, 635; Lemos v. Madden, 28 Wyo. 1, 200 P. 791, 793. That which is nearest in the order of responsible causation. Butcher v. R. Co., 37 W. Va. 180, 16 S.E. 457, 18 L.R.A. 519. That which stands next in causation to the effect, not necessarily in time or space but in causal relation. Cundiff v. City of Owensboro, 193 Ky. 168, 235 S.W. 15, 16; Carlock v. Denver & R. G. R. Co., 55 Colo. 146, 133 P. 1103, 1104. The last negligent act contributory to an injury, without which such injury would not have resulted. Estep v. Price, 93 W.Va. 81, 115 S.E. 861, 863. The dominant cause. Ballagh v. Interstate Business Men's Ass'n, 176 Iowa 110, 155 N.W. 241, 244, L.R.A.1917A, 1050; The moving or producing cause. Eberhardt v. Glasco Mut. Tel. Ass'n, 91 Kan. 763, 139 P. 416, 417, Buchanan v. Hurd Creamery Co., 215 Iowa 415, 246 N.W. 41. The efficient cause; the one that necessarily sets the other causes in operation. Baltimore & O. R. Co. v. Ranier, 84 Ind.App. 542, 149 N.E. 361, 364. The causes that are merely incidental or instruments of a superior or controlling agency are not the proximate causes and the responsible ones, though they may be nearer in time to the result. It is only when the causes are independent of each other that the nearest is, of course, to be charged with the disaster. Blythe v. Railway Co., 15 Colo. 333, 25 P. 702, 11 L.R.A. 615, 22 Am.St.Rep. 403; act or omission immediately

causing or failing to prevent injury; act or omission occurring or concurring with another, which, had it not happened, injury would not have been inflicted. Herron v. Smith Bros., 116 Cal.App. 518, 2 P.2d 1012, 1013.

"Proximate cause" is distinguishable from "immediate cause." Missouri, K. & T. Ry. Co. of Texas v. Cardwell, Tex.Civ.App., 187 S.W. 1073, 1076. The immediate cause is generally referred to in the law as the nearest cause in point of time and space, while an act or omission may be the proximate cause of an injury without being the immediate cause. Thus, where several causes combine to produce an injury, the last intervening cause is commonly referred to as the immediate cause, although some other agency more remote in time or space may, in causal relation, be the nearer to the result, and thus be the proximate responsible cause. Dunbar v. Davis, 32 Ga.App. 192, 122 S. E. 895, citing, among others, Insurance Co. v. Boon, 95 U. S. 117, 130, 24 L.Ed. 395; Terry Shipbuilding Corp. v. Grifflin, 112 S.E. 374, 153 Ga. 390. Moreover, there may be two or more proximate causes, but only one immediate cause. Thomas v. Chicago Embossing Co., 307 Ill. 134, 138 N.E. 285, 287; American Stone Ballast Co. v. Marshall's Adm'r, 206 Ky. 133, 266 S.W. 1051, 1052. But the two terms are sometimes used interchangeably. Wilczynski v. Milwaukee Electric Ry. & Light Co., 171 Wis. 508, 177 N.W. 876, 877; but see Wright v. Greenwood Telephone Co., 108 S.C. 84, 93 S.E. 398, 399; Knight v. Wessler, 67 Utah, 354, 248 P. 132, 133. See, also, Immediate Cause.

**PROXIMATE CONSEQUENCE OR RESULT.**

One which succeeds naturally in the ordinary course of things. Swaim v. Chicago, R. I. & P. Ry. Co., 187 Iowa 466, 174 N.W. 384, 386. A consequence which, in addition to being in the train of physical causation, is not entirely outside the range of expectation or probability, as viewed by ordinary men. The Mars, D.C.N.Y., 9 F.2d 183, 184. One ordinarily following from the negligence complained of, unbroken by any independent cause, which might have been reasonably foreseen. One which a prudent and experienced man, fully acquainted with all the circumstances which in fact existed, would, at time of the negligent act, have thought reasonably possible to follow, if it had occurred to his mind. Coast S. S. Co. v. Brady, C.C.A. Ala., 8 F.2d 16, 19. A mere possibility of the injury is not sufficient, where a reasonable man would not consider injury likely to result from the act as one of its ordinary and probable results.

**PROXIMATE DAMAGES.** See Damages.

**PROXIMATELY.** Directly or immediately. Kentucky Traction & Terminal Co. v. Bain, 161 Ky. 44, 170 S.W. 499, 501. Pertaining to that which in an ordinary natural sequence produces a specific result, no independent disturbing agency intervening. Weaver v. Landis, 66 Cal.App.2d 34, 151 P.2d 884, 886.

**PROXIMITY.** Kindred between two persons. Dig. 38, 16, 8. Quality or state of being next in time, place, causation, influence, etc.; immediate nearness. Webster, Dict.

**PROXIMUS EST CUI NEMO ANTECEDIT, SUPREMIUS EST QUEM NEMO SEQUITUR.** He is next whom no one precedes; he is last whom no one follows. Dig. 50, 16, 92.

**PROXY.** (Contracted from procuracy.) A person who is substituted or deputed by another to

"Here is the key to the juridical treatment of the problems of causation. We pick out the cause which in our judgment ought to be treated as the dominant one with reference, not merely to the event itself, but to the jural consequences that ought to attach to the event." Benjamin Cardozo, *The Paradoxes of Legal Science* 83 (1928).

**negative causation.** *Securities.* The defense that part of the plaintiff's damages were caused by factors other than the depreciation in value of the securities resulting from registration-statement defects. • If negative causation is proved, the plaintiff's damages should be reduced. 15 USCA § 77k(e). [Cases: Securities Regulation ⇨25.21(5). C.J.S. Securities Regulation § 89.]

**transaction causation.** *Securities.* The fact that an investor would not have engaged in a given transaction if the other party had made truthful statements at the required time. [Cases: Securities Regulation ⇨60.47. C.J.S. Securities Regulation §§ 208-210, 215.]

**causative** (kaw-zə-tiv), *adj.* 1. Effective as a cause or producing a result <causative factor of the accident>. 2. Expressive of causation <the causative relationship between drinking and assault>. Cf. CAUSAL.

**causator** (kaw-zay-tər), *n.* [Latin "promoter of litigation"] *Hist.* 1. A litigant. 2. A person who manages or litigates a cause for another.

**cause, n.** 1. Something that produces an effect or result <the cause of the accident>.

"It has been said that an act which in no way contributed to the result in question cannot be a cause of it; but this, of course, does not mean that an event which might have happened in the same way though the defendant's act or omission had not occurred, is not a result of it. The question is not what would have happened, but what did happen." Joseph H. Beale, *The Proximate Consequences of an Act*, 33 Harv. L. Rev. 633, 638 (1920).

**but-for cause.** The cause without which the event could not have occurred. — Also termed *actual cause*; *cause in fact*; *factual cause*.

**concurrent cause.** One of two or more causes that simultaneously produce a result.

**contributing cause.** A factor that — though not the primary cause — plays a part in producing a result.

**cooperative cause.** *Archaic.* A person who is contributorily or comparatively negligent.

**direct and proximate cause.** See *proximate cause*.

**direct cause.** See *proximate cause*.

**efficient adequate cause.** See *proximate cause*.

**efficient cause.** See *proximate cause*.

**efficient intervening cause.** See *intervening cause*.

**efficient proximate cause.** See *proximate cause*.

**factual cause.** See *but-for cause*.

**first cause.** See *proximate cause*.

**immediate cause.** The last event in a chain of events, though not necessarily the proximate cause of what follows. — Also termed *effective cause*.

**initial cause.** See *proximate cause*.

**intervening cause.** An event that comes between the initial event in a sequence and the end result, thereby altering the natural course of events that might have connected a wrongful act to an injury.

• If the intervening cause is strong enough to relieve the wrongdoer of any liability, it becomes a *superseding cause*. A *dependent intervening cause* is one that is not an act and is never a superseding cause. An *independent intervening cause* is one that operates on a condition produced by an antecedent cause but in no way resulted from that cause. — Also termed *intervening act*; *intervening agency*; *intervening force*; *independent intervening cause*; *efficient intervening cause*; *supervening cause*; *novus actus interveniens*; *nova causa interveniens*. See *superseding cause*. [Cases: Negligence ⇨430. C.J.S. Negligence §§ 202-205.]

**jural cause.** See *proximate cause*.

**legal cause.** See *proximate cause*.

**primary cause.** See *proximate cause*.

**procuring cause.** 1. See *proximate cause* (2). 2. *Real estate.* The efforts of the agent or broker who effects the sale of realty and who is therefore entitled to a commission. [Cases: Brokers ⇨53. C.J.S. Brokers §§ 166-169.]

**proximate cause.** 1. A cause that is legally sufficient to result in liability; an act or omission that is considered in law to result in a consequence, so that liability can be imposed on the actor. [Cases: Negligence ⇨375.] 2. A cause that directly produces an event and without which the event would not have occurred. [Cases: Negligence ⇨379, 385. C.J.S. Negligence § 197.] — Also termed (in both senses) *direct cause*; *direct and proximate cause*; *efficient proximate cause*; *efficient cause*; *efficient adequate cause*; *initial cause*; *first cause*; *legal cause*; *procuring cause*; *producing cause*; *primary cause*; *jural cause*. Cf. (in sense 2) *remote cause*.

"The four 'tests' or 'clues' of proximate cause in a criminal case are (1) expediency, (2) isolation, (3) foreseeability and (4) intention." Rollin M. Perkins & Ronald N. Boyce, *Criminal Law* 823 (3d ed. 1982).

"'Proximate cause' — in itself an unfortunate term — is merely the limitation which the courts have placed upon the actor's responsibility for the consequences of the actor's conduct. In a philosophical sense, the consequences of an act go forward to eternity, and the causes of an event go back to the dawn of human events, and beyond. But any attempt to impose responsibility upon such a basis would result in infinite liability for all wrongful acts, and would 'set society on edge and fill the courts with endless litigation.' [North v. Johnson, 58 Minn. 242, 59 N.W. 1012 (1894).] As a practical matter, legal responsibility must be limited to those causes which are so closely connected with the result and of such significance that the law is justified in imposing liability. Some boundary must be set to liability for the consequences of any act, upon the basis of some social idea of justice or policy." W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* § 41, at 264 (5th ed. 1984).

**remote cause.** A cause that does not necessarily or immediately produce an event or injury. Cf. *proximate cause* (2). [Cases: Negligence ⇨383.]

**sole cause.** The only cause that, from a legal viewpoint, produces an event or injury. • If it comes between a defendant's action and the event or injury at issue, it is treated as a *superseding cause*. [Cases: Negligence ⇨431. C.J.S. Negligence §§ 202, 315.]

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*superseding cause*.  
J.S. N. nce

"When this one dominant cause is found it is treated as the 'sole cause' for the purposes of the particular case, even if it might not be so treated in a different kind of cause of action. A 'sole cause' which intervenes between defendant's act and the result in question is spoken of as a 'superseding cause.' . . . The phrase 'sole cause,' meaning the only cause which will receive juridical recognition for the purposes of the particular case, is convenient to give emphasis to three points: (1) if defendant's act was the sole cause of the death or other socially-harmful occurrence, it is by definition a proximate cause thereof; (2) if something other than his act was the sole cause of the harm there need be no further inquiry so far as he is concerned; (3) it is not necessary that defendant's act should have been the sole cause of the harm, — which is merely another form of stating that a contributory cause is sufficient." Rollin M. Perkins & Ronald N. Boyce, *Criminal Law* 781-82 (3d ed. 1982).

**superseding cause.** An intervening act or force that the law considers sufficient to override the cause for which the original tortfeasor was responsible, thereby exonerating that tortfeasor from liability. — Also termed *sole cause*. Cf. *intervening cause*. [Cases: Negligence ⇨431. C.J.S. *Negligence* §§ 202, 315.]

**supervening cause.** See *intervening cause*.

**unavoidable cause.** A cause that a reasonably prudent person would not anticipate or be expected to avoid.

2. A ground for legal action <the plaintiff does not have cause to file suit>.

**good cause.** A legally sufficient reason. • Good cause is often the burden placed on a litigant (usu. by court rule or order) to show why a request should be granted or an action excused. The term is often used in employment-termination cases. — Also termed *good cause shown*; *just cause*; *lawful cause*; *sufficient cause*.

"Issues of 'just cause,' or 'good cause,' or simply 'cause' arise when an employee claims breach of the terms of an employment contract providing that discharge will be only for just cause. Thus, just cause is a creature of contract. By operation of law, an employment contract for a definite term may not be terminated without cause before the expiration of the term, unless the contract provides otherwise." Mark A. Rothstein et al., *Employment Law* § 9.7, at 539 (1994).

**probable cause.** See PROBABLE CAUSE.

3. A lawsuit; a case <the court has 50 causes on the motion docket>.

**preferred cause.** A case that a court may for good reason accelerate and try ahead of other cases. — Also termed *preference case*; *preference cause*.

**short cause.** A case that requires little time to try, usu. half a day or less. — Also termed *short-cause trial*.

4. CAUSA (2).

**cause, vb.** To bring about or effect <dry conditions caused the fire>.

**cause-and-prejudice rule.** *Criminal law.* The doctrine that a prisoner petitioning for a federal writ of habeas corpus on the basis of a constitutional challenge must first show that the claim rests on either a new rule of constitutional law (one that was unavailable while the case was heard in the state courts) or a fact that could not have been uncovered earlier despite due diligence, and then show by clear and convincing evidence that if the constitutional error

had not occurred, the prisoner would not have been convicted. 28 USCA § 2254(e)(2). • This is an exception to the procedural-default doctrine. Before 1996, the cause-and-prejudice rule allowed federal courts to grant relief on the basis of a constitutional challenge that was not presented to the trial if the prisoner showed good cause for failing to make the challenge at trial, and also showed that the trial court's error actually prejudiced the prisoner. [Cases: Criminal Law ⇨1438; Habeas Corpus ⇨404-409.]

**cause célèbre** (kawz sə-leb or kawz say-leb-rə). [French "celebrated case"] A trial or decision in which the subject matter or the characters are unusual or sensational <the O.J. Simpson trial was a cause célèbre in the 1990s>.

**cause in fact.** See *but-for cause* under CAUSE (1).

**cause list.** See DOCKET (2).

**cause of action.** 1. A group of operative facts giving rise to one or more bases for suing; a factual situation that entitles one person to obtain a remedy in court from another person; CLAIM (4) <after the crash, Aronson had a cause of action>. [Cases: Action ⇨1, 2. C.J.S. *Actions* §§ 2-9, 11, 17, 21, 26, 31-33, 36.]

"What is a cause of action? Jurists have found it difficult to give a proper definition. It may be defined generally to be a situation or state of facts that entitles a party to maintain an action in a judicial tribunal. This state of facts may be — (a) a primary right of the plaintiff actually violated by the defendant; or (b) the threatened violation of such right, which violation the plaintiff is entitled to restrain or prevent, as in case of actions or suits for injunction; or (c) it may be that there are doubts as to some duty or right, or the right beclouded by some apparent adverse right or claim, which the plaintiff is entitled to have cleared up, that he may safely perform his duty, or enjoy his property." Edwin E. Bryant, *The Law of Pleading Under the Codes of Civil Procedure* 170 (2d ed. 1899).

2. A legal theory of a lawsuit <a malpractice cause of action>. Cf. RIGHT OF ACTION. — Also termed (in senses 1 & 2) *ground of action*.

**new cause of action.** A claim not arising out of or relating to the conduct, occurrence, or transaction contained in the original pleading. • An amended pleading often relates back to the date when the original pleading was filed. Thus, a plaintiff may add claims to a suit without facing a statute-of-limitations bar, as long as the original pleading was filed in time to satisfy the statute. But if the amended pleading adds a claim that arises out of a different transaction or occurrence, or out of different alleged conduct, the amendment does not relate back to the date when the original pleading was filed. Fed. R. Civ. P. 15(c).

3. Loosely, a lawsuit <there are four defendants in the pending cause of action>.

**cause-of-action estoppel.** See COLLATERAL ESTOPPEL.

**causidicus** (kaw-zid-ə-kəs), *n.* [Latin "pleader"] *Roman law.* A speaker or pleader who pleaded cases orally for others. Cf. ADVOCATUS.

**cautio** (kaw-shee-oh), *n.* [Latin "security"] *Roman & civil law.* 1. Security usu. given to ensure the performance of an obligation. See BAIL (1); BOND (2). 2. A surety. Pl. *cautiones* (kaw-shee-oh-nee-z).

1 CHAIRMAN OMAS: We now come to the United  
2 States Postal Service. Mr. Tidwell?

3 MR. TIDWELL: Good morning, Mr. Chairman.  
4 The Postal Service has no questions.

5 CHAIRMAN OMAS: Thank you, Mr. Tidwell.

6 Is there any other party who wishes to  
7 cross-examine Witness Mitchell?

8 (No response.)

9 CHAIRMAN OMAS: There being none, is there  
10 any follow-up cross-examination?

11 (No response.)

12 CHAIRMAN OMAS: There being none, are there  
13 any questions from the bench?

14 (No response.)

15 CHAIRMAN OMAS: There being none, Mr. Olson,  
16 we come to you, sir. Would you like some time with  
17 your witness to review whether there's any redirect?

18 MR. OLSON: Maybe 90 seconds.

19 CHAIRMAN OMAS: Fine. Thank you.

20 (Pause.)

21 MR. OLSON: Thank you, Mr. Chairman. We  
22 have no questions.

23 CHAIRMAN OMAS: Thank you, Mr. Olson.

24 Mr. Mitchell, that completes your testimony  
25 here today. We appreciate your appearance and your

1 contribution to our record. Again, thank you, and you  
2 are now excused.

3 THE WITNESS: Thank you, Mr. Chairman.

4 (Witness excused.)

5 CHAIRMAN OMAS: Ladies and gentlemen, before  
6 we start on our next witness I think we'll take a 10  
7 minute recess. Let's come back at 11:05.

8 (Whereupon, a short recess was taken.)

9 CHAIRMAN OMAS: Mr. Olson, would you please  
10 identify your next witness?

11 MR. OLSON: Yes, Mr. Chairman. On behalf of  
12 Valpak we call to the stand Dr. John Haldi.

13 CHAIRMAN OMAS: Excuse me. I'm sorry. I'm  
14 jumping the gun.

15 Before moving to our next witness I would  
16 like to take this opportunity and take a moment of  
17 your time to express my and the Commission's  
18 appreciation to both Advo and to you, Mr. Olson and  
19 Valpak.

20 You all have submitted discovery requests to  
21 each other that could have been controversial as they  
22 sought information on volumes. Both Advo and Valpak  
23 provided this information, and as a result the  
24 Commission will be able to develop a far more reliable  
25 cost estimate that would maybe otherwise not been

1 quite possible, so we thank you.

2 We thank Advo and Valpak for that, and we  
3 would appreciate very much your informing your clients  
4 of our appreciation of that. We thank you.

5 Now you may proceed.

6 MR. OLSON: Thank you, Mr. Chairman. It was  
7 a pleasure working through a variety of issues with  
8 Mr. McLaughlin during the course of this case.

9 (The document referred to was  
10 marked for identification as  
11 Exhibit No. VP-T-2.)

12 MR. OLSON: Dr. Haldi, I would like to hand  
13 to you two copies of what is identified as the Direct  
14 Testimony of Dr. John Haldi Concerning Standard  
15 Enhanced Carrier Route Mail on Behalf of Valpak  
16 designated as VP-T-2.

17 CHAIRMAN OMAS: Excuse me. I've not sworn  
18 him in yet.

19 MR. OLSON: I'm sorry. I'm sorry.

20 CHAIRMAN OMAS: I thought you were going to  
21 introduce him.

22 MR. OLSON: Well, I still would like to hand  
23 that to him.

24 CHAIRMAN OMAS: Please raise your right  
25 hand.

1                   Whereupon,

2   JOHN HALDI

3                   having been duly sworn, was called as a  
4 witness and was examined and testified as follows:

5                   CHAIRMAN OMAS: Thank you. You may be  
6 seated.

7                   Ruth mentioned the champagne so we all got  
8 excited.

9   DIRECT EXAMINATION

10                   BY MR. OLSON:

11                   Q     Mr. Haldi, was this direct testimony  
12 prepared by you or under your direction?

13                   A     Yes, it was.

14                   Q     And do you have any edits today to that  
15 testimony?

16                   A     Yes, I do.

17                   Q     Could you identify those?

18                   A     Thank you. The first edit occurs on page  
19 17, Line 1. The second entry on that line is "2.0."  
20 That should be corrected to read "1.1."

21   The next edit occurs on page 41, Line 15.  
22 The penultimate word in that line, "costs" plural,  
23 should be changed to "cost" singular.

24                   MALE VOICE: That was on page 41?

25                   THE WITNESS: Page 41, Line 15.

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1           The next edit is on page 51. It's in Table  
2           3, Row 14. All of the figures in that table should be  
3           shifted to the right. It should be fairly obvious  
4           which columns the numbers should line up with.

5           The final edit is on page 62, Line 7. The  
6           first column there, Number of Possible Deliveries, has  
7           under it three zeros. Those three zeros should be  
8           struck. The numbers stand where they are without  
9           interpreting them as thousands.

10           BY MR. OLSON:

11           Q     Does that complete the edits?

12           A     That completes the edits.

13           Q     And have you made those edits on the two  
14           copies in the testimony?

15           A     I have made them by hand in each of the two  
16           copies. Yes, I have.

17           Q     And with those edits do you adopt this as  
18           your testimony in this docket?

19           A     Yes, I do.

20           MR. OLSON: Mr. Chairman, on behalf of  
21           Valpak we move the admission of this testimony into  
22           evidence.

23           MR. MCLAUGHLIN: Mr. Chairman?

24           CHAIRMAN OMAS: Yes?

25           MR. MCLAUGHLIN: I just want a clarification

1 here.

2 CHAIRMAN OMAS: Mr. McLaughlin?

3 MR. MCLAUGHLIN: Can you hear me?

4 CHAIRMAN OMAS: Yes, but identify yourself  
5 for the record please.

6 MR. MCLAUGHLIN: Tom McLaughlin for Advo. I  
7 just want a clarification here. Is the testimony  
8 being offered the testimony that includes the  
9 revisions that were filed yesterday late afternoon?

10 MR. OLSON: Yes. It has those revisions in  
11 it. They were made after the receipt of responses to  
12 interrogatories, institutional responses of Advo to  
13 certain discovery. They were filed yesterday. Yes.

14 MR. MCLAUGHLIN: Okay. Mr. Chairman, I  
15 would like to discuss that for a moment.

16 First of all, I would like to hand out to  
17 the -- let me make sure I've got the right one here.  
18 I'm going to hand the Commission the document that was  
19 filed yesterday at probably around 4:30 by Valpak.

20 The document that I just handed the  
21 Commissioners was the notice filed by Valpak  
22 concerning revisions. I have a question for Mr.  
23 Olson. The second line of that notice states, "The  
24 revisions are necessitated by the responses of Advo,  
25 Inc. to interrogatories received August 22."

1                   I would like to refer counsel's attention to  
2 revised pages 80 and 81 starting at Line 16 on page  
3 80, which appears to be two brand new tables with  
4 brand new data. I'd like to ask him how are these  
5 revisions necessitated by Advo's responses to  
6 interrogatories that were filed on Monday?

7                   MR. OLSON: Well, there are two revisions.  
8 There are certain categories of revisions. If you  
9 take a look at page 17, we made certain word changes  
10 that were also not directly necessitated. I'm sorry.  
11 Not page 17, but page 63.

12                   MR. MCLAUGHLIN: Excuse me. I'd like to cut  
13 through this a little bit. I'm not asking about the  
14 other revisions that were made. The other revisions  
15 do directly relate to the Advo interrogatory responses  
16 where Mr. Haldi has made adjustments based on the Advo  
17 interrogatory responses.

18                   I am now referring to the revisions on pages  
19 80 and 81 Revised starting at Line 16 on page 80. I'm  
20 asking how were those revisions necessitated by Advo's  
21 interrogatory responses?

22                   MR. OLSON: I'll be glad to respond to that,  
23 but I think it's worth saying that the changes on page  
24 63 were not necessitated by the Advo interrogatories  
25 either.

1 MR. MCLAUGHLIN: No. I understand that.

2 MR. OLSON: It was a mere correction.

3 MR. MCLAUGHLIN: I understand that. I'm  
4 talking now about the ones I just referred to.

5 MR. OLSON: What the situation was is that  
6 we filed interrogatory responses to Advo, had an  
7 agreement as to when they would be due. They were  
8 filed on Monday, and as a result of that we learned  
9 additional information about Advo's volumes and about  
10 the A.N.N.E. and the network and about certain other  
11 information, and that led us to make these edits.

12 The information in Table A-9 and A-10 was an  
13 indirect outgrowth of the responses. It was not a  
14 direct outgrowth because all the rest of the edits  
15 have to do with the A.N.N.E. information and Advo, but  
16 it was in an effort to reduce the volume of estimated  
17 DALs that Mr. Haldi had.

18 The Postal Service has estimated 3.375  
19 billion DALs. Mr. Haldi had estimated 5.4 billion  
20 DALs, and he reduced the estimate based on the  
21 information on Monday. He did it yesterday. It's now  
22 4.5 billion, so it's being reduced.

23 I'm not sure it's entirely objectionable to  
24 provide the full basis for it.

25 MR. MCLAUGHLIN: Mr. Chairman, it's quite

1 objectionable. If you will look, these additional  
2 numbers and data that are shown on these two pages do  
3 not reduce the number to which they relate in Mr.  
4 Haldi's testimony. They increase the number.

5           These numbers are used by Mr. Haldi to  
6 estimate other detached labels beyond Advo, other  
7 detached labels that did not consist of Advo DALs.  
8 This new data that has been filed yesterday at 4:30 is  
9 brand new information that attempts to increase that  
10 number in his prior testimony.

11           Is that correct, counsel? There are about  
12 185 million DALs in the Increased Other, and this is  
13 the basis for it.

14           MR. OLSON: There was an estimate of I  
15 believe it was 166 million Others Independent, which  
16 was revised based on this information. That's  
17 correct.

18           MR. MCLAUGHLIN: Where do you get the 185  
19 million?

20           MR. OLSON: Page 78.

21           MR. MCLAUGHLIN: Mr. Chairman?

22           MR. OLSON: I have to admit, Mr. Chairman,  
23 it's not an ideal situation, but it is when we got the  
24 information and when we did take a look at it. It is  
25 what it is. It is a matter of a very small percentage

1 of the total DALs.

2 MR. MCLAUGHLIN: Mr. Chairman, this is  
3 information that was dumped on us yesterday at 4:30  
4 involving a whole host of brand new names of mailers  
5 with new volumes that go on for basically a page and a  
6 half that represent to be additional detached label  
7 volumes that Mr. Haldi had discovered.

8 I think it's pretty outrageous to dump this  
9 kind of brand new information in testimony at the very  
10 last minute before the witness takes the stand.  
11 Normally I would move to strike this new material.  
12 The problem with moving to strike is it makes the  
13 appearance that we think that Mr. Haldi has  
14 information that's damaging to us.

15 On that basis I will not move to strike his  
16 testimony, this portion of the testimony, and I will  
17 instead attempt to determine the validity of these  
18 numbers on here through cross-examination, but I do  
19 want to express our extreme concerns about these kinds  
20 of tactics of throwing in random information on the  
21 eve of the hearing.

22 CHAIRMAN OMAS: Mr. McLaughlin, I will allow  
23 the new revised testimony into evidence, but I will  
24 allow Advo time for rebuttal or for questions. I will  
25 allow you additional time for questions or for

1       rebuttal if you so request.

2                   MR. MCLAUGHLIN: Thank you, Mr. Chairman.

3                   CHAIRMAN OMAS: Okay. Thank you.

4                   I guess I would say that it's fine to allow  
5 this in evidence, but if we could have gotten it a  
6 little bit earlier it would have made everybody a  
7 little bit happier, Mr. Olson and Mr. Haldi.

8                   MR. OLSON: Yes, sir.

9                   CHAIRMAN OMAS: With that would you proceed?  
10 I think you were trying to introduce it into evidence.

11                   MR. OLSON: I think the last statement I  
12 made was that I had moved its admission in evidence.

13                   CHAIRMAN OMAS: And there was an objection.  
14 We've taken care of that.

15                   MR. MCLAUGHLIN: Mr. Chairman, I did not  
16 object.

17                   CHAIRMAN OMAS: That's right. I was going  
18 to clarify that. I asked is there any objection, and  
19 there was a clarification made by Advo. As I said  
20 again, we'll allow it into evidence, and you will have  
21 any time you need to follow up with questions or  
22 prepare rebuttal.

23                   Hearing none, I will direct counsel to  
24 provide the reporter with two copies of the corrected  
25 direct testimony of John Haldi. That testimony is

1 received into evidence and is to be transcribed into  
2 the record.

3 (The document referred to,  
4 previously identified as  
5 Exhibit No. VP-T-2, was  
6 received in evidence.)

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VP-T-2

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

POSTAL RATES AND FEE CHANGES, 2005 )

Docket No. R2005-1

Direct Testimony of

DR. JOHN HALDI

Concerning

STANDARD ENHANCED CARRIER ROUTE MAIL

On Behalf of

VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.

William J. Olson  
John S. Miles  
Jeremiah L. Morgan  
WILLIAM J. OLSON, P.C.  
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Counsel for:

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and Valpak Dealers' Association, Inc.

July 19, 2005

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**AUTOBIOGRAPHICAL SKETCH**

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My name is John Haldi. I am President of Haldi Associates, Inc., an economic and management consulting firm with offices at 488 Madison Avenue, New York, New York 10022. My consulting experience has covered a wide variety of subjects for government, business and private organizations, including testimony before Congress and state legislatures.

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In 1952, I received a Bachelor of Arts degree from Emory University, with a major in mathematics and a minor in economics. In 1959, I received a Ph.D. in economics from Stanford University.

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From 1958 to 1965, I was an assistant professor at the Stanford University Graduate School of Business. In 1966 and 1967, I was Chief of the Program Evaluation Staff, U.S. Bureau of the Budget. While there, I was responsible for overseeing implementation of the Planning-Programming-Budgeting ("PPB") system in all non-defense agencies of the federal government. During 1966, I also served as Acting Director, Office of Planning, United States Post Office Department. I was responsible for establishing the Office of Planning under Postmaster General Lawrence O'Brien, where I established an initial research program, and hired the initial staff.

1 I have written numerous publications. Among those publications  
2 dealing with postal and delivery economics are an article, "The Value of  
3 Output of the Post Office Department," in *The Analysis of Public Output*  
4 (1970); a book, *Postal Monopoly: An Assessment of the Private Express*  
5 *Statutes*, published by the American Enterprise Institute for Public Policy  
6 Research (1974); an article, "Measuring Performance in Mail Delivery," in  
7 *Regulation and the Nature of Postal Delivery Services* (1992); an article  
8 (with Leonard Merewitz), "Costs and Returns from Delivery to Sparsely  
9 Settled Rural Areas," in *Managing Change in the Postal and Delivery*  
10 *Industries* (1997); an article (with John Schmidt), "Transaction Costs of  
11 Alternative Postage Payment and Evidencing Systems," in *Emerging*  
12 *Competition in Postal and Delivery Services* (1999); an article (with John  
13 Schmidt), "Controlling Postal Retail Transaction Costs and Improving  
14 Customer Access to Postal Products," in *Current Directions in Postal*  
15 *Reform* (2000); an article (with John Schmidt), "Saturday Delivery: Who  
16 Provides? Who Needs It?" in *Postal and Delivery Services: Pricing,*  
17 *Productivity, Regulation and Strategy* (2002); and an article (with William  
18 J. Olson), "An Evaluation of USPS Worksharing: Postal Revenues and  
19 Costs from Workshared Activities," in *Competitive Transformation of the*  
20 *Postal and Delivery Sector* (2004).

1           I have testified as a witness before the Postal Rate Commission in  
2   Docket Nos. R2000-1, R97-1, MC96-3, MC95-1, R94-1, SS91-1, R90-1,  
3   R87-1, SS86-1, R84-1, R80-1, MC78-2, and R77-1. I also have  
4   submitted comments in Docket No. RM91-1.

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## I. PURPOSE OF TESTIMONY

This testimony has three purposes. The first is to explain why the Commission’s methodology for developing attributable costs for ECR Saturation letters and flats should correct the costing of detached address labels (“DALs”) by (i) giving explicit recognition to the costs caused by processing and delivering DALs, (ii) removing all costs of DALs from the costs attributed to letters, and (iii) attributing all costs of DALs to the nonletter mailpieces that they accompany.

The second purpose is to explain why the Postal Service’s current cost systems fail to develop correct estimates of marginal costs in situations where it has low-cost capacity that is constrained, and to propose a better method for estimating marginal costs under such a condition.

The third purpose is (i) to propose an alternative method for estimating the volume of DALs currently in the system, and (ii) to develop an alternative estimate of the volume of DALs to use when attributing their costs to the mailings that they accompany.

## II. INTRODUCTION

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2 This testimony is presented on behalf of intervenors Valpak Direct  
3 Marketing Systems, Inc. ("VPDMS") and Valpak Dealers' Association,  
4 Inc., hereinafter collectively referred to as "Valpak." As described more  
5 fully below, Valpak's mail primarily consists of letter mail sent at the  
6 Standard Mail Saturation rate.

7 VPDMS is the nation's largest firm in a subset of the hard-copy,  
8 direct mail cooperative advertising industry which is sometimes referred  
9 to as "coupons in an envelope." Headquarters offices are located in  
10 Largo, Florida. VPDMS is a wholly-owned subsidiary of Cox Enterprises,  
11 Inc. of Atlanta, Georgia.

### 12 **VPDMS Mailing Practices**

13 VPDMS entered 505 million pieces of its own mail in the United  
14 States in 2004, and is estimated to mail 517 million pieces during the  
15 year 2005. In addition, it entered more than 42 million pieces under  
16 contract for various clients in 2004.

17 More than 95 percent of VPDMS' mailings use letter-shaped  
18 number 10 envelopes, while less than 5 percent use letter-shaped 6" x 9"  
19 envelopes. The average weight of a VPDMS piece is about 2.5 ounces.

1 All are trayed by VPDMS for individual carrier routes and entered at the  
2 Standard A Mail ECR Saturation Rate.

3 In business for more than 37 years, VPDMS operates throughout  
4 the United States through approximately 179 U.S. franchisees, which are  
5 members of the Valpak Dealers' Association, Inc. The work of these  
6 franchisees is supplemented by efforts of approximately 1,200 sales  
7 representatives. VPDMS' mailings reach 43.9 million households in the  
8 United States each year. Its mailings can be highly targeted to meet the  
9 marketing needs of even the smallest retail businesses. This is  
10 accomplished by Valpak's geographic advertising plan, which divides the  
11 country into thousands of "Neighborhood Trading Areas" ("NTAs"), most  
12 consisting of approximately 10,000 residences. These NTAs are built  
13 around neighborhood purchasing patterns, taking into account factors  
14 such as traffic zones and natural barriers, such as rivers. Through this  
15 NTA construct, businesses can precisely target for advertising purposes  
16 those geographic market segments that are most economically attractive.  
17 Advertisers may purchase coverage for the entire nation, or any number  
18 of NTAs, from several thousand down to only one.

19 Most franchisees mail at least 10 times per year, with many offices  
20 mailing on a monthly schedule.

1           Each year, more than 80,000 individual advertisers purchase ECR  
2 Saturation advertising with VPDMS. Some of these advertisers are  
3 national or regional businesses, but the vast majority are small, local  
4 businesses.

5           Once an advertiser places an order with a VPDMS franchisee for  
6 distribution of a particular coupon to a particular geographic area with a  
7 particular frequency, the order is directed to Valpak's corporate  
8 headquarters in Largo, Florida. There, the graphics for the coupon are  
9 created. VPDMS fashioned as many as 295,000 advertising layouts in  
10 2004 and projects to layout more than 320,000 in 2005.

11           After review and approval by the advertiser, the coupons are  
12 printed in either Largo, Florida or Elm City, North Carolina. Printing  
13 may be simple, involving only one color, or may involve sophisticated,  
14 four-color printing.

15           VPDMS has been encouraged by the Postal Service to put delivery  
16 point barcodes on all of its mail. At present, 100 percent of VPDMS' mail  
17 is walk sequenced Delivery Point Barcoded. VPDMS incurs additional  
18 computer charges as a result of adding the delivery point barcode to  
19 mailing lists that have only ZIP + 4 information. VPDMS works closely  
20 with firms supplying mailing lists to ensure that it buys the cleanest and  
21 most up-to-date lists available anywhere. For example, when the Postal

1 Service changes boundary lines, these lists are updated by list  
2 companies supplying VPDMS within the next bimonthly update from the  
3 Postal Service.

4 Also, for more than 10 years, VPDMS has participated voluntarily  
5 in Postal Service tests, such as those involving traying letter-shaped  
6 carrier route mail and palletizing trays, despite the fact that these  
7 procedures have caused VPDMS to incur additional costs. VPDMS has  
8 been a national test site for such tests. Since such traying became  
9 mandatory, VPDMS has been in full compliance.

10 Virtually all of VPDMS' mail is transported by truck at VPDMS'  
11 expense, of which 99 percent is entered at the destinating SCF. The  
12 remainder is entered at BMCs, or locally, in either St. Petersburg, Florida  
13 or Elm City, North Carolina.

14 VPDMS advertisers require that the Valpak mail be delivered in a  
15 timely fashion. For example, if a pizza carry-out firm issues \$1-off  
16 coupons to be delivered during a particular week, it must anticipate the  
17 additional business generated by purchasing additional ingredients and  
18 hiring additional staff. If the mail is delivered too early, the client may  
19 not be prepared, or if late, the extra ingredients can be wasted and the  
20 staff can stand idle.

1           Several other national and regional firms around the country are  
2 known to operate in a manner similar to that of Valpak. Money Mailer of  
3 Manhattan Beach, California, is believed to be the second largest such  
4 firm, followed by many others, such as SuperCoups in Taunton,  
5 Massachusetts, United Marketing Solutions in Springfield, Virginia, and  
6 Trimark in Wilmington, Delaware. Many competitors operate only in  
7 limited geographic markets.

1                   **III. ADJUSTMENTS TO ECR COSTS NEEDED ON ACCOUNT OF**  
2                   **DETACHED ADDRESS LABELS**

3                   Saturation non-letter mail may contain (i) addressed pieces, such  
4 as ordinary catalogs, or (ii) unaddressed pieces, provided that such  
5 pieces are accompanied by a letter-shaped detached address label that  
6 complies with specifications contained in the Domestic Mail Manual  
7 (“DMM”). As explained herein, unaddressed mailings with DALs can  
8 receive handling that differs from that received by addressed flats, which  
9 in turn gives rise to certain problems and issues in cost development.

10                   **A. Detached Address Label Mailings**

11                   Within ECR, a DAL can accompany non-letter-shaped pieces,  
12 which can be either flats or parcels.<sup>1</sup> Flat-shaped pieces most commonly  
13 mailed with DALs are a collection of loose (unbound) pieces enclosed  
14 inside a folded host piece, which the DMM refers to as a “cover,” “short  
15 cover,” or “protective cover.”<sup>2</sup> The only limit on the number of enclosures  
16 within the host piece is that the entire piece may not exceed the

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<sup>1</sup> Institutional response to VP/USPS-T30-18 (Tr. 8/\_\_\_\_). DALs are not permitted with letter-shaped pieces.

<sup>2</sup> See Docket No. R2001-1, response to VP/USPS-T31-2 (Tr. 8/1684), which also states that “[c]onversationally, these pieces may be referred to by mailers as ‘wraps,’ ‘half covers,’ or other terms.” The term “cover” will be used herein. Overall size of the cover may not exceed the size limits for flats, as specified in DMM 602.4.0.

1 maximum thickness for an ECR flat.<sup>3</sup> All Standard ECR Saturation  
2 parcels are required to be merchandise samples and must be mailed with  
3 DALs.<sup>4</sup>

4 **B. Recording of Detached Address Label Mail Upon Entry**

5 When saturation non-letter mailings with DALs are entered with  
6 the Postal Service, the Revenue, Pieces and Weight (“RPW”) system  
7 credits non-letters with all revenue. Consistent with this treatment, the  
8 RPW system records the volume of all such mailings as the number of  
9 non-letter items only; *i.e.*, the DAL and accompanying piece are counted  
10 **as only one item** in the RPW database and RPW reports. Accordingly, if  
11 a mailing consists of 1 million DALs and 1 million accompanying covers,  
12 the RPW system records the volume of the mailing as 1 million non-  
13 letters.<sup>5</sup>

14 The RPW system does **not distinguish** between (i) mailings of  
15 unaddressed ECR flats accompanied by DALs, and (ii) mailings that

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<sup>3</sup> See Docket No. R2001-1, response to VP/USPS-T31-3 (Tr. 8/1685).

<sup>4</sup> The vast majority of all DAL mailings consist of saturation flats, but certain other items in Periodicals, Standard Mail, and Bulk Printed Matter also may be entered with DALs. See responses to VP/USPS-T30-18b-c, and VP/USPS-T30-28b (Tr. 8/\_\_\_\_ and Tr. 8/\_\_\_\_, respectively).

<sup>5</sup> See Docket No. R2001-1, response to VP/USPS-T4-6 (Tr. 3/337).

1 consist of addressed ECR flats, such as catalogs. Thus, the RPW system  
2 neither counts nor records the volume of DALs, and it would be correct  
3 to say that the volume of DALs is disregarded by the RPW system.  
4 Moreover, none of the Postal Service's other data systems contain any  
5 information about the volume of saturation flats accompanied by DALs.  
6 Consequently, none of the Postal Service's data systems contain any data  
7 that identify the total annual volume of DALs handled each year. As  
8 discussed below, this is an important void in the data system. Because  
9 of this void, the Postal Service in this case has undertaken an initial ad  
10 hoc effort to estimate the annual volume of DALs. That estimate, and the  
11 procedure used to derive it, are discussed in the Appendix.

12 **C. Need for Consistency in Recording Revenues and Attributing**  
13 **Costs**

14 In order to estimate accurately the unit cost of individual rate  
15 categories, such as saturation letters and flats, costs must be attributed  
16 to each respective rate category consistent with the way revenues and  
17 volumes for each rate category are recorded. When costs are not  
18 attributed consistently with respect to the way revenues and volumes are  
19 recorded, the result is a mismatch, or inconsistency, in the data.<sup>6</sup> When

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<sup>6</sup> See responses to VP/USPS-T16-7(a) and 19 (Tr. 7/2860-62 and  
(continued...))

1 a rate category is affected by such a mismatch, the resulting unit cost  
 2 will not provide an accurate estimate of marginal cost, which is what the  
 3 Postal Service aspires to use when setting rates.<sup>7</sup>

4 The first docket to establish ECR rates, Docket No. MC95-1, used  
 5 modeled costs to develop bottom up costs for each rate category. That  
 6 procedure had an internal consistency that avoided any mismatch  
 7 between the costs of letters and flats. However, in each successive  
 8 docket (Docket Nos. R97-1, R2000-1, and R2001-1), this mismatch  
 9 occurred when, for ECR DAL mailings, (i) the RPW system recorded all  
 10 revenue and volume as being derived from flats, and (ii) both the city and  
 11 rural carrier cost systems distributed to letters certain costs attributable  
 12 to handling DALs.<sup>8</sup>

13 It makes no sense to distribute to letters any of the costs  
 14 attributable to DALs, when the RPW system always classifies the revenue  
 15 and volume of every DAL mailing solely as non-letters. The effect of this  
 16 mismatch has been to (i) **overstate** the unit costs of letters,

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<sup>6</sup> (...continued)  
 7/2882-87, respectively.)

<sup>7</sup> See library reference USPS-LR-K-1, App. H.

<sup>8</sup> The unit cost data developed by the Postal Service in Docket No. MC95-1 were not similarly biased because their unit cost development was based on modeled cost, not sample data. This mismatch was first identified by Valpak in Docket No. R2001-1, and resulted in a small adjustment to saturation letter rates in the settlement agreement.

1 (ii) **understate** the unit cost of nonletters, and (iii) thereby bias  
 2 downward the letter/flat cost difference used for ratemaking within the  
 3 saturation rate category. The letter/flat cost difference is a key  
 4 determinant, through the presort tree, of relative rate levels within ECR.  
 5 The systematic bias from the mismatch in the underlying data identified  
 6 here explains some of what has appeared to be a decline in the shape-  
 7 based cost differences since Docket No. MC95-1.<sup>9</sup>

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9 **D. Costs of DALs in Cost Segment 7 (City Carrier Street Time)**  
 10 **and Cost Segment 10 (Rural Carriers)**

11

12 The mismatch described in the preceding section arises from the  
 13 way certain data used for cost attribution are systematically recorded.  
 14 As noted above, DALs are **not** counted or recorded in the RPW system,  
 15 which credits to non-letters the revenue and volume from all ECR pieces  
 16 mailed with DALs. At the same time, in both the city and rural carrier  
 17 cost systems DALs **are** counted — as letters.<sup>10</sup> The city carrier mail  
 18 count includes both the number of DALs and the accompanying covers,  
 19 because carriers must handle each DAL when on the street. Likewise, in  
 20 the national rural mail count used to attribute rural carrier costs, the

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<sup>9</sup> For commercial ECR, using PRC costs, at the Basic level the difference was 2.5299 cents in Docket No. R97-1, 0.849 cents in Docket No. R2000-1, and 0.251 cents in Docket No. R2001-1.

<sup>10</sup> Response to VP/USPS-T30-20(c) (Tr. 6/2377-78).

1 DAL and the accompanying non-letter piece each incurs time credits that  
2 translate directly into costs, and costs associated with handling DALs are  
3 attributed to letters. The resulting mismatch, with all revenues and  
4 volumes being credited to non-letters, but some of the costs being  
5 attributed to letters, is an inconsistency which long has been in need of  
6 correction.

7 Those who record the mail count data are not instructed to  
8 distinguish between DALs and ordinary letters. Consequently, the  
9 problem has been recurring and continues to this day. Furthermore,  
10 since the problem arises from the way the data are recorded, the end  
11 result would not be improved by expanding the size of either the city or  
12 rural carrier sample. And because the sampling systems consistently  
13 develop erroneous unit costs for saturation letters and flats, an after-the-  
14 fact adjustment needs to be made to correct the costs improperly  
15 attributed to those letters and flats.

16 In this docket, the Postal Service has undertaken to calculate a  
17 correction. Library reference USPS-LR-K-67, sponsored by witness  
18 Kelley (USPS-T-16), estimates that the total volume of DALs in FY 2004  
19 was 3.375 billion. Interestingly, the Postal Service's estimated volume of  
20 DALs amounts to 98 percent of the FY 2004 volume of saturation letters,  
21 or 3.444 billion, in the Billing Determinants, USPS-LR-K-77. The

1 estimated volume of DALs is used to adjust the cost of letters and flats.  
2 Because the estimated volume of DALs is so large in comparison to  
3 saturation letters, the resulting correction makes a meaningful  
4 difference. It reduces the Test Year USPS delivery cost of saturation  
5 letters from 6.665 to 4.137 cents, while increasing the cost of saturation  
6 flats from 3.191 to 4.163 cents.<sup>11</sup> Of course, since the Postal Service's  
7 proposed rates are not designed to reflect Test Year costs, proposed rates  
8 have not been adjusted to reflect the extent of the mismatch.

9         The Commission likewise should adopt a procedure to correct for  
10 the mismatched data. It either should adopt the procedure used by the  
11 Postal Service for the first time in this docket, or it should develop its  
12 own procedure for removing all DAL costs that are incorrectly attributed  
13 to letters and instead attribute them to flats.

14         The volume of 3.375 billion DALs estimated by the Postal Service is  
15 not inconsequential; it amounts to 35.5 percent of the total volume of  
16 saturation non-letters (*i.e.*, 9.515 billion). At the same time, based on  
17 other data sources considered to be more authoritative, as explained in  
18 the Appendix, the Postal Service estimate appears to understate by

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<sup>11</sup> See Notice of Unites States Postal Service of Filing of Revisions to the Testimony of Witness Kelley (USPS-T-16) - Errata (June 9, 2005), p. 6.

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1 approximately ~~2.0~~<sup>1.1</sup> billion the total volume of DALs actually handled.<sup>12</sup>  
 2 Therefore, when adjusting for the cost of handling DALs, I recommend  
 3 that the Commission use the figure of 4.5 ~~5.4~~ billion as developed in the  
 4 Appendix, and shown there in Table A-8. This would be the conservative  
 5 approach to correct the current over-attribution of costs to saturation  
 6 letters. Finally, the Commission should assume that only 6.13 ± percent  
 7 of all DALs are delivered to P.O. Boxes, and that the remaining 93.87 ~~99~~  
 8 percent of DALs are delivered by city or rural carriers.

9 **E. Costs of DALs in Cost Segment 6 (City Carrier In-Office Time)**

10 The In-Office Cost System (“IOCS”) is used to allocate city carrier  
 11 in-office costs to rate categories of ECR mail. When a DAL is being  
 12 handled at the time a tally is taken (*e.g.*, being cased manually by the  
 13 carrier), the tally taker is instructed to record the characteristics of the  
 14 accompanying piece (*e.g.*, weight, shape, etc.), not the characteristics of  
 15 the DAL. As a result, with respect to tallies taken when DALs are being  
 16 cased manually, the IOCS should attribute in-office carrier costs to flat-  
 17 shaped pieces in a manner consistent with the way revenues and  
 18 volumes are recorded, so long as IOCS instructions are followed. The

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<sup>12</sup> See the Appendix for more discussion on estimating the volume of DALs.

1 type of consistency problem that arises with respect to attributing  
2 delivery costs for rural carriers and street time costs of city carriers  
3 should occur only on those occasions when an error is made when  
4 recording an IOCS tally. Two Postal Service witnesses have mentioned  
5 recording error as a distinct possibility for anomalous cost results (*see*  
6 *fn. 23, infra*).

7         Although recording cased DALs as flats does not create a  
8 mismatch, it does create another problem. Namely, because cased DALs  
9 are recorded as flats, the Postal Service has no data on how many DALs  
10 are cased each year.<sup>13</sup> To estimate the number of flats that are cased,  
11 the Postal Service uses costs developed from the IOCS to estimate the  
12 number of hours spent casing flats, and then divides those hours by the  
13 rate for casing ordinary flats (casing rates are from witness Shipe in  
14 Docket No. R90-1).<sup>14</sup> The obvious assumption underlying this procedure  
15 is that all carrier time recorded as casing flats was in fact spent casing  
16 catalogs or other flats, not DALs. However, if some of the time was spent  
17 casing DALs, as it would be reasonable to expect, and if the letter shape  
18 of DALs enables them to be cased at the much faster rate for letters, as it

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<sup>13</sup> Response to VP/USPS-T30-16 (Tr. 6/2373).

<sup>14</sup> The procedure is described by witness Bradley, USPS-T-14, p. 59, ll. 5-17, and implemented by witness Kelley, USPS-T-16, in library reference USPS-LR-K-67, which he sponsors.

1 also would be reasonable to expect, then the estimated number of flats  
2 that are cased and taken to the street would be erroneous for several  
3 reasons.

4 First, since DALs are recorded as flats by the IOCS, the procedure  
5 used actually is estimating the number of **pieces** cased — addressed  
6 flats and DALs combined — not just flats. Second, since DALs are  
7 probably cased at a faster rate than ordinary flats, using the casing rate  
8 for flats alone underestimates the actual volume of pieces cased. Third,  
9 many of the cased pieces are DALs, and the uncased covers that  
10 accompany those DALs would bypass casing and be taken directly to the  
11 street. After all, the very reason DALs are cased is to enable the covers  
12 to be taken to the street, and any implicit assumption that the volume of  
13 cased DALs represents flats **not** taken directly to the street is about as  
14 wrong as can be. Underestimating the volume of flats taken directly to  
15 the street will underestimate the share of city carrier street costs of  
16 sequenced mail that should be attributed to flats.

17 **F. Costs of DALs in Cost Segment 3 (Mail Processing)**

18 Prior to development of equipment that could delivery point  
19 sequence (“DPS”) letters, all DALs either were cased manually by carriers  
20 or taken directly to the street (uncased) along with the accompanying

1 covers, as “third bundles.” Now, however, it seems that some unknown  
2 volume of DALs are sorted on automation equipment. One prerequisite  
3 is that DALs have barcodes, which can be applied by the Postal Service  
4 using automation equipment with optical character reader (“OCR”)   
5 capability, or sometimes are pre-applied by the mailer.<sup>15</sup> According to  
6 witness Lewis (USPS-T-30), “there is field interest in DPSing the letter-  
7 shaped component of a DAL mailing and ... in some places delivery and  
8 plant managers have implemented local procedures to do this.”<sup>16</sup>  
9 Sometimes, when ECR flats with DALs are entered at Destination  
10 Delivery Units (“DDUs”), the DALs may even be transported back to the  
11 Processing and Distribution Center (“P&DC”) to be processed on  
12 automation equipment.<sup>17</sup> At the same time, despite knowledge that  
13 interest in DPSing of DALs is increasing, and the practice is growing,  
14 “[t]he Postal Service has no estimate of the volume or percentage of the  
15 amount of letter-shaped DAL pieces processed on automated  
16 equipment.”<sup>18</sup>

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<sup>15</sup> Response to VP/USPS-T30-13(a) (Tr. 6/2369).

<sup>16</sup> Response to VP/USPS-T30-14 (Tr. 6/2370-71).

<sup>17</sup> Response to VP/USPS-T30-15 (Tr. 6/2372). Such transportation costs, although small, are likely attributed incorrectly to saturation letters, given the tendency to record DALs as letters unless explicitly instructed to do otherwise.

<sup>18</sup> Response to VP/USPS-T30-13 (Tr. 6/2369); also response to  
(continued...)

1           To the extent that DALs are processed on automated equipment,  
 2 the cost of such processing occurs within MODS cost pools for which  
 3 most or all of the cost is distributed to letters. For instance, costs are  
 4 attributed to saturation letters from the BCS and OCR cost pools (in  
 5 addition to the BCS/DBCS MODS costs pool). All saturation letters are  
 6 required to be barcoded by mailers, whereas no such requirement exists  
 7 for DALs, which may or may not be barcoded. It therefore is easy to  
 8 comprehend why DALs with no barcodes would be processed on BCS or  
 9 OCR equipment, but impossible to comprehend why any pre-barcoded  
 10 saturation letters would be processed on such equipment.<sup>19</sup> If any costs  
 11 incurred to process DALs on automated equipment are being attributed  
 12 to letters, that would create yet another mismatch situation. That is, all  
 13 revenues and volumes arising from DAL mailings are credited to  
 14 saturation flats, while certain costs incurred to process some unknown,  
 15 but possibly large and growing, volume of DALs are being attributed to  
 16 letters.<sup>20</sup>

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<sup>18</sup> (...continued)  
 VP/USPS-T30-16(a-d) (Tr. 6/2373).

<sup>19</sup> When the handling of a DAL is tallied, IOCS procedures call for the information about the accompanying cover to be entered. The IOCS handbook presumes that covers and DALs are physically proximate. But it seems unlikely that pallets of covers would be stored in automated processing areas while DALs are being run on automated equipment.

<sup>20</sup> The additional mismatch problem within Cost Segment 3 did not  
 (continued...)

1 **G. Other Mismatch Data Problems**

2 **1. Letter-shaped pieces over 3.5 ounces.** A mismatch between  
3 revenues and volumes on the one hand, and costs, on the other hand,  
4 also can arise from simple identification errors when recording  
5 information. The result is similar: unit cost is erroneous, and fails to be  
6 a correct measure of marginal cost. One example of such a possible  
7 recording error in ECR mail would occur if costs of **letter-shaped pieces**  
8 **in excess of 3.5 ounces** were attributed to letters. This clearly would be  
9 erroneous, because all pieces in excess of 3.5 ounces pay non-letter  
10 rates, and the revenues and volumes of such pieces are credited  
11 appropriately to non-letters in the RPW system.<sup>21</sup> It is unclear whether  
12 these pieces are always counted as letters. Possible recording errors,  
13 such as that just described, pose an issue of what I would describe as  
14 asymmetrical bias. Namely, it is not difficult to envision a letter-shaped

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<sup>20</sup> (...continued)

occur to Valpak until drafting of interrogatories to the Postal Service. Having been unaware of the problem before, Valpak did not alert the Postal Service to the problem. Consequently, in this docket, the Postal Service does not address this potential mismatch problem, since it offers no correction for any mail processing costs of DALs that may have been mis-attributed to saturation letters, which would require attribution to saturation flats in order to correct any such error.

<sup>21</sup> In TY 2003 of Docket No. R2001-1, approximately 3.7 percent of the total mail processing cost (segment 3.1) and 1.8 percent of in-office carrier cost (segment 6.1) were estimated to arise from such letter-shaped pieces weighing in excess of 3.5 ounces; see Docket No. R2001-1, response of witness Schenk to ADVO/USPS-T43-1.

1 piece that weight more than 3.5 ounces, and which therefore paid non-  
2 letter rates (and was included appropriately in non-letter revenues and  
3 volumes in the RPW system), being recorded in the carrier cost systems  
4 as a letter, which would result in the cost of that piece being attributed  
5 incorrectly to letters. It seems far less likely that a compensating error  
6 would be made by misidentifying a letter-shaped piece under 3.3 ounces  
7 as a flat.

8 **2. Letter-shaped pieces between 3.3 and 3.5 ounces.** A more  
9 ambiguous, and possibly more difficult, case concerns letter-shaped  
10 pieces (both Regular and ECR) that **weigh between 3.3 and 3.5 ounces.**  
11 Since Docket No. 2001-1, such pieces pay (i) a pound rate, plus (ii) the  
12 non-letter piece rate, less the differential between the piece-rated letters  
13 and flats. In essence, such pieces pay the piece rate for letters plus the  
14 pound rate for all excess weight between 3.3 and 3.5 ounces. In the  
15 Billing Determinants, USPS-LR-K-77, for saturation mail the revenues  
16 and volumes of such pieces are recorded as non-letters. In USPS-LR-K-  
17 87, such pieces are recorded as letters, based solely on their shape.<sup>22</sup> It  
18 is not known how such pieces are recorded when they are the subject of  
19 an IOCS tally, nor how such pieces are counted in the city and rural

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<sup>22</sup> See response to VP/USPS-T16-2 (Tr. 7/2841-47), Alternative Attachment B.

1 carrier cost systems. The IOCS may use the recorded weight of these  
2 pieces to count them as **non-letters**, while the two respective carrier  
3 systems record them as **letters** on account of their shape. Again,  
4 revenues and volumes, on the one hand, and costs, on the other, may be  
5 recorded inconsistently.

6 That recording errors, with similar erroneous results, may have  
7 occurred in First-Class Mail with respect to the costs of automation  
8 presort and non-automation presort is acknowledged by witness  
9 Abdirahman (USPS-T-21), who candidly admits that “[b]ased solely on  
10 the physical examination of mail piece characteristics (e.g., barcodes), it  
11 is not always possible for data collectors to determine whether the  
12 revenue of a given mail piece, and the piece itself, was recorded at the  
13 nonautomation or automation rates.”<sup>23</sup>

#### 14 **H. Summary**

15 To sum up the discussion in this part of my testimony, I conclude  
16 the following. First, the Commission should agree with the Postal Service  
17 that costs of DALs have been mis-attributed to saturation letters.

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<sup>23</sup> See response to POIR No. 1a. See responses to VP/USPS-T16-16 (Tr. 7/2875-77, and VP/USPS-T16-17 (Tr. 7/2878-79) for additional examples of possible data entry error.

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1 Second, it should change its cost model so as to remove the costs that  
2 are mis-attributed to saturation letters, and attribute those costs to  
3 saturation flats. Third, when making such a correction, it should adopt  
4 a volume of 4.5 ~~5.4~~ billion DALs, as developed in the Appendix to this  
5 testimony. Fourth, the Commission should assume that 93.87 ~~99~~  
6 percent of all DALs are delivered by city and rural carriers. Fifth, the  
7 Commission should be aware that even after correcting for the  
8 inconsistency created by the way DALs are counted in the city and rural  
9 carrier cost systems, other possible inconsistencies and recording errors  
10 exist that may have mis-attributed costs systematically to saturation  
11 letters instead of flats.

12 As a further suggestion, the ad hoc nature of the procedure used  
13 by the Postal Service to estimate the volume of DALs, combined with the  
14 total lack of any reliable data on the volume of DALs that are DPS'd,  
15 cased, or taken to the street, demonstrates the need to obtain more  
16 accurate data both as regards the annual volume of DALs and the way  
17 DALs are handled. By any reckoning, the volume of DALs is quite  
18 substantial. The Postal Service should be urged to improve its data  
19 systems in this regard.

1           **IV. CITY CARRIER COST OF HANDLING SEQUENCED MAIL**

2           Some of the problems associated with costing of DALs, as  
3           discussed in the preceding section of this testimony, were raised via a  
4           number of interrogatories in Docket No. R2001-1, prior to that case being  
5           settled. This section of my testimony discusses other costing issues, not  
6           heretofore raised, pertaining to saturation mail and city carrier costs.

7           **A. Sequenced Mail: The Extra Bundle Option**

8           The Postal Service has a low-cost option used by city carriers to  
9           handle a limited amount of saturation mail. Such mailings, which  
10          mailers presort by carriers' walk sequence or line of travel, can be  
11          handled as separate, "extra" bundles on the street.<sup>24</sup> Advantages of the  
12          extra-bundle system are explained by witness Lewis (USPS-T-30), who  
13          says "[t]he additional bundles carriers take to the street save a  
14          considerable amount of in-office time."<sup>25</sup> However, this savings of in-  
15          office time also results "in carriers retrieving mail from more sources  
16          when delivering mail on the street"<sup>26</sup> — ergo, higher street costs. In view

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<sup>24</sup> Testimony of witness Lewis, USPS-T-30, at: p. 2, l. 21 to p. 3, l. 16; p. 8, ll. 8-13; p. 9, ll. 10-15; p. 16, ll. 8-9; p. 16, l. 19 to p. 17, l. 12; and p. 18, ll. 12-17.

<sup>25</sup> USPS-T-30, p. 3, ll. 12-13.

<sup>26</sup> USPS-T-30, p. 3, ll. 12-14.

1 of the fact that the option of taking sequenced mail directly to the street  
2 is the preferred handling method that the Postal Service wants city  
3 carriers to use to the maximum extent feasible, savings of in-office time  
4 presumably more than offsets any extra street time. According to  
5 witness Lewis, city carriers are paid by the hour, so,

6 with city carriers we prefer to have work rates  
7 that minimize costs, so we'll take bundles  
8 directly to the street because overall that  
9 reduces the amount of time it takes to finish an  
10 assignment. [Tr. 6/2424.]

11 **1. Cost consequences of the extra bundle option are limited**

12 **to city carriers.** The savings in city carrier cost from the extra-bundle  
13 option raises important issues, discussed below, with regard to  
14 determining the cost of saturation letters and flats. These costing issues  
15 pertain only to city carriers; they do not pertain to rural carriers. For  
16 rural carriers, the volume variable portion of their compensation is based  
17 on a formula which has fixed per-piece rates for various types of pieces.  
18 Consequently, the cost to the Postal Service does not vary with handling  
19 procedures or work method. For any given volume and mix of mail, rural  
20 carriers receive the same pay, regardless of whether they elect to sort any  
21 or all of their sequenced mail in the office, or take such mail directly to

1 their vehicle and handle it as one or more extra bundles on their  
 2 routes.<sup>27</sup>

3       **2. Capacity limitations.** According to witness Lewis, “[w]ork  
 4 rules stipulate that the Postal Service not require carriers serving foot  
 5 routes and park and loop deliveries to work from more than three  
 6 bundles on the street.... When delivering to curblines, centralized, cluster  
 7 box unit (“CBU”), and dismount stops, carriers on motorized routes have  
 8 no restriction on the number of bundles they can take directly to the  
 9 street.”<sup>28</sup> It is possible to quantify the number of (i) foot routes and  
 10 (ii) park and loop routes.<sup>29</sup> However, according to witness Lewis,  
 11               the Postal Service does not maintain statistics  
 12               identifying the routes where on-street work rules  
 13               strictly limit to three the number of bundles  
 14               carriers take directly to the street. Whether or  
 15               not carriers can work from more than three  
 16               bundles when making deliveries on the street is  
 17               a function of the type of deliveries that they are

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<sup>27</sup> Response to VP/USPS-T16-22 (Tr. 7/2893-94).

<sup>28</sup> USPS-T-30, p. 3, ll. 1-10. *See also* Docket No. R2001-1, responses to VP/USPS-T39-4 (Tr. 10-C/3734) and 65 (Tr. 10-C/3784). Since carriers on mounted routes can take more than one additional bundle directly to the route, the term “extra bundle,” rather than “third bundle,” is used here to describe this low-cost option. The vehicles typically used on city carrier routes can accommodate three letter trays; Tr. 6/2422; *see also* Docket No. R2001-1, response to VP/USPS-T39-43 (Tr. 10-C/ 3769).

<sup>29</sup> Foot routes and park and loop routes constituted about 60 percent of all city carrier routes. Responses to VP/USPS-T30-1, 2, and 3 (Tr. 6/2353-55).

1 serving rather than the classification of the route  
2 or whether it has an assigned vehicle.<sup>30</sup>

3 Although some city carriers have no restrictions on the number of  
4 extra bundles that they can take to the street, and some segments of  
5 other routes are not restricted to three bundles, just how many extra  
6 bundles a carrier can handle efficiently on a single day is somewhat  
7 ambiguous. When city carriers have two sequenced mailings for delivery  
8 on a given day, witness Lewis states that,

9 [t]he supervisor of the operation is responsible  
10 for ensuring carriers take the appropriate  
11 number of bundles of mail directly to the street  
12 ... where carriers are delivering to centralized,  
13 cluster box, curblin and dismount deliveries,  
14 they would take both sequenced mailings  
15 directly to the street uncased.<sup>31</sup>  
16

17 Where carriers have routes that preclude them from taking two  
18 extra bundles, "the supervisor would ensure the carriers collated the  
19 mailings together into a third bundle."<sup>32</sup> Since each year a significant  
20 number of saturation mailings are in fact DPS'd, or cased (or collated) by  
21 city carriers, there would seem to be some practical limit to the number  
22 of such mailings that, on any given day, can be handled more efficiently

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<sup>30</sup> Response to VP/USPS-T30-1 (Tr. 6/2353).

<sup>31</sup> Response to VP/USPS-T30-5 (Tr. 6/2357).

<sup>32</sup> Response to VP/USPS-T30-6 (Tr. 6/2358).

1 by taking them directly to the street.<sup>33</sup> At the same time, witness Lewis  
2 “know[s] of no guidance or analysis limiting the number of bundles that  
3 City carriers can work from while on the street.”<sup>34</sup> Even though the limit  
4 may not be well defined, when saturation mailings exceed that limit it  
5 probably is more practical for carriers to sort any additional saturation  
6 mailings at the DDU.

7 The layout of a carrier’s vehicle is an important constraint limiting  
8 the number of bundles from which a carrier can work effectively. Postal  
9 Service vehicles have the most flexibility, because they have space for  
10 three trays near the seat. (Tr. 6/2422, l. 23 to 6/2423, l. 1.) Private  
11 vehicles are more constrained, and the interior layout typically gives the  
12 carrier less flexibility.

13 Further evidence that capacity of the extra-bundle option is  
14 constrained (*i.e.*, does not offer incremental savings when the number of  
15 such bundles is too large) is provided by rural and highway contract  
16 carriers, who “have significant discretion regarding the work methods  
17 they employ.” According to witness Lewis, “[m]any rural and HCR  
18 carriers case both the detached address label and the unaddressed

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<sup>33</sup> The Postal Service estimates that 25.7 percent of all saturation flats are cased, and 63.8 percent of all saturation letters are DPS’d or cased; response to VP/USPS-T16-22 (Tr. 7/2893-94).

<sup>34</sup> Response to VP/USPS-T30-9 (Tr. 6/2362).

1 component of detached address label mailings as a way to minimize the  
2 number of bundles they must work from on the street.”<sup>35</sup>

3           **3. Data Limitations.** The option of taking saturation mail  
4 directly to the street is considered to be sufficiently important to warrant  
5 inclusion as an explicit variable in the regression models for city carrier  
6 costs of witness Bradley (USPS-T-14). Despite rising above this  
7 threshold of significance, however, witness Lewis states that “[t]he Postal  
8 Service does not maintain statistics showing the volume of either letter or  
9 non-letter shaped saturation mail carriers take directly to the street  
10 without casing.”<sup>36</sup> As discussed in more detail elsewhere in this  
11 testimony, the RPW system does not record the volume of DAL mailings,  
12 yet the Piece Count Recording System (“PCRS”) does count DALs  
13 separately,<sup>37</sup> and it includes them in the count of letters. However, when  
14 DALs are cased by carriers, they are recorded as flats. This adds a  
15 further complication to the data problems concerning sequenced mail  
16 (see Section III-G, *supra*), and indicates a need for the Postal Service to  
17 gather more and better data on DALs.

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<sup>35</sup> Response to VP/USPS-T30-26 (Tr. 6/2385-86).

<sup>36</sup> Response to VP/USPS-T30-25 (Tr. 6/2384).

<sup>37</sup> Response to VP/USPS-T30-20 (Tr. 6/2377-78).

1     **B.     City Carrier Priorities for Handling Extra Bundles Strongly**  
 2     **Favor DAL and Addressed Flat Mailings**

3  
 4           Within saturation mail, a hierarchy clearly exists as to which  
 5 mailings receive extra bundle treatment. DALs with unaddressed flats  
 6 (referred to in the DMM as “covers”) virtually always preempt addressed  
 7 flats or letters for extra-bundle status. As the Postal Service itself  
 8 acknowledges, “[t]he Postal Service considers the casing of unaddressed  
 9 flats as wasteful and unnecessary.<sup>38</sup> Consequently, “[u]naddressed flats  
 10 are very rarely cased. On those rare occasions when it does happen, it  
 11 usually involves park and loop and foot routes, and managing the third  
 12 bundle issue.”<sup>39</sup>

13           In the absence of covers with DALs, addressed saturation flats  
 14 always will preempt letters for extra bundle treatment, because it costs  
 15 more to case flats manually than it does to case letters manually.<sup>40</sup> In

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<sup>38</sup> Docket No. R2001-1, responses to VP/USPS-T39-16 (Tr. 10-C/3478) and 42 (Tr. 10-C/3768). If the type of flat that typically accompanies a DAL had to be cased, data providing a reliable indication of what the unit cost would be do not exist; see Docket No. R2001-1, responses to VP/USPS-T39-17 (Tr. 10-C/3749) and 41 (Tr. 10-C/3767).

<sup>39</sup> Docket No. R2001-1, response to VP/USPS-T39-12 (Tr. 10-C/3745). This statement can be interpreted as an implicit acknowledgment that, whenever the volume of covers exceeds the extra-bundle limit, the marginal cost of such mail increases sharply, as discussed in Section C, *infra*.

<sup>40</sup> The minimum rate for carriers to case letters and flats is 18 and 8 pieces per minute, respectively. In Docket No. R90-1, Postal Service witness Shipe, USPS-T-10, introduced evidence that walk-sequenced letters and flats can be cased at rates of 41.2 and 27.4 pieces per minute, respectively. Docket  
 (continued...)

1 general, a saturation letter mailing will become a candidate for the extra-  
2 bundle option only when the DDU has no DAL mailings and no  
3 saturation addressed flat mailings. And even when the DDU has no  
4 saturation flats that could go directly to the street, the supervisor may  
5 deny the lowest-cost treatment to saturation letters just because of the  
6 **contingency** that a mailing of saturation flats may arrive. Tr. 6/2436,  
7 ll. 9-16. Postal Service data confirm the handling hierarchy described  
8 here. It estimates that 74.3 percent of all saturation **flats** are taken  
9 directly to the street (*i.e.*, as “sequenced” mailings described in the  
10 testimony of witness Bradley, USPS-T-14), but only 36.2 percent of all  
11 saturation **letters** are taken directly to the street as extra bundles.<sup>41</sup>

12 Within the universe of saturation flats, when carriers have to select  
13 from two or more mailings one that is to be handled as an extra bundle,  
14 it would be reasonable to expect carriers to take the bundle that contains  
15 noticeably thicker, or heavier pieces, and case the others, so long as both  
16 mailings were addressed or both were covers with DALs.<sup>42</sup>

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<sup>40</sup> (...continued)

No. R2001-1, response to VP/USPS-T39-5 (Tr. 10-C/3735-36). In this docket, witness Shipe’s data are used by witnesses Bradley (USPS-T-14), and Kelley (USPS-T-16), to estimate the volume of sequenced mail that is cased manually.

<sup>41</sup> Response to VP/USPS-T16-22 (Tr. 6/2893-94).

<sup>42</sup> Docket No. R2001-1, response to VP/USPS-T39-60 (Tr. 10-C/3780).

1           The hierarchy described above has important consequences for the  
2 way the costs of affected categories are determined, as discussed below.  
3 When the Postal Service systematically gives high priority to certain  
4 subsets of mail in one rate category, so that those subsets benefit from  
5 an option with low recorded costs, while giving low priority to other  
6 **equally eligible** subsets in other rate categories (and diverting those  
7 subsets to other alternatives with higher recorded costs), the subset(s)  
8 selected for preferred treatment then will appear to have a lower unit cost  
9 than the other subsets, whose access to the extra-bundle option has  
10 been systematically restricted. If all eligible subsets of mail capable of  
11 benefitting from the extra-bundle option were selected on a random  
12 basis, then the cost benefits would be spread randomly amongst all  
13 eligible subsets, but that clearly is not the case.

#### 14   **C. In-Office Cost Issues Posed by the Extra Bundle Option**

15           Stated in somewhat general terms, when the Postal Service has  
16 available a strictly limited, low-cost handling option that, once  
17 exhausted, requires resort to higher-cost alternatives, an important issue  
18 arises with respect to measuring costs for subsets (*i.e.*, rate categories) of  
19 mail that are eligible to use the low-cost option. The importance of  
20 recognizing this capacity limitation cannot be overstated. When a critical

1 limitation on low-cost capacity exists, **the Postal Service cost systems**  
2 **fail to produce estimates of marginal cost.** Importantly, the Postal  
3 Service itself acknowledges that “**Postal Service costing methods do**  
4 **not presuppose persistent processing capacity constraints.**”<sup>43</sup>

5       When capacity is constrained by space or equipment, given  
6 sufficient time the Postal Service can overcome the constraint and  
7 expand capacity. With respect to automated equipment for sorting flats,  
8 it took the Postal Service many years, far longer than the average three-  
9 year interval between rate cases, to overcome the capacity constraint.  
10 Ultimately, however, it did so.

11       With respect to the number of extra bundles that can be handled  
12 more efficiently when taken directly to the street, the constraints are (i)  
13 the average length of a carrier’s arm, (ii) the configuration of the vehicle,  
14 and (iii) contractual constraints. Obviously, the first of these  
15 constraints— arm length— will not change. As to the second constraint,  
16 the interior configuration of Postal Service delivery vehicles appears to be  
17 optimized and no testimony in this case indicates that new vehicle  
18 designs with expanded tray capacity within arm’s reach of the carrier are

---

<sup>43</sup> Response to VP/USPS-T2-15 (Tr.8/\_\_\_). USPS-LR-K-1, Appendix H, discusses the relationship between (i) costs generated by Postal Service costing methods and (ii) economic concepts of volume variable and marginal cost, but it does not point out this important limitation.

1 on the horizon. In theory, the constraint on extra bundles for certain  
2 routes (or route segments) could be changed in any negotiation with the  
3 union. The contract has contained such a constraint for many years,  
4 however, and it would seem imprudent to forecast any such change.  
5 Consequently, the capacity constraint on extra bundles is far more  
6 permanent than any constraint that the Postal Service has ever faced  
7 with respect to automation equipment or space. For saturation mail,  
8 Postal Service costing methods need to change and presuppose  
9 persistent processing capacity constraints.

10 The capacity constraint just described necessarily restricts all  
11 benefits from the low-cost option to a limited portion of eligible mail. All  
12 other eligible mail that might benefit from the low-cost option instead  
13 must be diverted to higher-cost alternatives. Further, since the low-cost  
14 option is limited, it must be rationed.<sup>44</sup> Every mailer that prepares  
15 eligible mail would naturally prefer that its mail be processed using the  
16 low-cost option. It is the Postal Service, of course, that does the  
17 rationing; *i.e.*, it determines which subset(s) of mail will be selected and  
18 subsequently appear to have the lowest cost. Under the circumstances

---

<sup>44</sup> In a competitive market system, the low-cost option would be rationed by assigning it an appropriate scarcity rent, which would then raise the cost of the low-cost option to that of the higher-cost options. In the context of a linear programming model, this scarcity rent would be reflected as a high shadow price on the limited low-cost option. The IOCS is not designed to produce such costs, or take into account such considerations.

1 of a capacity constraint and hierarchical operating procedures described  
 2 here, a number of important issues arise, such as:

- 3 ● Do the costs for each rate category, as measured  
 4 by the IOCS, reflect the “true” marginal cost  
 5 which that subset imposes on the Postal  
 6 Service?
  - 7 ○ Are IOCS costs the most appropriate  
 8 basis for establishing cost-based  
 9 rates within affected rate categories?
  - 10 ○ Do IOCS costs provide a reliable  
 11 basis to guide pricing, marketing  
 12 and internal operating decisions?<sup>45</sup>
- 13 ● Do costs allocated to rate categories of mail on  
 14 the basis of IOCS tallies constitute a fair and  
 15 equitable distribution?

16 The issues posed here raise an important question — namely,  
 17 whether the IOCS is the most appropriate vehicle for “slicing and dicing”  
 18 costs within subsets (*i.e.*, at the rate category level) whenever capacity is  
 19 constrained, and most especially when capacity is permanently  
 20 constrained.

21 **1. The estimate of city carrier in-office costs may be distorted**  
 22 **for individual rate categories of sequenced mail.** Every saturation  
 23 mailing is presorted by line of travel or walk sequence, and therefore

---

<sup>45</sup> The advent of negotiated service agreements (“NSAs”) increases the importance of accurate marginal costs for each rate category, since major mailers who are most likely to become recipients of an NSA often enter much of their mail in a single rate category.

1 qualifies for extra bundle delivery, regardless of whether the mailing  
2 consists of letters, addressed flats, flats/covers with DALs, or parcels  
3 with DALs.

4           When carriers take saturation mailings directly to their vehicles as  
5 an extra bundle, the likelihood that carriers will be sampled by the IOCS  
6 while handling such mailings is greatly reduced, to the point of being  
7 minimal. Further, if carriers use any kind of rolling equipment (*e.g.*, a  
8 cart or hamper) to take mail from inside the office to their parked  
9 vehicles, any IOCS tally taken during this operation likely would be  
10 recorded as a “mixed mail” tally, not as handling sequenced mail. Thus,  
11 for those mailings that carriers handle as extra bundles, the Postal  
12 Service will attribute little or no in-office cost, because the mailing is  
13 handled only briefly, and in bulk, not as individual pieces. The  
14 distribution of city carrier direct costs is shown in Table 1, columns 4-6.  
15 Any costs attributed to mail taken directly to the street would be part of  
16 “Other” (column 5), which also includes tallies for clocking in and out,  
17 obtaining mail or keys, loading and unloading vehicle, attending a safety  
18 meeting, training, break and personal needs and moving empty  
19 equipment.<sup>46</sup> The fact that the percentage of “Other” costs for flats  
20 (10.6%) is greater than for letters (7.0%) is consistent with the fact that

---

<sup>46</sup> Response to VP/USPS-T16-23(d) (Tr. 7/2895-96)

1 74 percent of all saturation flats are taken directly to the street, whereas  
 2 only 36 percent of all letters are taken directly to the street.<sup>47</sup>

---

4 **Table 1**

5 **In-Office Direct Costs for Saturation Letters and Flats**  
 6 **BY 2004**

	-----Cost (\$,000) -----			-----Distribution (%) -----		
	Casing (1)	Other (2)	Total (3)	Casing (4)	Other (5)	Total (6)
10 Letters	25,600	1,925	27,525	93.0	7.0	100.0
11 Flats	28,573	3,399	31,972	89.4	10.6	100.0

12 Source: Responses to VP/USPS-T16-21 and 24 (Tr. 7/2889-92 and Tr. 7/2897,  
 13 respectively).

---

15 Among qualified candidates for the extra-bundle option, the  
 16 hierarchical procedure described above clearly gives lowest priority to  
 17 saturation letters, which means that this option frequently is denied to  
 18 saturation letters.<sup>48</sup> At the same time, saturation covers accompanied by  
 19 DALs, which generally would be among the most expensive saturation  
 20 mail to process if cased, instead will appear to have the lowest in-office  
 21 unit cost when estimated solely on the basis of IOCS tallies. In other  
 22 words, the extra bundle option helps not only to reduce costs for the

---

<sup>47</sup> A resulting trade-off for lower in-office costs may, of course, be higher street costs.

<sup>48</sup> See Docket No. R2001-1, responses to VP/USPS-T39-8(b-c) (Tr. 10-C/3739-41) and 55 (Tr. 10-C/3773-74).

1 subclass as a whole, it also **results in an appearance of the lowest**  
2 **average mail processing cost** for the particular subset (*i.e.*, rate  
3 category) of mail that is selected to receive such handling. One obvious  
4 result of this handling hierarchy is to reduce the letter-flat difference  
5 below what it otherwise would have been.<sup>49</sup>

6 The cost to process letter-shaped mail is generally thought to be  
7 less than the cost to process flat-shaped mail. For example, the  
8 traditional sorting standard was 18 and 8 pieces per minute for letters  
9 and flats, respectively. And when both letters and flats are sorted to  
10 carriers' line of travel, witness Shipe, in Docket No. R90-1, found that  
11 they could be sorted, respectively, at a rate of 41.2 and 27.4 pieces per  
12 minute.<sup>50</sup> For saturation mail that is actually cased, the unit cost for  
13 flats, \$0.0209, is about \$0.0069, or 50 percent greater than the unit  
14 costs for letters, \$0.0140, as shown in Table 2, column 3.<sup>51</sup>

---

<sup>49</sup> The letter-flat difference is an issue of particular concern in this testimony, especially the differential for saturation letters and flats. It also is worth noting that when the combination of a capacity constraint and the costing system reduces the apparent cost of flats while increasing the apparent cost of Saturation letters, other differences in the presort tree also are distorted. For instance, the difference between Basic Automation letters and saturation letters will be reduced, while the difference between Basic flats and saturation flats will be increased.

<sup>50</sup> This is the most recent study of casing rates and costs; response to VP/USPS-T30-27 (Tr. 6/2387).

<sup>51</sup> These are direct costs only. The absolute difference will increase when indirect costs are included.

1

2

Table 2

3

**Direct Casing Costs for Saturation Letters and Flats  
BY 2004**

4

	(1) Casing Costs (000)	(2) Volume Cased (000)	(3) Unit Cost
5			
6			
7			
8			
9	Letters	25,600	1,833,667
10	Flats	28,573	1,366,096
			0.0140
			0.0209

11

Sources: Column 1, response to VP/USPS-T16-21 and 24 (Tr. 7/2889-92 and Tr. 7/2897, respectively).

12

Column 2, response to VP/USPS-T16-25 (Tr. 7/2898-99).

13

14

15

Despite the fact that letters can be cased at a lower costs than

16

flats, witness Kelley finds that the **average** city carrier in-office cost for

17

**all** saturation flats and letters is, respectively, \$0.0053 and \$0.0121.<sup>52</sup>

18

He thus finds that the **average** in-office cost for saturation letters is more

19

than twice the cost of flats. This average reflects the much greater

20

proportion of flats that bypass casing altogether. On the surface, this

21

result appears anomalous, but with understanding from the preceding

22

discussion, it is perhaps an understandable result from the combination

23

of circumstances described here.

24

**2. Estimates of in-office cost for individual rate categories of**

25

**saturation mail are not marginal.** As discussed above, prioritizing use

26

of the limited low-cost option to those non-letter mailings that are the

<sup>52</sup> Response to VP/USPS-T16-38(a) (Tr. 7/2915-18).

1 most expensive for carriers to sort can result in a low **average cost**.  
2 Interpreting the average cost as equal to **marginal** cost then gives the  
3 false impression that an incremental volume of those mailings will cause  
4 the Postal Service to incur little or no in-office costs.<sup>53</sup> Any such  
5 impression, however, is likely to be erroneous, because capacity of the  
6 low-cost option is strictly limited.<sup>54</sup>

7       What must be recognized is that giving higher-cost non-letter mail  
8 priority access to low-cost handling often preempts such handling by  
9 saturation letter mail, which otherwise also could have benefitted from  
10 the low-cost option. On those occasions when non-letter mailings have  
11 used up the capacity of the low-cost option, any additional non-letter

---

<sup>53</sup> A similar result obtains when using costs developed from the IOCS to study the weight-cost relationship of ECR mail. When carriers have more than one saturation mailing of flats, they virtually always will prefer to take heavier weight pieces to the street before other eligible lighter weight pieces, at least if there exists a noticeable difference in weight. Consequently, the hierarchical handling procedure also is tilted strongly toward using the low-cost option for heavier-weight pieces, while denying the lowest-cost option to lighter-weight pieces, and forcing them to use higher-cost options. The resulting lack of tallies for heavier weight pieces can make it appear that lighter weight pieces cost more than heavier weight pieces. Such a result can be described aptly as anomalous, counter-intuitive, or downright nonsensical. The result is caused by the combination of a capacity constraint coupled with a cost system that is inappropriate for such circumstances. See cross-examination of witness Shaw (USPS-T-2) at Tr. 5/1259-1267.

<sup>54</sup> The Postal Service seemingly has no way to measure or estimate whether, on average, it has any unutilized capacity to carry extra bundles. Not only is the capacity undefined and unmeasured, but also “[t]he Postal Service does not maintain statistics showing the volume of either letter or non-letter shaped saturation mail carriers take directly to the street without casing.” Response to VP/USPS-T30-25 (Tr. 7/2898-99).

1 saturation mailings will then have to incur the cost of manual in-office  
2 sortation or collation; *i.e.*, the unit cost shown in Table 2. Thus, at the  
3 point where the constrained capacity is fully utilized, the marginal cost  
4 curve rises sharply and the marginal in-office cost of additional  
5 saturation non-letter mailings would exceed by a considerable amount  
6 the average cost as estimated by the IOCS sampling system.

7       In any situation where saturation letter mailings would have been  
8 handled by the low-cost option but for priority having been given to an  
9 additional saturation non-letter mailings — *i.e.*, where non-letter mailings  
10 “bump” or pre-empt letter mailings — the cost of sorting letters will  
11 appear to have increased and be higher than it would be had the Postal  
12 Service given the letter mailing the low-cost extra-bundle option (which  
13 bypasses DPSing and manual sortation). The non-letter mailing will  
14 appear to have a cost lower than the letters which it pre-empted. In  
15 other words, the average cost for **letters** (as measured by the IOCS) is  
16 **higher** than it otherwise would have been, while the average cost for  
17 **non-letters** (as measured by the IOCS) is **lower** than it otherwise would  
18 have been. Significantly, the resulting **average costs cannot be relied**  
19 **upon to represent the marginal cost** of either saturation letters or non-  
20 letters. The marginal cost from additional saturation mailings is the

1 change in the Postal Service's total cost caused by the additional  
2 volume.<sup>55</sup>

3 Under the circumstance where capacity of the low-cost option has  
4 been reached (as described here), and saturation non-letters bump  
5 letters, the change in total mail processing cost from additional  
6 saturation non-letter mailings would be (i) the additional in-office cost of  
7 handling the non-letter mailing using the low-cost extra-bundle option,  
8 **plus** (ii) the additional in-office cost of sorting the "bumped" saturation  
9 letters using the lowest-cost option available (*e.g.*, either by DPSing or  
10 manual sortation) in lieu of the low-cost option. In other words, the  
11 **marginal cost includes the full amount of the high-cost option** that  
12 must be used.<sup>56</sup> Witness Bozzo (USPS-T-12) concurs. Tr. 5/1561, ll. 14-  
13 22. In general terms, when a "joint" capacity for handling either X or Y is  
14 constrained, the marginal cost of handling any given volume of X (*e.g.*,  
15 saturation letters) depends not only on the volume of X, but also on the  
16 volume of Y (*e.g.*, saturation non-letters).

17 To sum up this discussion about the marginal costs of city carrier  
18 in-office activity, the net result of the capacity constraint, coupled with

---

<sup>55</sup> Response to VP/USPS-T12-1 (Tr. 5/1492).

<sup>56</sup> Here the additional cost includes the cost of sorting letters. If a saturation mailing with DALs were to bump a mailing of addressed flats, the additional cost of the DAL mailing would include the cost of sorting the addressed flats.

1 the handling hierarchy described above, is that the existing cost  
2 measurement system can (i) result in the most expensive-to-handle non-  
3 letters appearing to have the least cost, (ii) introduce an upward bias to  
4 estimated marginal cost of the least expensive-to-handle pieces, and (iii)  
5 distort the cost difference between the two.

6 **D. Hypothetical Illustrations Showing the Effect of Capacity-**  
7 **constrained Low-Cost Options on Cost Estimation**

8 A hypothetical example can help illustrate the issue. First,  
9 suppose that within saturation mail the Postal Service developed  
10 separate in-office cost estimates for casing (i) letters, (ii) addressed flats,  
11 (iii) unaddressed covers with DALs, and (iv) parcels.

12 Second, assume that whenever carriers sort letters, addressed  
13 flats, and covers with DALs, the in-office cost is, respectively, 1.0, 2.0  
14 and 3.0 cents per piece.<sup>57</sup> Any of these, when entered as a sequenced  
15 saturation mailing, can be taken on the route as an extra bundle, and  
16 little or no in-office cost will be incurred or attributed by the IOCS,  
17 because the brief in-office handling of the extra bundle will be tallied  
18 rarely, if ever.

---

<sup>57</sup> Parcels are mentioned here because the Postal Service does develop separate costs for parcels. In the remainder of the discussion, however, they are ignored because the total volume of ECR parcels is so low as to indicate that saturation mailings of parcels have become somewhat rare and inconsequential.

1           Third, assume that whenever covers are taken directly to the route,  
2 the pre-sequenced DALs also are taken directly to the route, with no in-  
3 office sortation (note that this sometimes occurs, but not always).

4           Fourth, to keep this hypothetical simple, assume that only one  
5 sequenced mailing can be taken as an extra bundle.

6           Fifth, to handle one extra-bundle piece on the street costs an  
7 additional 0.25 cents over the cost of pieces cased or DPS'd. This means  
8 that (i) the in-office savings from extra-bundle treatment more than  
9 offsets the additional street time cost, regardless of which type of mail is  
10 taken to the street, and (ii) the procedure that minimizes mail processing  
11 cost also will minimize total cost.

12           On a particular day, assume that a carrier has three saturation  
13 mailings for delivery, one of each type. From an operations perspective,  
14 it would be mismanagement, to the point of being downright frivolous,  
15 not to obtain a gross savings of 3.0 cents by taking the covers with DALs  
16 as the third bundle. This would minimize total costs for the Postal  
17 Service, and it also would minimize costs for the subclass as a whole. At  
18 the same time, it would be foolish to the point of wilful self-deception to  
19 pretend that the covers and DALs, which are the most expensive to sort  
20 under this hypothetical, instead are the least expensive to process,  
21 simply because of the way the IOCS tallies and records costs.

1           When estimating costs for individual subsets within the subclass,  
2 the capacity limitation on the low-cost option requires that other  
3 considerations be into account. For example, it is assumed here that the  
4 carrier also had a saturation mailing of addressed flats which could have  
5 been the extra bundle. Hence, in order for the Postal Service to realize  
6 the 3.0 cents per-piece savings from not sorting the DAL mailing, it must  
7 forgo a potential 2.0 cents per-piece savings from not sorting the mailing  
8 of addressed flats. (Such foregone savings are referred to by economists  
9 as opportunity costs.)

10           As a variation within this hypothetical, suppose that on some  
11 particular day a carrier had only two saturation mailings, one of letters  
12 and one of addressed flats. In this case, it would be wrong not to save  
13 2.0 cents per piece by taking the addressed flat mailing as the extra  
14 bundle. As before, however, it would be equally wrong to pretend that  
15 the addressed flats cost less to process than letters simply because they  
16 are not tallied. Whenever carriers have more saturation mailings to  
17 deliver on one day than can be accommodated with the “extra bundle”  
18 method, an opportunity cost is involved. Namely, those mailings not  
19 taken as an extra bundle will have to be sorted (or collated) before leaving  
20 the DDU. These mailings are far more likely to be the subject of an IOCS

1 sample, and the cost of sorting those mailings will show up explicitly in  
2 estimated costs.

3 Or consider yet another variant of this hypothetical. Assume that,  
4 on a particular day, a carrier has three saturation mailings for delivery:  
5 two are addressed flats, and one is letters. If one of the addressed flat  
6 mailings is carried as an extra bundle, it will not be the subject of an  
7 IOCS tally, hence, for all practical purposes, its in-office mail processing  
8 cost will appear to be zero. At the same time, the second flat mailing,  
9 which must be sorted manually, would show up under the IOCS as  
10 having an in-office cost of 2.0 cents per piece. Under the circumstances  
11 here, the **average** in-office cost of the two flat mailings is, of course,  
12 equal to 1.0 cent, which is equal to the cost of sorting the letter mailing.  
13 This “outcome” from the IOCS does **not** mean that the **marginal cost** of  
14 sorting **flats** is equal to the **marginal cost** of sorting **letters**. Any such  
15 inference would be wrong and misleading. Thus, great care must be  
16 taken with regard to inferences drawn from IOCS data when capacity  
17 constraints impose different operating procedures and result in certain  
18 subsets not having the same probability of being sampled.

19 The purpose of a hypothetical is to simplify things in a way that  
20 helps illustrate essential points. The real world, of course, is more  
21 complex than the hypothetical. When saturation letters are not taken as

1 the extra bundle, they can be cased manually by carriers or, at many  
2 facilities, they can be sorted into delivery point sequence using  
3 automation equipment. When the covers accompanied by DALs are  
4 taken as a third bundle on foot routes or park and loop routes, the DALs  
5 may need to be cased manually, whereas, when carriers on mounted  
6 routes use the extra bundle option, they also may load the DALs directly  
7 into an extra letter tray in their vehicles without any in-office casing.  
8 Such added complexities should not obscure the fact that marginal cost  
9 estimates can be badly skewed when one rate category of mail  
10 systematically receives preferential access to a capacity-constrained low-  
11 cost option.

12 **E. Estimating City Carrier Street Costs (Cost Segment 7) of**  
13 **Handling Sequenced Mail**

14 Prior to this docket, the only study specifically concerned with the  
15 cost of handling and delivering any sequenced mail was that of witness  
16 Acheson, USPS-RT-1, in Docket No. C87-1. That study was limited to  
17 comparing the cost of (i) unaddressed flats with DALs to (ii) addressed  
18 flats.<sup>58</sup> The cost of handling sequenced letter-shaped mailings was not

---

<sup>58</sup> Witness Acheson also compared the cost of handling DALs and addressed flats when neither was sequenced. Mailer sequencing is now required for both, hence that portion of his study is not applicable to today's saturation mail.

1 examined by witness Acheson, hence that study has no relevance to the  
2 cost of handling sequenced letters, or to the letter-flat cost difference.

3 In his study, witness Acheson found significant in-office benefits,  
4 in the form of time savings, from either (i) casing DALs in lieu of the  
5 accompanying flat-shaped mail pieces, or (ii) not casing the DALs at all,  
6 and instead taking sequenced DALs to the street as a third bundle. On  
7 routes with curblines or centralized delivery, the in-office benefits were  
8 offset by higher street costs on account of having to combine the  
9 unaddressed flat with regular flats after reaching the delivery point. On  
10 foot routes and park and loop routes, carriers were able to select mail  
11 from the extra bundle while traveling between delivery points and  
12 without incurring any additional street time, hence on these routes the  
13 Postal Service realized a net savings.

14 In this docket, witness Bradley (USPS-T-14) presents a new study  
15 of city carrier street time. In that study, he includes specific variables in  
16 his regression equations for sequenced mail delivered by carriers. This  
17 enables an estimate of the total street cost of handling sequenced mail,  
18 which includes letters, addressed and unaddressed flats, and DALs.  
19 That cost, then, needs to be allocated between letters and flats, with the  
20 costs attributable to DALs included in flats. Once the costs have been so  
21 allocated, the unit cost of delivering sequenced letters and flats can be

1 determined by dividing costs by the respective volumes of letters and  
 2 flats (including DALs) that bypass casing and are taken directly to the  
 3 street.<sup>59</sup> The resulting unit costs are shown in Table 3, Column 3.

4  
 5 **Table 3**  
 6 **City Carrier Street Costs of Saturation ECR Mail Taken Directly to the Street**  
 7 **BY 2004**

	(1) Volume Taken to Street (000)	(2) Direct Costs for "Sequenced" Mail (\$, 000)	(3) Unit Cost
8 Letters	1,863,243	11,400	0.0061
9 Flats	3,949,453	75,900	0.0192

10 Sources: Column 1, response to VP/USPS-T16-25 (Tr. 7/2898-99).  
 11 Column 2, response to VP/USPS-T16-21 (Tr. 7/2889-92).  
 12  
 13  
 14

15  
 16  
 17  
 18 **F. Using Marginal Costs to Determine the Cost of Sequenced Mail**

19 **1. A form of standard costs is used for rural carriers.** The

20 procedure for determining volume variable rural carrier costs, discussed  
 21 previously, is based on standardized payments specified in the union  
 22 contract with rural carriers. The unit cost neither depends on, nor  
 23 reflects, the priority that rural carriers give to one rate category versus  
 24 another, or work methods of rural carriers. Whether rural carriers sort

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<sup>59</sup> Response to VP/USPS-T16-21 (Tr. 7/2889-92).

1 sequenced mail in the office, or take it out as extra bundles, affects  
2 neither attributable cost, nor average unit cost, nor marginal cost. Nor  
3 do the standardized payments to rural carriers contain or reflect any  
4 capacity constraints.

5         Development of rural carrier volume variable costs requires neither  
6 regression analysis nor any other form of econometric analysis. In  
7 comparison to the city carrier cost system, the procedure is relatively  
8 simple and straightforward. The only “sample” involved is the mail  
9 count. The basic requirement to achieve consistency, and avoid a  
10 mismatch problem, is that mail be counted and recorded accurately vis-  
11 a-vis the way revenues and volumes are recorded. That is, cost data  
12 need to be attributed in a manner that is consistent with revenue and  
13 volume data. When standardized payments are used, as they are in the  
14 rural carrier cost system, cost relationships, including the letter-flat  
15 difference, reasonably can be expected to remain fairly constant over  
16 time.

17         **2. The Commission has confronted the special treatment of**  
18 **extra bundles on at least one prior occasion.** This case is not the first  
19 time the Commission has been confronted with the letter/flat cost issue  
20 raised by saturation mail that has been presorted in a manner that  
21 enables it to be taken directly to the street as an extra bundle. In Docket

1 No. R90-1, several years before the saturation subclass was created, the  
 2 Commission dealt with the issue as follows.

3           However, for the saturation letter/flat  
 4 differential, we recommend applying the 50  
 5 percent passthrough to only the portion of the  
 6 differential representing the street time cost. Of  
 7 the factors Crowder identified, we believe only  
 8 the third bundle problem and the centralized  
 9 delivery problem bear directly on the letter/flat  
 10 differential for saturation mail. Based on the  
 11 record, we cannot estimate what proportion of  
 12 saturation mail volume is carried in third  
 13 bundles nor can we estimate the effects of  
 14 saturation mail on centralized delivery.  
 15 Adhering to our traditional approach, we  
 16 conservatively assume for this case that all  
 17 saturation mail is handled in third bundles and  
 18 thus avoids in-office casing. For this reason, we  
 19 exclude the in-office cost from the letter/flat  
 20 differential.<sup>60</sup>

21           **3. The Commission used modeled costs in Docket No. MC95-1**  
 22 **to deal with cost issues raised by the extra bundle handling**  
 23 **procedure.** Instead of using costs based on IOCS samples to estimate  
 24 city carrier costs of rate categories within a subclass, an alternative  
 25 method is to use modeled costs, as was done in Docket No. MC95-1. Use  
 26 of modeled costs is more complex, and requires more data than the  
 27 standard costs used for rural carriers. Significantly, under the modeling  
 28 approach used in Docket No. MC95-1, **no eligible subset of mail was**

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<sup>60</sup> Docket No. R90-1, *Op. & Rec. Dec.*, p. V-244, para. 5965.

1 **assumed to receive preferential access to capacity-constrained, low-**  
2 **cost options.** This put eligible rate categories (*i.e.*, ECR saturation  
3 letters and flats) on an equal footing with regard to extra bundle  
4 treatment.

5 Rate differentials, such as the letter-flat differential, were  
6 maintained and did not vary with the particular subset given preferential  
7 access to the limited capacity, low-cost option. To the extent that use of  
8 the low-cost option resulted in lower subclass costs, the adjustment to  
9 Cost and Revenue Analysis (“CRA”) costs was reduced, and all eligible  
10 subsets and rate categories participated ratably in the reduced  
11 adjustment. That resulted in non-discriminatory, fair and equitable  
12 costs for each rate category. It also reflected relative costs of individual  
13 rate categories better than costs developed via the IOCS. The use of  
14 modeled costs also resulted in a substantial letter-flat cost difference  
15 (1.36 cents at the Basic level; 0.63 cents at the saturation level).<sup>61</sup>

16 As discussed previously, handling priority for the low-cost extra-  
17 bundle option favors pieces that generally are the most difficult and  
18 expensive to handle, with the result that the mail handled under the low-  
19 cost option essentially escapes being sampled by the IOCS.

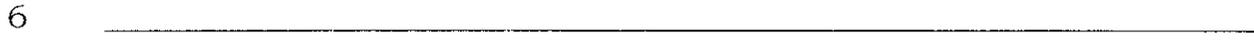
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<sup>61</sup> Docket No. MC95-1, *Op. & Rec. Dec.*, p. V-265. Subsequently, after reclassification, the Postal Service reverted to using the IOCS to determine costs of rate categories, and the letter-flat difference has not only diminished, but has also shown substantial volatility.

1 Consequently, increasing the sample size would not solve the issue of  
2 how to estimate properly the marginal costs of (i) the subset of mail that  
3 systematically is exempted from in-office handling, and (ii) other eligible  
4 mail with more limited access to the low-cost option. Nor is it clear that  
5 any sampling system could be designed that would result in a reliable,  
6 fair and equitable allocation of costs when costs are interdependent by  
7 virtue of being eligible candidates for a capacity-constrained, low-cost  
8 option. Use of modeled costs at the rate category level, adjusted to reflect  
9 aggregate subclass costs as determined by the IOCS, and within the  
10 context of the CRA, would appear to be one way out of the impasse.

11 **4. In this docket, the Commission should use marginal costs**  
12 **to establish the letter-flat cost difference.** In the absence of an  
13 entirely new and better way to estimate marginal costs and the letter/flat  
14 cost difference, for in-office city carrier costs, it is recommended to treat  
15 the unit costs in Table 2 as marginal in-office costs in BY 2004. The unit  
16 costs shown in Table 3 are city carrier street time costs for the limited  
17 low-cost option, hence it would not be appropriate to use these as  
18 marginal costs. For city carrier street time, the marginal cost would be  
19 the unit cost for **regular** delivery of letters and flats, \$0.0181 and

1 \$0.0193 respectively.<sup>62</sup> These costs are summarized in Table 4. The  
 2 difference in direct cost between letters and flats is \$0.0081. Adjusting  
 3 direct costs to include indirect piggybacked costs will increase the  
 4 difference slightly. Total delivery costs will of course be a weighted  
 5 average of city and rural carrier costs.



7 **Table 4**  
 8 **Marginal City Carrier Direct Costs for Saturation ECR Mail**  
 9 **BY 2004**

	(1)	(2)	(3)
	In-Office	Street	
	Costs	Costs	Total
13 Letters	0.0140	0.0181	0.0321
14 Flats	0.0209	0.0193	0.0402
15 Difference	0.0069	0.0012	0.0081
17 Sources:	Column 1, see Table 2, <i>supra</i> .		
18	Column 2, USPS-LR-K-67, file LR-K-67_2nd.revised.xls,		
19	worksheet 21. ECR Unit Costs FY04		



21 **G. Summary**

22 All saturation mailers would like to have the Postal Service always  
 23 deliver their mail using the lowest cost option of taking the mail directly  
 24 to the street, since their mail is prepared in carriers' walk sequence. If  
 25 the Postal Service were able to oblige, the low **average** cost of saturation

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<sup>62</sup> USPS-LR-K-67, file LR-K-67, worksheet 21. ECR Unit Costs FY04.

1 mail would be even lower, and the marginal cost would be equal to the  
2 average cost.

3 Postal Service costing methods for saturation mail are premised on  
4 the incorrect presupposition that persistent capacity constraints do not  
5 exist for the extra bundle option used by city carriers. Clearly, such  
6 constraints do exist, because no saturation mail would be cased or DPS'd  
7 if extra-bundle capacity were not constrained. In consequence thereof,  
8 Postal Service costing methods distort the estimated marginal cost of  
9 saturation letters and flats. In turn, the letter-flat cost difference is  
10 distorted, as are the differences between (i) Basic Automation and  
11 saturation letters, and (ii) Basic and saturation flats.

12 To correct for the distortion caused by the capacity constraint, the  
13 Commission should rely on marginal costs for individual rate  
14 subcategories.

## Appendix A

### Estimating the Number of DALs

#### Introduction

In Docket No. R2005-1, the Postal Service has given explicit recognition to the following set of facts: (i) DALs are handled separately at various points in the postal network; (ii) each such handling incurs a cost; (iii) the Postal Service's aggregate costs obviously reflect all such handling costs; (iv) the Postal Service's systems used to develop the cost of individual rate categories capture this cost; (v) at each point where the costs of handling DALs are captured, they routinely are attributed to letters, even though all revenues and volumes of DAL mailings are credited to flats, and the result is a mismatch, or inconsistency, of data between costs, revenues and volumes; (vi) a correction for the mismatch needs to be made — namely, **deduct** all the costs of DALs mis-attributed to saturation **letters**, and **add** those costs to saturation **flats**; and (vii) in order to make such a correction, the Postal Service requires an estimate of the annual volume of DALs, because none of its data systems identify, much less record, the volume of DAL mailings separately.

In consequence of the foregoing, in this docket, for the first time, the Postal Service has developed a procedure to estimate of the annual volume of DALs. As explained elsewhere in this testimony, explicit

1 recognition of the cost of DALs is long overdue. This Appendix has two  
2 purposes: (i) to assess the Postal Service's procedure and its resulting  
3 estimate of the total volume of DALs, and (ii) to develop an alternative  
4 estimate using publicly available data considered to be more  
5 authoritative and reliable than the source used by the Postal Service. By  
6 way of overview, the Postal Service's estimate is, at best, conservatively  
7 low, and other evidence offered here indicates that it substantially  
8 underestimates the total volume.

### 9 **Postal Service Methodology**

10 The Postal Service's estimate of the number of DALs is developed in  
11 library reference USPS-LR-K-67, sponsored by witness Kelley (USPS-T-  
12 16). The procedure is as follows. First, the number of possible  
13 residential and business delivery points (including P. O. Boxes) as of  
14 September 30, 2004 is obtained. Second, the number of DALs received  
15 per week per delivery point is estimated on the basis of data from the  
16 2004 Household Diary Survey (discussed below). Third, to estimate the  
17 annual volume delivered to residences, the estimate of DALs received per  
18 week is multiplied by (i) the number of residential delivery points, and  
19 (ii) 52 weeks.

1           For business deliveries, a procedure generally similar to that  
2 described above is followed, but only for business delivery points on rural  
3 and contract highway routes. The reason for including these business  
4 delivery points is because saturation rural mailings that use a simplified  
5 address format are required to send a piece to every delivery point,  
6 including all businesses. Neither the 7,185,300 businesses on city  
7 routes, nor any of the 4,321,862 post office boxes are assumed to be  
8 recipients of any DALs because, according to witness Kelley:<sup>63</sup>

9           My understanding is that DAL mailings going to 100% of all  
10 possible rural-route residential and business delivery points  
11 are the only mailings among all city and rural Saturation  
12 DAL mailings that include business delivery points.<sup>64</sup>

13           When computing the annual volume of DALs for rural and highway  
14 contract business points, witness Kelley uses the same basic procedure  
15 described above, but with one significant change. He reduces the  
16 frequency of DAL mailings to businesses on these routes. The figure of  
17 6,248(000) shown in Table A-1 represents an 80 percent reduction in the  
18 number of DALs delivered to businesses on rural routes, and a 90

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<sup>63</sup> Response to VP/USPS-T16-10 (Tr. 7/2866-68).

<sup>64</sup> The Form 10-K of a major mailer of DALs, Harte-Hanks, states that it delivers to **every business** and residence in the parts of California that it covers. As Harte-Hanks is a major mailer covering much of California, this statement alone indicates that some businesses on city routes probably receive DALs, contrary to witness Kelley's assumption. Since The Household Diary Survey does not cover businesses, no recipient data are available that would either refute or support the statement by witness Kelley.

1 percent reduction in the number of DALs delivered to businesses on  
2 highway contract routes. Although witness Kelley offers no explanation  
3 for this reduction, it presumably reflects the small and shrinking number  
4 of delivery points to which simplified addresses are applicable, on  
5 account of the switch to numbered street addresses to facilitate  
6 responses to 911 emergency telephone calls.

7 The Postal Service's estimating procedure is summarized below in  
8 Table A-1. As shown there, the Postal Service estimates the total annual  
9 volume of DALs at 3.375 billion.

Table A-1

## Postal Service Estimate of Annual Volume of DALs

	Sept 30, 2004 Number of Possible Deliveries (000)	Estimated FY04 DAL Mailings/week Per Delivery Point	Estimated FY04 DAL Mailings/Year (000)
<b>Residential Delivery Points:</b>			
1. City	77,967.046	0.50	2,027,143
2. Rural	33,817.615	0.50	879,258
3. P. O. Box	15,634.610	0.50	406,500
4. Highway Contract	<u>2,162.772</u>	0.50	<u>56,232</u>
5. Total Residential	129,582.043		3,369,133
<b>Business Delivery Points:</b>			
6. City	7,165.300		
7. Rural	1,172.499		6,097
8. P. O. Box	4,321.862		
9. Highway Contract	<u>58.084</u>		<u>151</u>
10. Total Business	12,737.745		<u>6,248</u>
<b>TOTAL ANNUAL VOLUME OF DALs</b>			<b>3,375,381</b>

Source: USPS-LR-K-67, file FY2004.DAL.MAILING.VOLUME.ESTIMATED.WithFootnotes.xls, Attachment B, Annual Delivery Points.

Revised 8/23/05

1           Having estimated the total volume of DALs shown in Table A-1,  
2           witness Kelley then extrapolates from his estimating procedure to  
3           assume that only 2,912.5 million of the total 3,375.4 million DALs — or  
4           86.3 percent — are delivered by city and rural carriers.<sup>65</sup> The remaining  
5           462.9 million — or 13.7 percent — are assumed to be delivered to P.O.  
6           Boxes (which are serviced by clerks) or by highway contract carriers.  
7           Apparently relying on this assumption, witness Kelley deducts the costs  
8           of 2,912.5 million DALs attributed to letters, and he attributes those  
9           costs to flats.<sup>66</sup>

10           In order to assess witness Kelley's assumption with regard to the  
11           volume of DALs delivered to P.O. Boxes, Valpak was asked to determine  
12           how many saturation letters ~~DALs~~ it mailed to P.O. Boxes. As described  
13           in Section II of this testimony, Valpak is a major user of saturation mail.  
14           Although Valpak uses only letter-shaped mail, its mailing lists and its  
15           mailing practices are thought to be representative of saturation mailers  
16           generally. For a recent month, May, 2005, Valpak determined that less  
17           than 1.0 percent of its mail (0.77 percent) was sent to P.O. Boxes.  
18           Valpak

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<sup>65</sup> USPS-LR-K-67 87, file  
FY2004.DAL.MAILING.VOLUME.ESTIMATES.xls.

<sup>66</sup> Neither witness Kelley's testimony nor his library reference  
provides any rationale for reducing the volume of DALs used to correct the  
costs mis-attributed to letters.

- 1 considers its mailings in May, including the percent to P.O. Boxes, to be
- 2 typical of the entire year.

1 **The Household Diary Survey**

2 **Detached labels.** One item that respondents to the Household  
 3 Diary Survey are asked to report is “detached label.” Quarterly results of  
 4 the surveys for FY 1987 and FY 1999-2003 are shown in Table A-2. As  
 5 shown there, the yearly average for FY 2003 was 0.50 detached labels  
 6 per week.

7 Table A-2

8 **Detached Labels in Household Diary Survey**  
 9 (Pieces per Household Per Week)

	<b>FY 1987</b>	<b>FY 1999</b>	<b>FY 2000</b>	<b>FY 2001(a)</b>	<b>FY 2001(b)</b>	<b>FY 2002</b>	<b>FY 2003</b>
10 Quarter 1	0.6	0.6	0.2	0.1	0.3	0.6	0.5
11 Quarter 2	0.5	0.5	0.2	0.1	0.3	0.5	0.5
12 Quarter 3	0.7	0.7	0.5	0.1	0.3	0.5	0.5
13 Quarter 4	0.6	0.6	0.4	0.1	0.3	0.6	0.5
14 Total	2.4	2.4	1.3	0.4	1.2	2.2	2.0
15 <b>Yearly Average</b>	<b>0.6</b>	<b>0.6</b>	<b>0.33</b>	<b>0.1</b>	<b>0.3</b>	<b>0.55</b>	<b>0.5</b>

17 Source: Data from The Household Diary Study, Mail Use & Attitudes in PFYs 2000-2003,  
 18 Table A3-2, Standard Mail by Major Industry by Quarter.

19 In FY 2002, the yearly average was 0.55 DALs per week, 10  
 20 percent higher than in FY 2003, and in FY 1987 and FY 1999, the yearly  
 21 average was 0.60 DALs per week, 20 percent higher. In FY 2000,  
 22 however, the yearly average inexplicably dropped to 0.33 DALs per week.  
 23 For FY 2001, two sets of data, labeled (a) and (b), are shown. The first,  
 24 FY 2001(a) appeared in the FY 2001 volume, and one year later, in the

1 FY 2002 volume, revised data, FY 2001(b) were published.<sup>67</sup> Like the FY  
2 2000 yearly average, both of the FY 2001 yearly averages are inexplicably  
3 low. As discussed below, major mailers that use DALs with their  
4 saturation mailings, including the largest, Advo, Inc., mail in a pattern  
5 that has been rather consistent from year to year. Fluctuations in the  
6 yearly averages shown in Table A-2 indicate that Household Diary Survey  
7 data for detached label mail are subject to a fairly wide range of  
8 uncertainty, and possible unreliability.

9 Examination of Table A-2 also shows that data reported in the  
10 Household Diary Survey are rounded to a single decimal point. That  
11 alone introduces a range of uncertainty into the estimated annual  
12 volume of DALs. Allowing for rounding, the average number of DALs was  
13 anywhere between 0.45 (which would round up to 0.5) and just under  
14 0.55 (which would round down to 0.5). Applying this range to the  
15 estimated annual volume of 3.4 billion, using Household Diary Survey  
16 data the actual number of DALs could have been anywhere from 3.06  
17 billion to 3.74 billion.

---

<sup>67</sup> The yearly average for 2001(a), 0.10, is clearly an outlier. Disregarding this datum, the ratio of the high yearly averages in FY 1987 and FY 1999 (0.60) are twice the low yearly average of 0.30 in FY 2001(b).



1 category is almost 2.5 times the average number of DALs. Under witness  
 2 Kelley's estimating procedure, 0.5 detached labels per week translate into  
 3 3.4 billion pieces annually. Thus, using the same procedure, and  
 4 focusing only on one year, 1.22 pieces per week would translate into an  
 5 annual volume of around 8.3 billion pieces of N-FOO mail. This 8.3  
 6 billion pieces is about two-thirds of the total FY 2004 volume of  
 7 commercial saturation mail (letters and flats combined), which was 12.7  
 8 billion pieces. Table A-4 is constructed on the assumption that all 8.3  
 9 billion pieces of N-FOO mail were commercial saturation mail, and it  
 10 distributes those pieces between letters and flats in proportion to FY  
 11 2004 volume.

---

12 Table A-4

13 Mail Not From One Organization  
 14 (Volumes in billions)

	FY04 RPW Volume <sup>1</sup>	Dist. (percent)	Volume of Mail Not From One Org.
15	—	—	—
16	Commercial Saturation Letters	3.148	24.9%
17	Commercial ECR Flats	<u>9.514</u>	<u>75.1</u>
18	TOTAL	12.662	100.0%
19			2.1
20			<u>6.2</u>
21			8.3

22 <sup>1</sup> Response to VP/USPS-T16-2, Alternative Attachment B (Tr. 7/2841-47).

---

23 To sum up this part of the discussion about the category of N-FOO  
 24 mail, the volume of 3.4 billion DALs estimated by witness Kelley is  
 25 substantially less than the estimate of about 6.2 billion N-FOO flats in

1 Table A-4. Nothing in these data for FY 2003 indicate that the Postal  
2 Service's estimated volume of 3.4 billion DALs is too high, and they  
3 suggest that it could be too low by a substantial margin.

4 Looking at years prior to FY 2003, the yearly averages of N-FOO  
5 mail are seen to vary far more widely than the corresponding averages for  
6 detached labels. The low yearly average was 0.28 pieces per week in FY  
7 2001(a), and the high yearly average was 2.53 pieces per week in FY  
8 2000. Again, the yearly average for FY 2001(a) is something of an outlier.  
9 Disregarding this datum, FY 1999 had the lowest yearly average, 0.35  
10 per week. Using these data, along with witness Kelley's procedure for  
11 estimating the annual volume of DALs, gives results that appear to be  
12 both unrealistic and unreliable; *see* Table A-5, column 2.<sup>68</sup> Such wide  
13 variations in yearly volumes are inexplicable, and call into question the  
14 amount of weight that should be given to Household Diary Survey data,  
15 especially data for a single year.

---

<sup>68</sup> The volumes shown in Column 2 are in proportion to witness Kelley's estimate of 3.375 billion DALs.

1

2

Table A-5

3

## Annual Mail Volume Not From One Organization

4	Fiscal Year	Pieces per Household per Week (1)	Pieces per Household per Year (billions) <sup>1</sup> (2)
5	—	—	—
10	1987	0.45	3.04
11	1999	0.35	2.36
12	2000	2.53	17.08
13	2001(a)	0.28	1.89
14	2001(b)	0.78	5.27
15	2002	1.13	7.63
16	2003	1.22	8.24

17

<sup>1</sup> Not adjusted for annual changes in residential delivery points.

18

19

**Total number of pieces per week.** Because of the wide variations

20

in the yearly averages of mail received each week and recorded as (i)

21

Detached Label, and (ii) Not From One Organization, data for the total

22

number of pieces per week also were examined. These data are shown in

23

Table A-6.

Table A-6

**Total Pieces in Household Diary Survey**  
(Pieces per Household per Week)

	FY	FY	FY	FY	FY	FY	FY
	1987	1999	2000	2001(a)	2001(b)	2002	2003
Quarter 1	8.2	9.5	11.1	9.6	13.0	11.6	12.1
Quarter 2	7.3	7.2	8.9	8.8	11.7	10.3	10.1
Quarter 3	8.4	9.0	17.9	7.9	10.6	11.2	10.7
Quarter 4	7.4	7.6	16.4	7.9	10.3	11.2	10.0
Total	31.3	33.3	54.3	34.2	45.6	44.3	42.9
<b>Yearly</b>							
<b>Average</b>	<b>7.83</b>	<b>8.33</b>	<b>13.58</b>	<b>8.55</b>	<b>11.4</b>	<b>11.08</b>	<b>10.73</b>

Source: Data from The Household Diary Study, Mail Use & Attitudes in PFYs 2000-2003, Table A3-2, Standard Mail by Major Industry by Quarter.

The low yearly average of 7.83 pieces per week was recorded in FY 1987, and the high yearly average of 13.58 pieces per week occurred in FY 2000. These averages show less variation than for N-FOO mail. Nevertheless, the year-to-year change is much greater than the change in total mail volume. Using the data in the bottom row of Table A-6, along with witness Kelley's procedure for estimating the annual volume of DALs, gives interesting results for the total volume of mail received by all Households; see Table A-7, column 2.<sup>69</sup> For comparison, total mail volume for the years FY 1999-2003 is shown in column 4. The year-to-

<sup>69</sup> The volumes shown in column 2 are in proportion to witness Kelley's estimate of 3.375 billion DALs.

1 year percentage change for recent years is shown in columns 3 and 5,  
 2 and the lack of correlation between the percentages in those two  
 3 columns is rather marked. Clearly, changes in the estimated total  
 4 volume of mail received by households has been a rather poor predictor  
 5 of total mail volume.

---

7 Table A-7

8 Annual Mail Volume Received by Households

9	10	11	12	13	14	15	16	17	18	19	20	21	22
	Fiscal	Pieces per	Pieces per	Year-to-	Total	Year-to-							
	Year	Household	Household	Year	Volume	Year							
		per Week	per Year	Change	(billions)	Change							
		(1)	(billions) <sup>1</sup>	(percent)	(4)	(percent)							(5)
	—	—	—	—	—	—							—
	1987	7.83	52.85										
	1999	8.33	56.23		201,644								
	2000	13.58	91.67	+16.0%	207,882	+3.1%							
	2001(a)	8.55	57.71	-37.0	207,643	-0.1							
	2001(b)	11.40	76.95	-16.1	207,643	-0.1							
	2002(a)	11.08	74.79	+29.6	202,843	-2.3							
	2002(b)			-2.8									
	2003	10.73	72.43	-3.2	202,185	-0.3							

23 <sup>1</sup> Not adjusted for annual changes in residential delivery points.

---

25 To sum up this discussion, whether Household Diary Survey data  
 26 constitute a sample of households that is reliable, consistent, and  
 27 representative of total mail volume sent to all households therefore  
 28 appears highly questionable. Although better than no data at all,  
 29 reliability of the Household Diary Survey data pertaining to detached  
 30 labels deserves to be weighed against other publicly available sources of  
 31 information discussed in the next section.

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1     **Other Information**

2             The universe of saturation mailers using DALs consists of one  
3 major, national firm, a few large regional firms, and a number of  
4 relatively small firms that are more local than regional. A limited  
5 amount of information on the larger firms is publicly available, and is  
6 reviewed here.

7             **Advo.** Advo is a publicly traded company, operating nationwide.  
8 Its Form 10-K for the fiscal year ended December 31, 2004, filed with  
9 the Securities and Exchange Commission (“SEC”), states (at p. 1) that  
10 “[t]he Company currently is the largest commercial user of standard  
11 mail in the United States.” Advo’s core product, a shared advertising  
12 program called Shopwise(TM) “reaches approximately 78 million  
13 households, primarily on a weekly basis.” That program alone would  
14 distribute approximately 4.06 billion pieces a year.<sup>70</sup> However, perhaps  
15 at odds with the statement in its Form 10-K, Advo reports that in 2004  
16 it mailed 3,145,472,576 DALs with its Shopwise product, which  
17 represents an average of only 60.5 million pieces per week.<sup>71</sup> City and  
18 rural carriers delivered 2,988,799,732, or 95.0 percent, of Advo’s DALs,

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<sup>70</sup> Advo’s website states that the “missing child piece” (a DAL) reaches up to 85 million homes per week. On this basis, the annual volume of DALs from Advo alone is as much as 4.4 billion pieces.

<sup>71</sup> Response to VP/ADVO-1.

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1 and the remaining 156,672,844 DALs, or 5.0 percent, were delivered via  
2 P.O. Boxes, Highway Contract Routes, or General Delivery.

3         In addition, the Form 10-K states (at p. 2) that Advo has a wholly-  
4 owned subsidiary, Mail Marketing Systems, Inc. ("MMSI"), which  
5 "complements Advo's core distribution network by providing additional  
6 shared mail coverage to approximately 4.5 million households in 109  
7 smaller market areas not served by ADVO." Assuming this coverage in  
8 smaller market areas is only monthly, that would represent an  
9 additional 54 million DALs annually. MMSI mailed 53,581,776 DALs in  
10 2004, of which 44,172,776 were delivered by city and rural carriers, and  
11 9,409,000 were delivered via P.O. Boxes, Highway Contract Routes, or  
12 General Delivery.<sup>72</sup>

13         Further, the Form 10-K states (at p. 3) that "ADVO [has] expanded  
14 advertising programs in the Southern California and Pittsburgh  
15 metropolitan areas at the end of the fiscal year 2004 approximately  
16 doubling ADVO's advertising program frequency" to twice a week.  
17 Although the extra volume generated by these semi-weekly mailings is  
18 not stated, the existence of such volume reinforces credibility of more  
19 than 3.145 ~~at least 4~~ billion DALs from Advo alone.

---

<sup>72</sup> Response to VP/ADVO-2.

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1           Finally, Advo “is part of a network, described as A.N.N.E.,  
2           comprising of [sic] regional shared mail companies, which provides its  
3           clients with extended coverage outside the markets already served by  
4           the Company ... [and reaching] approximately 34 million additional  
5           households.” Advo’s A.N.N.E. network mailed a total of 383,785,000  
6           DALs in 2004, of which 329,906,000 were delivered by city and rural  
7           carriers, and 53,879, 000 were delivered via P.O. Boxes, Highway  
8           Contract Routes, or General Delivery. See the sub-section “other  
9           mailers,” below, for further discussion of annual volume generated by  
10          other mail marketing firms that use DALs, some in conjunction with  
11          Advo, and some independent of Advo.

12           **Harte-Hanks.** Harte-Hanks, Inc. is a publicly traded company.  
13          Its core business is Shoppers, which “are weekly advertising  
14          publications delivered free by Standard Mail to households and  
15          businesses in a particular geographic area.” These publications have  
16          “virtually 100% penetration in their area of distribution.”<sup>73</sup> Harte-Hanks  
17          is a regional company; its “California publications account for 87% of  
18          Shoppers’ weekly circulation.” The balance of its business is in Florida.  
19          Harte-Hanks’ Form 10-K for the fiscal year ended December 31, 2004,

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<sup>73</sup> All quotations are from the Harte-Hanks Form 10-K for the year ended December 31, 2004, pp. 7-8.

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1 filed with the SEC, states (at p. 7) that “[a]s of December 31, 2004,  
2 [Harte-Hanks] Shoppers delivered more than 11 million shopper  
3 packages in four major markets each week.” All of Harte-Hanks  
4 Shoppers are DAL mailings. Harte-Hanks thus claims to have entered  
5 more than 572 million DALs with the Postal Service in 2004.

6 **MailSouth.** MailSouth, Inc. is a regional mailer that, according to  
7 a press release dated May 25, 2005, “specialize[s] in shared mail  
8 advertising services in which advertising circulars and flyers of multiple  
9 retailers and service businesses are collated into a single package and  
10 then direct mailed to every household in a given market area with  
11 targeting selectivity by postal zip code, neighborhood or specific  
12 demographic variable.” According to the press release, which concerned  
13 acquisition of another firm, MailSouth “will now serve over 11.5 million  
14 unduplicated households in 285 different rural market areas on a  
15 monthly basis.” On this basis, MailSouth can be expected to enter each  
16 year approximately 138 million DALs with the Postal Service. MailSouth  
17 is part of Advo’s A.N.N.E. network, hence its volume is included in the  
18 data for that network, as discussed above.<sup>74</sup>

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<sup>74</sup> See ADVO/VP-T2-26.

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1           **Other regional mailers.** A number of other regional and local  
2 mailers are said to exist.<sup>75</sup> As discussed above, for example, Advo  
3 claims to have an alliance with a network of such regional dealers that  
4 reaches 34 million households, and mails 383.8 million DALs annually.  
5 ~~Assuming that these others allied with Advo collectively mail once a~~  
6 ~~month would result in an additional annual volume of 408 million DALs.~~  
7 Finally, allowing for a small volume from a collection of other saturation  
8 mailers independent of Advo indicates a total annual volume of DALs of  
9 4.5 5.4 billion, as shown in Table A-8. Information on the annual  
10 volumes mailed by some other mailers of DALs, as advertised by Echo-  
11 Media, is shown in Table A-9. Similar information for some “insert”  
12 mailers who likely use DALs is shown in Table A-10. The data in Tables  
13 A-9 and A-10 amply support the conservative estimate of 0.345 billion  
14 DALs by other independent mailers shown in Table A-8.

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<sup>75</sup> See, for example, testimony of Harry J. Buckle (SMC-T-1) in Docket Nos. R97-1 and R2000-1, on behalf of Saturation Mail Coalition.



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1 series for detached labels shows considerable year-to-year variation.  
2 That variation greatly exceeds the variation in the annual volume of  
3 saturation flats, and it likely exceeds the variation in the actual number  
4 of DALs mailed. In addition, the annual variation in the total volume of  
5 mail recorded by recipients greatly exceeds variations in the total  
6 volume of mail. Reliability of these data appears highly questionable,  
7 especially when used to extrapolate total volumes of mail for the entire  
8 country.

9 Over 90 percent of the total volume shown in Table A-8 is derived  
10 from data and information submitted to the SEC by major mailers  
11 known to use DALs and by responses to interrogatories in this docket.  
12 They constitute much of the universe of saturation mailers that use  
13 DALs. Unlike the Household Diary Survey data, virtually no  
14 extrapolation is required. These data would thus appear to be a  
15 considerably more reliable source for estimating the universe of DALs.

16 In sum, the Postal Service's estimated volume of DALs appears to  
17 be substantially understated on the basis of other readily available  
18 evidence. The annual volume of DALs in the saturation mailstream is  
19 obviously quite large, and an adjustment clearly needs to be made to  
20 recognize the cost of handling such a large volume of DALs. When  
21 adjusting for the cost of handling DALs, I recommend that the

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1 Commission use the figure of 4.5 ~~5.4~~ billion shown in Table A-8. I  
 2 further recommend that the Commission assume that 93.87 ~~99~~ percent  
 3 of all DALs are delivered by city and rural carriers. This  
 4 recommendation reflects Advo's percentage, as computed from its  
 5 responses to VP/ADVO-1-3 ~~the only data on record with regard to~~  
 6 ~~saturation mail sent to P.O. Boxes; i.e. Valpak's percentage.~~

7 By any reckoning, the annual volume of DALs is quite substantial.  
 8 Using the Postal Service's ultra-conservative low estimate of 3.4 billion  
 9 derived entirely from indirect sources, the volume of DALs is seen to  
 10 exceed the entire volume of Nonprofit Enhanced Carrier Route mail in  
 11 FY 2004. An annual volume of 4.5 ~~5.4~~ billion DALs would be a large  
 12 percentage of ~~almost as much as~~ the entire volume of First-Class cards.  
 13 For a category this large, the Postal Service clearly needs to establish  
 14 better procedures for gathering volume data and other pertinent  
 15 information.

---

17 Table A-9

18 Annual Volume of DALs of Some Other Mailers

19	<u>Abilene Money Clip</u>	<u>1,242,696</u>
20	<u>Crookston Shopper</u>	<u>561,600</u>
21	<u>El Flyer</u>	<u>12,090,000</u>
22	<u>El Pennysaver</u>	<u>57,200,000</u>
23	<u>Focus on Results</u>	<u>13,708,164</u>
24	<u>Green Tree Marketing</u>	<u>3,613,464</u>
25	<u>Mail-Net</u>	<u>53,834,040</u>
26	<u>Market Select</u>	<u>5,252,000</u>

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1	<u>Maryland/Virginia Pennysaver</u>	<u>66,652,300</u>
2	<u>National Mail It</u>	<u>26,573,696</u>
3	<u>Pittsburg Pennysaver</u>	<u>37,107,380</u>
4	<u>Readers Digest Label Carrier Program</u>	<u>1,000,000</u>
5	<u>Reading Merchandiser</u>	<u>5,053,932</u>
6	<u>Stone Creek Mailbox Shopper</u>	<u>2,408,688</u>
7	<u>Target Direct</u>	<u>2,822,112</u>
8	<u>Target Marketing of Maine</u>	<u>7,220,076</u>
9	<u>Tucson Shopper</u>	<u>14,235,832</u>
10	<u>Value pages</u>	<u>18,700,000</u>
11	<u>ValuMail</u>	<u>24,365,544</u>
12	<u>Wal-Mart C&amp;D County Wrap</u>	<u>32,843,965</u>
13	<u>TOTAL</u>	<u>386,485,489</u>

14 Source: Echo-Media.com

15

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16

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17 Table A-10

18 Annual Volumes of Some "Insert" Mailers Which Likely Use DALs

19	<u>Atlanta Savings &amp; Values</u>	<u>52,000,000</u>
20	<u>Cap Media</u>	<u>25,537,668</u>
21	<u>Cincinnati Reach</u>	<u>7,800,000</u>
22	<u>Cleveland Plain Dealer Statements</u>	<u>1,800,000</u>
23	<u>Dallas Ad Pages</u>	<u>9,060,000</u>
24	<u>Echoland-Piper Shoppers/Morris</u>	<u>1,391,000</u>
25	<u>Flashes Shoppers/Morris</u>	<u>8,241,012</u>
26	<u>Heartland Shoppers/Morris</u>	<u>7,698,756</u>
27	<u>Jasper-Okatie Sun Shoppers/Morris</u>	<u>226,200</u>
28	<u>Morris Communications Shoppers</u>	<u>27,819,584</u>
29	<u>Phoenix Suguaro Gold</u>	<u>6,762,000</u>
30	<u>Phoenix Value Clipper</u>	<u>9,435,514</u>
31	<u>Polk Shoppers/Morris</u>	<u>4,598,100</u>
32	<u>Tip-Off Shoppers/Morris</u>	<u>1,000,636</u>
33	<u>Town &amp; Country News/ Morris</u>	<u>520,000</u>
34	<u>TOTAL</u>	<u>163,890,470</u>

35 Source: Echo-Media.com

36

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1           CHAIRMAN OMAS: Mr. Haldi, have you had the  
2 opportunity to examine the packet of designated  
3 written cross-examination that was made available to  
4 you this morning?

5           THE WITNESS: Yes, I have, Mr. Chairman.

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

10          THE WITNESS: Yes, Mr. Chairman, but I would  
11 note that the packet now includes some errata to some  
12 interrogatories which were filed yesterday.

13          CHAIRMAN OMAS: Are there any additional  
14 corrections you would like to make to your answers?

15          THE WITNESS: No, Mr. Chairman.

16          CHAIRMAN OMAS: Counsel, would you now  
17 please provide two copies of the corrected designated  
18 written cross-examination of Witness Haldi to the  
19 reporter? That material is received into evidence and  
20 is to be transcribed into the record.

21   (The document referred to,  
22   previously identified as  
23   Exhibit No. VP-T-2, was  
24   received in evidence.)

25        //

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

Request of the United States Postal  
Service for a Recommended Decision on  
Changes in Rates of Postage and Fees for  
Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION  
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION INC.  
WITNESS JOHN HALDI  
(VP-T-2)

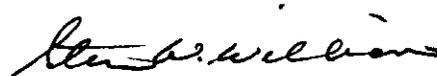
Party

Interrogatories

Advo, Inc.

ADVO/VP-T2-1-8, 11-16

Respectfully submitted,



Steven W. Williams  
Secretary



**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-1.**

On page 16, line 16 of your testimony, please provide the source for the figure of 9.515 billion saturation non-letters.

**Response:**

See the response to VP/USPS-T16-2, Alternative Attachment B, cell G-23.

**Revised Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc. (8/23/05)**

**ADVO/VP-T2-2.** On page 17 of your testimony, you recommend that your estimate of 5.4 billion detached address labels (DALs) be used to develop an adjustment for the handling of DALs. And, you also recommend that the total number of city and rural delivered DALs should be assumed to be 99% of 5.4 billion (i.e., 5.346 billion).

- (a) Please confirm that the base year carrier cost systems identify 5.144 billion CCCS saturation “letters plus DALs” (USPS LR K67, Sheet 3) and 1.651 billion RCCS saturation “letters plus DALs” (USPS LR K67, Sheet 8), for a total of 6.795 billion city and rural carrier delivered saturation “letters plus DALs.”
- (b) Please confirm that 6.795 billion “letters plus DALs” minus your estimate of 5.346 billion DALs would leave only 1.449 billion saturation letters delivered by city and rural carriers.
- (c) The RPW identifies 3.826 billion saturation letters. Please confirm that, if your DAL estimate were correct, it would mean that only 37.8% of RPW saturation letters are delivered by carriers on city and rural carrier routes.

If you cannot confirm any of the above, please explain why not, and provide the figures you believe to be correct, including your calculations and sources.

**Response:**

- a. Confirmed that the figures you use are found in cell E-22 of Sheet 3 and cell D-35 of Sheet 8. However, I do not confirm that “the base year carrier cost systems identify” the volumes of DALs shown in sheets 3 and 8, or that they are derived in any way from the mail counts that underlie the surveys of city and rural carriers. They appear to be derived solely from witness Kelley’s estimate of the number of DALs, which is based primarily on the number of residential delivery points and The Household Diary Survey, as developed in USPS-LR-K-67, file FY2004.DAL.MAILING.VOLUME.ESTIMATES.xls. For a critique of witness Kelley’s estimate, see the Appendix in my testimony. For further

**Revised Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc. (8/23/05)**

discussion of the specific issue raised which this question intends to preface, see my response to part c of this interrogatory, below.

- b. I can confirm that the result of subtracting 5.346 from 6.795 is 1.449. However, the caveats expressed in preceding part a, as well as in part c below, are equally applicable here.
- c. Confirmed only that the RPW identifies 3.826 billion saturation letters. In order to provide you with a more informed answer to your question, I have prepared three ~~two~~ attachments to this interrogatory. Attachment 1 incorporates the Postal Service assumptions with respect to the volume of DALs, ~~and~~ Attachment 2 incorporates my recommendations with respect to the volume of DALs (VP-T2-2, p 17, ll. 2-8), and Attachment 3 incorporates my revised recommendation with respect to the volume of DALs, which reflects new information obtained from responses to VP/ADVO-1-3, filed August 22, 2005, and also from publicly available information contained on the web site of Echo-Media.

In **Attachment 1**, under column F, rows 9, 10 and 12, you will find the totals for letters delivered by city and rural carriers exactly as referenced in part a of this interrogatory. Column D shows the total volume of DALs (3.375 billion) as **estimated by the Postal Service**, and column C shows the total ECR letters

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delivered by city and rural carriers as shown in the source cited at the bottom of the table. To facilitate reference, the RPW total which you cite, 3.826 billion saturation letters, is shown in cell C21. Four observations about Attachment 1 are worth noting. First, the Postal Service estimate of total saturation letters exceeds the RPW figure by some 56.894 million, or by some 1.5 percent; *i.e.*, it is 101.5 percent of the RPW figure, a curious result. Second, as shown in cell E17, the Postal Service estimates that 13.7 percent of all DALs (463 million) are delivered to P.O. Boxes and highway contract routes, but that no saturation letters are delivered to P.O. Boxes and highway contract routes, as can be seen from perusing column C. That residents who live on highway contract routes and renters of P.O. Boxes should receive so much DAL mail, while receiving no saturation letter mail, reflects a somewhat anomalous situation, to say the least. Third, since the volume of letters delivered by city and rural carriers in cells C9 and C10 is already 101.5 percent of the RPW total, no "residual" is available which could be said to be delivered to P. O. Boxes or highway contract routes. Fourth, since RPW has no data on the volume of DALs, no RPW statistics are applicable to any of the data shown in column D.

**Attachment 2**, column D, shows the volume and distribution of DALs as recommended originally in my testimony (VP-T2-2, p. 17, ll 2-8, and the

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Appendix), with the DALs delivered by city and rural carriers distributed in the same proportion vis-a-vis each other as in Attachment 1.

The hypothesis in part c of your question is fundamentally wrong for the following reason. As Attachment 1 clearly shows, the total combined volume of letters and DALs delivered by city and rural carriers, 6.795 billion in cell F12, reflects exactly the volume of DALs as estimated by the Postal Service in USPS-LR-K-67 — nothing more, and nothing less. That is, the totals in column F are not any kind of control totals derived from RPW (or any other reliable independent source), and using them in this manner, as your question does, is therefore totally inappropriate. As noted above, RPW has no data on the volume of DALs. As ADVO/VP-T2-1 points out, however, the RPW shows a total of 9.515 billion flats in FY 2004, which greatly exceeds my estimated volume of 5.4 billion DALs. If the Postal Service were to increase its estimate of the volume of DALs, then the volumes in column D of Attachment 1 would change, and the totals in column F would increase, just as they do in Attachment 2, which I consider to be a superior estimate based on more reliable data sources than The Household Diary Survey used by witness Kelley in USPS-LR-K-67. In Attachment 2, note that 100 percent of saturation letters continue to be delivered by city and rural carriers, exactly as assumed by the Postal Service in Attachment 1 as my focus was limited to revising the number of DALs.

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Accordingly, the question about 37.8 percent of RPW saturation letters being delivered by carriers on city and rural routes is without meaning, as it is based on a flawed assumption.

Attachment 3, column D, shows my new estimate of the volume of DALs, revised to incorporate information supplied in responses to VP/ADVO-1-3 (received 8/22/05), and explained in the errata to my testimony filed August 23, 2005. Advo's DALs, 3.583 billion, represent 79.6 percent of the 4.5 billion total DALs shown in cell D21, and Advo's DALs alone exceed witness Kelley's estimated number of DALs by 6 percent. In Attachment 3, the DALs delivered via P.O. Boxes, highway contract routes, and General Delivery are 6.14 percent of the total, and the percentages shown in column E correspond exactly to the percentages supplied by Advo, and are applied to the 4.5 billion total DALs. The balance, 93.86 percent, or 4.224 billion DALs, are assumed to be delivered by city and rural carriers, and are distributed to rural and city carriers using the same proportions as witness Kelley (as shown in my Attachment 1). In column C, the data for saturation letters differ from the data shown in Attachments 1 and 2. Attachment 3 uses the total volume of saturation letters, 3.826 billion, as shown in the RPW file in USPS-LR-K-67, and distributes the total to the various modes. The percent of saturation letters delivered to P.O. Boxes is estimated at 2.0 percent. This reflects the fact that Valpak sends less than 1.0 percent (0.77

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percent) to P.O. Boxes, whereas Advo sends 5.13 percent of its flats to P.O. Boxes. Highway contract routes are assumed to receive about one-fifth the volume that is delivered to P.O. Boxes, in line with Advo's data. The 3.734 billion saturation letters assumed to be delivered by city and rural carriers is distributed to each mode in the same proportions used by witness Kelley, and as shown in my Attachment 1. The figures in each row of column F reflect the sum of the corresponding entries in columns C and D. The totals in column F do not correspond to the corresponding USPS totals in Attachment 1, as there is no way that the RPW data for saturation letters and the more reliable DAL data supplied by Advo can be shoe-horned into the respective CCS and RCS estimates. Since the CCS and RCS sample-based estimates cannot be checked against any kind of control total that includes the aggregate volume of DALs, I reject them as flawed. For more discussion on independent checks using reliable independent sources and control totals, see my response to ADVO/VP-T2-25.

## Attachment 1 to Advo/VP-T2-2

	A	B	C	D	E	F
1						
2		<b>Saturation Letters and Postal Service Estimated Volume of DALs</b>				
3		<b>FY 2004</b>				
4		<b>(000)</b>				
5						
6			<b>USPS</b>	<b>Dist.</b>		
7			<b>Letters</b>	<b>DALs</b>	<b>(%)</b>	<b>Total</b>
8						
9		City Carriers	3,048,834	2,095,359	62.1%	5,144,193
10		Rural Carriers	834,304	817,139	24.2%	1,651,443
11			-----	-----	-----	-----
12		Subtotal, city and rural carriers	3,883,138	2,912,498	86.3%	6,795,636
13						
14		P.O. Box		406,500	12.0%	406,500
15		Highway Contract Routes		56,383	1.7%	56,383
16			-----	-----	-----	-----
17		Subtotal, P.O. Box & HCR		462,883	13.7%	462,883
18			-----	-----	-----	-----
19		<b>GRAND TOTAL</b>	3,883,138	3,375,381	100.0%	7,258,519
20						
21		Control Total: RPW	3,826,244	n.a.		n.a.
22						
23		<b>Sources:</b>				
24		Cell C9, LR-K-67, Sheet 10, column 4				
25		D9, USPS-LR-K-67, FY2004.DAL.MAILING.VOLUME.ESTIMATES.xls,				
26		also, LR-K-67, Sheet 10, col 1.				
27		C10, LR-K-67, Sheet 10, column 4				
28		D10, USPS-LR-K-67, FY2004.DAL.MAILING.VOLUME.ESTIMATES.xls,				
29		also, LR-K-67, Sheet 10, col 1.				
30		D14, USPS-LR-K-67, FY2004.DAL.MAILING.VOLUME.ESTIMATES.xls.				
31		D15, USPS-LR-K-67, FY2004.DAL.MAILING.VOLUME.ESTIMATES.xls.				

	A	B	C	D	E	F
1		<b>Saturation Letters and Valpak Estimated Volume of DALs</b>				
2		<b>FY 2004</b>				
3		<b>(000)</b>				
4						
5						
6						
7			<b>Letters</b>	<b>Valpak DALs</b>	<b>Dist. (%)</b>	<b>Total</b>
8						
9		City Carriers	3,048,834	3,846,111	71.2%	6,894,945
10		Rural Carriers	834,304	1,499,889	27.8%	2,334,193
11			-----	-----	-----	-----
12		Subtotal, city and rural carriers	3,883,138	5,346,000	99.0%	9,229,138
13						
14		P.O. Box		43,200	0.8%	43,200
15		Highway Contract Routes		10,800	0.2%	10,800
16			-----	-----	-----	-----
17		Subtotal, P.O. Box & HCR		54,000	1.0%	54,000
18			-----	-----	-----	-----
19		GRAND TOTAL	3,883,138	5,400,000	100.0%	9,283,138
20						
21		Control Total: RPW	3,826,244	n.a.		n.a.
22						
23		<b>Sources:</b>				
24		Cell C9, LR-K-67, Sheet 10, column 4.				
25		C10, LR-K-67, Sheet 10, column 4.				
26		D12, 0.99*D19.				
27		D14, 0.7*D17.				
28		D15, 0.3*D17.				
29		D17, 0.01*D19; VP-T2-2, p. 62, l. 16 to p. 63, l. 2.				
30		D19, VP-T-2, p. 17, ll. 2-8.				

Attachment 3 to ADVO/VP-T2-2  
Revised August 23, 2005

	A	B	C	D	E	F	G	
1								
2		<b>Saturation Letters and Valpak Estimated Volume of DALs</b>						
3		FY 2004						
4		(000)						
5								
6								
7								
8			<b>Saturation</b>	<b>Valpak</b>	<b>DAL</b>			
9			<b>Letters</b>	<b>Estimated</b>	<b>Dist.</b>			
10				<b>DALs</b>	<b>(%)</b>	<b>Total</b>		
11		City Carriers	2,931,764	3,038,709	0.6753	5,970,473		
12		Rural Carriers	802,268	1,185,023	0.2633	1,987,291		
13			-----	-----	-----	-----		
14		Subtotal, city and rural carriers	3,734,032	4,223,732	0.9386	7,957,764		
15								
16		P.O. Box	76,525	230,668	0.0513	307,193		
17		Highway Contract Routes	15,305	45,136	0.0100	60,441		
18		General Delivery	383	464	0.0001	846		
19			-----	-----	-----	-----		
20		Subtotal, P.O. Box & HCR	92,212	276,268	0.0614	368,480		
21			-----	-----	-----	-----		
22		GRAND TOTAL	3,826,244	4,500,000	1.0000	8,326,244		
23								
24								
25		<b>Sources:</b>						
26		Cell E11-12 and E16-18, responses to VP/ADVO-1-3.						
27		D22, VP-T-2, Table A-8, p. 76 (revised 8/22/05).						
28		C22, USPS-LR-K-67, file LR-K-67_2ndrevised.xls, sheet '5.RPW.'						
29								
30								
31								

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**ADVO/VP-T2-3.**

On pages 17 and 18 (lines 15 through 6), you suggest that there may be IOCS errors with respect to accounting for DAL handlings. And, you state that “Two Postal Service witnesses have mentioned recording error as a distinct possibility for anomalous cost results (see fn. 23, *infra*).” With respect to those USPS responses, please confirm the following:

- (a) The POIR No. 1a response refers to the way in which certain IOCS tallies were used and does not mention or suggest any errors in the tallies themselves.
- (b) The responses to VP/USPS-T16-16 and -17 do not confirm any anomalous cost results and do not relate to any IOCS errors.
- (c) None of the responses identified in footnote 23 have anything to do with the number or cost of DALs.

If you cannot confirm any of the above, please explain why not, with specific reference to the statements made in the sources you have cited.

**Response:**

- a. The response to POIR No. 1a speaks for itself. However, I would note the following statement contained in that response:

Based solely on the physical examination of mail piece characteristics (e.g., barcodes), it is **not always possible for data collectors to determine** whether the revenue of a given mail piece, and the piece itself, was recorded at the nonautomation rates or automation rates. [Emphasis added.]

If data collectors cannot determine and therefore cannot record accurately the classification of the mailpiece, the tallies themselves contain errors, and those errors result in erroneous costs for the affected rate categories.

- b. The responses to VP/USPS-T16-16 and 17 speak for themselves. However, I would note the following statement contained in the response to VP/USPS/T16-16:

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The pieces may have been entered as flats for a number of reasons including, but not limited to, ... 3) **data entry error**. It is not possible to determine if the processing category was checked as flats because the piece was flat shaped or **because of an error**. [Emphasis added.]

Similarly, the response to VP/USPS-T16-17, states:

The 0.33 percent of ECR NONLTR BASIC PIECE RATE pieces ... **may reflect a data entry error** or clerk oversight. [Emphasis added.]

Both of the above statements refer to possible data entry errors at the point of acceptance, not data entry errors with respect to IOCS tallies. Any possible errors, such as those alluded to in the above-quoted statements, however, would affect the computation of unit cost for the affected rate categories. Of course, whether they have created **anomalous** cost results would depend on the frequency and magnitude of the errors. Further, to the extent that possibilities of data entry errors at the point of acceptance are a consideration, so also is the possibility of data entry errors in IOCS tallies.

- c. The subject addressed by the references in my footnote 23 is possible data entry error for ECR mail. Accordingly, although the responses identified in footnote 23 do not directly deal with the number of DALs, they nevertheless are pertinent. Indeed, since that the Postal Service makes no effort at the point of acceptance to record or enter (i) data concerning the volume of DALs, or (ii) data which distinguish the volume of non-letter mail that is accompanied by DALs from other (addressed) non-letter mail, no data entry errors for DALs could occur at the point of acceptance. State more briefly, if

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nothing is required to be entered, it is difficult for one to err when recording nothing (in this respect, the procedure is almost foolproof). After DALs have been accepted, the Postal Service does not record or develop any kind of systematic data concerning the way DALs are handled (*i.e.*, DPS'd, cased, or taken to the street as separate bypass bundles, the three possible ways of handling DALs discussed by witness Lewis, USPS-T-30). This is the reason for the estimating procedures being used in this docket, rather than any kind of specific mail count.

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**ADVO/VP-T2-4.**

On page 19 of your testimony, you note that IOCS casing costs for flats also include casing costs for DALs. You state “. . . since DALs are probably cased at a faster rate than ordinary flats, using the casing rate for flats alone underestimates the actual volume of pieces cased.” If the saturation flat in-office casing cost is comprised of a mix of high-productivity DAL casing cost and low-productivity flat casing cost, please confirm that dividing that total cost by the flat low-productivity figure will provide an overestimate of the actual number of flats cased and therefore an underestimate of the actual number of flats taken to the street. If you cannot confirm, please explain fully why you cannot.

**Response:**

As noted in my response to ADVO/VP-T2-3(c), the Postal Service apparently collects no systematic data on the billions of DALs entered by mailers, or on the number of DALs cased, DPS'd, or taken directly to the street as an extra bundle. Moreover, the Postal Service's procedure for estimating the number of flats cased by carriers does not even consider the possibility that carriers may case some, perhaps many, of those billions of DALs, which is what my testimony endeavored to point out.

Witness Bradley, USPS-T-14, at page 59, lines 5-17, develops the “theory” that underlies the Postal Service's procedure for estimating the number of cased flats. That “theory” is implemented in USPS-LR-K-67, file CASING04\_revised.xls, sheet ‘EstimatesOfCased.Sat.Ltrs.Flts.’ Unfortunately, witness Bradley's theory fails in a number of important ways to account for certain ways that DALs and saturation flats are handled by city carriers, as pointed out not only by this question, but also by ADVO/VP-T2-12.

In order to arrive at the conclusion postulated in your question, it is not necessary to speculate about the rate at which carriers case DALs. If carriers case **ANY** DALs, rather than (i) taking all DALs directly to the street as extra bundles, or (ii) sorting them on automation

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equipment (the other two possible ways to handle DALs that are discussed by witness Lewis, USPS-T-30), then the Postal Service's procedure for estimating the number of cased saturation flats will, as your question correctly points out, (i) overestimate the actual number of flats cased, and (ii) underestimate the actual number of flats taken to the street as bypass mail. Other than a study by witness Shipe in Docket No. R90-1, which studied city carriers' casing rate for letters and flats (but not for cards), the Postal Service has cited no study, or offered any other data, concerning the rate at which carriers actually case DALs in vertical flats cases.

The greater the number of DALs that city carriers actually case, the more the Postal Service's estimate will differ from the actual number of flats taken directly to the street. In other words, the Postal Service's procedure for estimating the number of flats taken directly to the street might be considered correct only if (i) **NO** DALs were cased by city carriers, **AND** (ii) city carriers are actually engaged in casing flats throughout the entire time that the IOCS records as casing of flats. *Because the last two points are important to a fuller understanding, let me elaborate briefly on each.*

With respect to the number of DALs not cased by city carriers, but instead sorted on automation equipment, it would appear that the intent of interrogatories ADVO/VP-T2-6, 7, and 8 is to emphasize a conjecture by witness Lewis that "it's got to be a pretty small number at this point" (Tr. 6/2433). As my response to ADVO/VP-T2-6 points out, no credible data are available to support or refute this conjecture by witness Lewis. As an aside, I would note that the issue turns not on data quality, but purely on conjecture, speculation, and anecdotal information --- e.g., "I know there is field interest in DPSing the letter-shaped component of a

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DAL mailing and that in some places delivery and plant managers have implemented local procedures to do this.” (Response of witness Lewis to VP/USPS-T30-14(c), Tr. 6/2370.)

Issues concerning data quality typically begin by assessing the quality of one or more existing bodies of data. However, in the case of DALs, which by any estimating procedure number in the billions, the Postal Service has no body of data that can be assessed, and that makes any discussion about quality of DAL data somewhat academic, to say the least.

Assuming *arguendo*, though, that the volume of DALs sorted on automation equipment is *de minimus*, then most DALs either are (i) cased, or (ii) taken directly to the street as an extra bypass bundle. Since city carriers on many route segments are restricted to no more than three bundles, the only possible inference under this assumption is that a great many DALs must be cased. This in turn means that the procedure for estimating the number of flats which are cased and taken to the street as cased flats may be grossly overstated. The one datum that the IOCS collects with respect to DALs is the response to question 22, where employees handling a flat, IPP or parcel are asked whether they are handling a DAL (*see* the IOCS handbook, F-45, pp. 12-8 to 12-11, which was provided in Docket No. R2000-1, in USPS-LR I-14). Apparently neither witness Bradley (USPS-T-14) nor witness Kelley (USPS-T-16) were supplied with a compilation showing, for city carriers, the proportion of ECR non-letter tallies where the presence of a DAL was indicated. Inasmuch as witness Bradley’s estimating procedure depends critically on the assumption that city carrier casing cost for saturation flats represents time spend casing flats, and not DALs, it is unclear to me why such information was not made available to witness Kelley.

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With respect to the issue of whether all casing time charged to flats is actually spent casing flats that subsequently are taken to the street as cased flats (as the “theory” developed by witness Bradley assumes), yet another possibility exists that is not considered anywhere in the “theory” developed by witness Bradley. Namely, some city carrier time charged to casing flats instead may be spent **collating** two bundles of saturation flats, which then are taken to the street **not as cased flats** (as witness Bradley’s procedure assumes), **but as an extra bundle**. Collating is described by witness Lewis as (i) a well-understood procedure among delivery personnel, and (ii) more advantageous to the Postal Service than casing. Tr. 6/2431, l. 12 to 2432, l. 2. To the extent that collating occurs very often (again, no data are available on the volume of saturation flats that are collated and then taken to the street as an extra bundle), the estimated number of flats cased and taken to the street as cased flats would be even more erroneous. The combined omission of casing DALs and collating flats could make the Postal Service’s estimated volume of bypass mail so erroneous as to be unacceptable.

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**ADVO/VP-T2-5.**

Please confirm the following or explain fully why you cannot:

- (a) The distribution key for city letter route delivery costs is the City Carrier Cost System (CCCS).
- (b) If the percentage of CCCS ECR saturation flats that are sequenced increases, then ECR saturation flats should be allocated a correspondingly larger portion of city letter route sequenced delivery cost.
- (c) If the percentage of CCCS ECR saturation flats that are sequenced increases, then the percentage of ECR saturation flats that are cased and delivered as non-sequenced mail decreases.
- (d) If the percentage of CCCS ECR saturation flats that are cased and delivered as non-sequenced mail decreases, then ECR saturation flats should be allocated a correspondingly smaller portion of city letter route non-sequenced flat delivery costs.
- (e) USPS LR K67 [sic] uses CCCS volumes to distribute city letter route delivery costs among the various categories of ECR volumes.

**Response:**

Let me preface my response to these questions by noting that **all** saturation mail, both letters and flats, must be sequenced by the mailer. Because of this requirement, I consider the term “sequenced mail” in the sense used by witness Bradley to be a somewhat unfortunate choice of words. When referring to saturation mail taken directly to the street, my own preference would be to refer to it as “bypass mail.”

- a. Confirmed.
- b. Confirmed, assuming that your reference is to saturation flats that bypass casing.
- c. Confirmed, again assuming that your reference is to saturation flats that bypass casing.

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- d. Confirmed.
- e. Confirmed that this accords with my understanding of the distribution key for volume variable city delivery costs.

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**ADVO/VP-T2-6.**

On page 20 (lines 1 and 2) of your testimony, you state that . . . “it seems that some unknown volume of DALs are sorted on automation equipment.” And, you state (lines 12-13) that . . . “despite knowledge that interest in DPSing of DALs is increasing and the practice is growing. . . .” Separately, on page 21 (lines 14-15), you state that there is an . . . “unknown, but possibly large and growing, volume of DALs [being automated]. . . .” A review of the cites provided in footnote 18 show no support for the assertion that “the practice [of DPSing DALs] is growing.” Please provide any evidence you have, including sources, for the assertions that the number of DALs being automated is large and growing.

**Response:**

In Docket No. R2001-1, VP/USPS-T39-1(c) asked Postal Service witness Kingsley:

“Would having barcodes on DALs facilitate processing?” Her response was as follows:

No. Running DALs into DPS is inconsistent with keeping DALs matched up with the matching host piece. If DALs were put into DPS, then the carriers would have to check through the DPS volumes to see what DALs were run that day by the plant to see what host pieces were to go out that day. This is inconsistent with the DPS process of carriers taking DPS volumes right to their route/vehicle as well as providing an opportunity for curtailing the mail if it is a heavy volume day. [Tr. 9/2444.]

Also in Docket No. R2001-1, VP/USPS-T39-2(c) asked Postal Service witness

Kingsley: “to what extent is automation equipment likely to be used to sort the DALs into delivery point sequence?” Her response was as follows:

Highly unlikely, if ever. The requirements for DALs state that pallets of items must be palletized with the DALs, specifically to ensure that for mailings entered upstream from a delivery office, the DALs will remain with the host pieces all the way through to the delivery office, bypassing mail processing operations. [Tr. 9/2446.]

And also in Docket No. R2001-1, VP/USPS-T39-2(d) asked Postal Service witness

Kingsley to “provide your best estimate of the percentage of DALs that are pre-barcoded and

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the percentage of DALs that the Postal Service must first barcode before sorting on automation equipment.” Again, her response was as follows:

As stated above, DALs are highly unlikely, if ever, sorted on automation equipment. [Tr. 9/2446.]

In this docket, however, VP/USPS-T30-14(c) asked Postal Service witness Lewis “to what extent is automation equipment likely to be used to sort the DALs into delivery point sequence?” His response was:

I know there is field interest in DPSing the letter-shaped component of a DAL mailing and that **in some places delivery and plant managers have implemented local procedures to do this.** [Tr. 6/2370, emphasis added.]

Also in this docket, VP/USPS-T30-15(a) asked Postal Service witness Lewis, “When Standard ECR flats with DALs are entered at DDU, are the DALs sometimes returned to the P&DC to be DPS on automation equipment?” His answer was: “Yes.”

Comparing the answers of witness Kingsley in Docket No. R2001-1 with those of witness Lewis in this docket — *i.e.*, nearly four years later — the Postal Service now states that “in some places delivery and plant managers have implemented local procedures to” DPS DALs, including transporting DALs back from a DDU to a P&DC. I consider the Postal Service responses in this docket to be different from its position in Docket No. R2001-1, and conclude that interest in the practice of DPSing DALs is increasing and the practice is growing.

The question of whether the volume of DALs sorted on automation equipment is in fact large can only be speculated upon based on this record, exactly as I have done. In response to VP/USPS-T30-16, witness Lewis states:

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The Postal Service does not maintain statistics that track the number or composition of bundles City carriers take directly to the street. Therefore, **it is not possible to know what percentage of DAL mailings the Postal Service sorts either manually or on automation** with either letter-shaped or flat-shaped mail. [Tr. 6/2373, emphasis added.]

Based on all of these responses, I stated that the volume of DALs processed on automation equipment is unknown, but “possibly large.” Until the Postal Service produces credible data pertaining to DALs that prove otherwise, I stand by my statement.

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to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-7.**

On page 21 (lines 14-16), you state that “. . . certain costs incurred to process some unknown, but possibly large and growing, volume of DALs are being attributed to letters.” You provide no cites for the assertions that a large volume of DALs is being automated. At TR 7/2717, in response to a Val-Pak question, the USPS responded that a review of the FY04 IOCS data indicate that there were no Standard Mail “DAL” tallies in the MODS cost pool BCS/DBCS. Further, in response to a Val-Pak question about the extent of automation processing of DALs, USPS witness Lewis stated that “it’s got to be a pretty small number at this point” (TR 6/2433). Please provide any evidence you have, including sources, to support your speculation that there is a large volume of DALs being automated.

**Response:**

Your question warrants several observations. First, the transcript reference 7/2717 does not contain the information you cite. However, a lack of DAL tallies in one MODS cost pool -- BCS/DBCS -- would not confirm the lack of DAL tallies in other automated MODS costs pools with costs attributed to saturation letters in the Base Year, including BCS and OCR. It is not clear why saturation letters, all of which were required to be barcoded in the Base Year, ever would incur any costs in these two cost pools. If any costs in these two pools are attributed to saturation letters, it would appear that they are caused by DALs, which are not required to be barcoded.

Further, the above-cited Postal Service response notes that “[t]he recording of DALs for the In-Office Cost System (IOCS) is described in the IOCS handbook, F-45, pages 12-8 to 12-11 (which was provided in Docket No. R2000-1, in USPS-LR-I-14).” The instructions pertinent to recording of a DAL are applicable only when question 22 records that a single-shape piece of mail is being handled. It is not in the nature of operations at automated cost pools such as BCS, OCR, or BCS/DBCS to handle individual pieces of mail (except, perhaps,

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

in the event of a jam). After all, the whole purpose of automation is to avoid the handling of individual pieces. Therefore, it would not surprise me if (i) few of the “handling mail” tallies in these cost pools reflect that a single piece of mail was being handled (as in response to IOCS question 22), and (ii) a large proportion of the “handling mail” tallies reflect either mixed mail or handling of an “item” or “container” within a single subclass (*see* USPS-T-11, p. 13, fn. 14 for IOCS definitions of “item” and “container”). When an item or container (within a single subclass), or mixed mail, is being handled, and DALs are included with other letter-shaped pieces, costs of such tallies would be distributed to subclasses on the basis of **shape**. That is, if DALs have been merged with other letter-shaped pieces (First-Class, Periodicals, Standard and ECR) they would be counted as ECR saturation **letters** and — erroneously — would **not** appear as DALs or flats. The direct costs of “ECR saturation letters” arising from these tallies then would be charged with all the “not handling” and other piggyback costs of the automated MODS cost pools, thereby compounding the error. It does seem to me that the Postal Service procedures for tracking the processing of DALs on automated equipment are inadequate and in need of rethinking, both now and in anticipation of the day when the practice becomes more widespread.

Finally, it is possible that witness Lewis’s conjecture, referred to in your question, may be correct — *i.e.*, the vast majority of DALs either are cased or taken in bundles directly to the street as bypass mail. See my response to ADVO/VP-T2-4 for discussion of the implications of this possibility. With respect to my statement that the volume of DALs

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

processed on automation equipment is unknown, but “possibly large,” see my response to ADVO/VP-T2-6.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-8.**

In lines 11-16 and footnote 20 on page 21 of your testimony, you suggest that costs to automate DALs may be wrongly attributed to saturation letters. In footnote 19, you imply that IOCS mail processing tallies of DALs may not be correctly attributed to flats because the host flats may not be available for review. At TR 7/2717, in response to a Val-Pak question, the USPS responded that in the case were the host piece cannot be identified, the IOCS editing process classifies the DAL tallies as flat shape (see USPS LR-K-9, Appendix B, page 137). Please provide any other evidence you have, including sources, to support your speculation.

**Response:**

See my response to ADVO/VP-T2-7.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-11.**

At page 8 of your testimony, you state that 99 percent of ValPak's mail is entered at the destinating SCF, with the remainder "entered at BMCs, or locally, in either St. Petersburg, Florida or Elm City, North Carolina" where Val-Pak's production facilities are located.

(a) Please confirm that this means that well less than 1 percent of Val-Pak's coupon enveloped mail is entered at destination delivery units. If you cannot confirm, please provide the correct percentage of Val-Pak's DDU-entered mail.

(b) Please confirm that in Docket MC95-1, you then similarly testified that 98 percent of Val-Pak's mail was entered at destination SCFs, and that "the remaining 2 percent is entered at BMCs (with a fraction of a percent of the mail being entered locally in the St. Petersburg, Florida area)." VP-T-1, Docket MC95-1, at 6.

(c) Is this very small proportion of volume drop shipped to destination delivery units typical of the other national coupon envelope mailers that produce their mailings at central locations for distribution to multiple markets and postal facilities across the country? If not, explain your understanding of coupon envelope mailer practices and how Val-Pak's practices differ.

**RESPONSE:**

- a. Redirected to Valpak.
- b. Confirmed.
- c. My response in Docket No. MC95-1 was applicable only to Valpak. I have neither surveyed, nor studied, nor am I familiar with the mailing practices of any national coupon envelope mailer other than Valpak.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-12.**

On page 33 of your testimony, you assert that it would be reasonable to expect that, when carriers have to select from two or more mailings one that is to be handled as an extra bundle, carriers select only one saturation flat mailing to be handled as an extra bundle on an individual day and case the others. To support your assertion, you cite the USPS institutional response to VP/USPS-T39-60 in R2001-1.

(a) Please confirm that the question asked by Val-Pak in VP/USPS-T30-12 in this Docket R2005-1 proceeding is identical to the question asked in the interrogatory you cite from Docket R2001-1.

(b) Please confirm that USPS witness Lewis, in this proceeding, responded to that interrogatory by stating that the supervisor would most likely direct carriers to collate the two mailings together to make a third bundle.

(c) Please explain how your assertion comports with another USPS response in this rate case to VP/USPS-T30-6 [positing two saturation mailings to be delivered on a certain day]: “. . . normally, where motorized carriers are serving centralized, cluster box, curblines, and dismount deliveries, the supervisor would ensure they take their sequenced mailings directly to the street uncased. If the carriers in your example were carriers on motorized routes that served park and loop deliveries, for those park and loop deliveries, the supervisor would ensure the carriers collated the mailings together into a third bundle.”

(d) Please explain how your assertion comports with USPS witness Lewis’s responses in this rate case to VP/USPS-T30-11, 12, and 19 (TR 6/2365, 2368, 2376) that city carriers would most likely collate two or more flat saturation mailings into a third bundle in order to avoid casing those flats.

**RESPONSE:**

- a. Confirmed.
- b. Your question helps to point out that, when responding to VP/USPS-T30-12(e), witness Lewis did not answer the question that was asked. The question posed to witness Lewis was, regarding foot routes and park and loop routes that in general are restricted to three bundles (*i.e.*, except for certain segments, such as cluster box units, where more than three bundles may be permitted), if a choice had to be made by a carrier, which of the two hypothetical mailings would be

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

cased. In his response — “The supervisor would most likely direct carriers to collate the two mailings together to make a third bundle” — I would interpret “most likely” to mean that the two mailings would be collated together somewhat more than 50 percent of the time, but not necessarily always. In this docket, VP/USPS-T30-12 asked what happens when the two bundles are **not collated** and carriers **are limited** to three bundles. Unfortunately, that question remains unanswered. The response of witness Lewis, cited in full above, speaks for itself and confirms that (i) he did say the two bundles “most likely” would be collated, and (ii) he did not say what would happen when they were not collated.

- c. The sentence cited from my testimony in your question appears at page 33, lines 12-16, and begins by stating, “[w]ithin the universe of saturation flats, when carriers have to select from two or more mailings ....” (Emphasis added.) VP/USPS-T30-6 concerned one saturation mailing of **letters** and one saturation mailing of **flats**, both for delivery on the same day. The interrogatory is inapplicable to the cited sentence in my testimony. However, I should elaborate on the issue which you raise.

The immediately preceding sentence in my testimony (p. 33, ll. 7-11) cites the large discrepancy in the percent of saturation letters and flats taken directly to the street: 36.2 vs. 74.3 percent, respectively. The response by witness Lewis indicated that (i) where carriers have no restriction on the number of extra

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

bundles, both would be taken directly to the street, and (ii) where carriers are restricted on the number of bundles, “the supervisor would ensure the carriers collated the [letter and flat] mailings together into a third bundle.” In other words, the response of witness Lewis to VP/USPS-T30-6, if taken literally, could be said to indicate that saturation letters would be collated and taken to the street as often as saturation flats, but such a reading does not comport with the statistical evidence cited from the Postal Service in my testimony.

- d. My “assertion,” as you describe the cited sentence in my testimony, discusses what happens “when carriers have to select.” The responses of witness Lewis to VP/USPS-T30-11, 12 and 19 are to the effect that when (i) carriers are limited in the number of extra bundles that they can take, and (ii) they have two saturation flat mailings for delivery on the same day, they will collate the two bundles of flats into a single saturation bundle, so that a choice like that posited in my testimony will have to be made only rarely. My testimony at page 33, line 8, notes that the Postal Service’s estimating procedure concludes that 74.3 percent of all saturation flats bypass casing and are taken to the street in the form of extra bundles. Moreover, in my response to ADVO/VP-T2-4, I concurred with your deduction that the Postal Service’s estimating procedure probably overestimates, perhaps by a wide margin, the volume of saturation flats actually cased before being taken to the street. Correspondingly, the volume of flats taken directly to the street would be underestimated. Thus, to

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

the extent that witness Lewis is correct about the frequency with which saturation flats are collated and then taken to the street as a third bundle, and the volume of saturation flats actually cased (with other non-saturation flats) before being taken to the street is substantially less than 25.7 percent, the extra-bundle treatment given to flats, and the discrimination against letters in that respect, is even greater than discussed in my testimony.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-13.**

On page 30 of your testimony (lines 7-12) you state that "Private vehicles are more constrained, and the interior layout typically gives the [city] carrier less flexibility." Please provide your estimate of the number of city letter carriers that use private vehicles. If you cannot provide a specific number, please indicate whether you believe the use of private vehicles on city delivery routes is common or rare, and explain the basis for your belief.

**RESPONSE:**

Witness Lewis says that city carriers sometimes use private vehicles. Tr. 6/2419, ll. 14-20. He did not provide, and I do not have, an estimate of either the number or percentage of city carriers that use a private vehicle. In comparison to rural carriers, many of whom use a private vehicle on a percentage basis, I would expect that the figure for city carriers is much lower.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-14.**

Referring to Table 2, page 41 of your testimony, please confirm the following or explain fully why you cannot:

(a) You intend to measure the direct casing costs per actually-cased saturation letter and saturation flat.

(b) The flats casing cost includes not only the cost to case the flats actually cased but also any DALs that were also cased.

(c) If your estimate of the number of DALs is correct, then there is a correspondingly lower number of non-DAL letters cased and a correspondingly higher unit letter casing cost.

**RESPONSE:**

- a. My testimony on page 41, at lines 15-17, cites the average in-office costs for saturation letters and flats presented by witness Kelley in USPS-LR-K-67. It is these average costs that caused me to prepare my Table 2. Using saturation flats for purposes of illustration, witness Kelley's average cost is computed as (i) total in-office costs for all saturation flats divided by (ii) the sum of pieces cased plus pieces not cased. In essence, this is a weighted average of (i) the unit cost of flats not cased (which is very low) and (ii) the unit cost of flats that are cased (which is very high in comparison to the unit cost of flats not cased). In other words, the unit cost of flats cased and flats not cased is not unlike a bi-polar distribution. I find averages over bi-polar distributions to be somewhat uninformative as to the underlying reality. Thus, the purpose of my Table 2 is to show the direct unit casing cost per actually-cased saturation letter and saturation flat using Postal Service estimates of (i) casing cost, and (ii) the number of pieces cased, as a means of providing a sort of benchmark for

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

comparison with witness Kelley's averages. In this particular instance, the unit cost of casing flats (\$0.0209, as shown in my Table 2) is 3.94 times witness Kelley's average cost for all saturation flats, and this ratio would be much greater still if the comparison were with the unit in-office cost of flats taken directly to the street, which is not computed.

- b. Confirmed that the saturation flats casing cost, as estimated by IOCS, includes whatever pieces that carriers were handling at the time of the IOCS tally, which could have been either DALs or flats, and which pieces were in the process of being cased (with other flats). Presumably, flats casing cost, as estimated by IOCS, also could include collation of two bundles of saturation flats into a single extra bundle to be taken directly to the street, but I do not know how the IOCS records a carrier's activity when the carrier is collating, as opposed to casing.
- c. I cannot confirm the assertion contained in this part of your interrogatory. I am assuming that a "non-DAL letter" is, simply, a normal addressed letter. So long as the IOCS records as a flat any DAL handled by a carrier when working in the office, the estimated in-office cost of saturation letters, and the resulting estimate of the volume of saturation letters cased, would be independent of the volume of DALs.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-15.**

Have you (or witness Mitchell) made any estimates of the impact on ECR rates of the use of your Table 4 marginal cost estimates for saturation mail by shape in combination with the USPS's estimates of marginal costs for High-Density, Basic, and Automation categories by shape? If so, please provide them, all assumptions you used to develop them (e.g., period that costs and volumes represent, coverage levels, cost differential passthroughs, etc.), and the workpapers you used to develop them.

**RESPONSE:**

No.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-16.**

On page 38 (lines 4-7), you state: “When carriers take saturation mailings directly to their vehicles as an extra bundle, the likelihood that carriers will be sampled by the IOCS while handling such mailings is greatly reduced, to the point of being minimal. . . . for those mailings that carriers handle as extra bundles, the Postal Service will attribute little or no in-office cost, because the mailing is handled only briefly, and in bulk, not as individual pieces.”

(a) Will the IOCS also attribute little or no in-office cost (on a per piece basis) to DPS letters that have avoided in-office casing and been taken directly to carrier vehicles? Please explain.

(b) Do you have any reason to believe that the unit attributable in-office costs of saturation letters taken out as extra bundles is any greater than for DPS saturation letters? Please explain.

**RESPONSE:**

- a. Yes, DPS letters taken directly to the street should incur only trivial in-office costs in cost segment 6, **but**, in order to avoid such in-office costs, they must incur non-trivial DPS costs in cost segment 3. The option of taking presorted saturation mailings directly to carriers’ vehicles — *i.e.*, without casing and without DPS — as described in the testimony of witness Lewis (USPS-T-30, p. 3), is the lowest overall cost option, as my testimony acknowledges. My statement, which you cite, refers to “saturation mailings,” and applies to letter-shaped mail as much as it does to flat-shaped mail. That is why, under the IOCS cost measurement system used by the Postal Service, saturation letter mailers would strongly prefer to have their mail receive equal extra-bundle treatment.
- b. As indicated in my response to preceding part a, DPS letters and presorted saturation letters that bypass sortation altogether and that are taken directly to

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

the street should each incur similar, almost trivial, in-office unit costs.

However, the cost of DPSing letters is not trivial, hence I would expect the total unit cost of saturation letters taken directly to the street to be less than the unit cost of letters that are DPS'd.

1                   CHAIRMAN OMAS: This brings us to oral  
2 cross-examination.

3                   MR. KOETTING: Mr. Chairman?

4                   CHAIRMAN OMAS: Yes?

5                   MR. KOETTING: The Postal Service would like  
6 to designate Mr. Haldi's answers to some Postal  
7 Service interrogatories that were received I believe  
8 late Monday afternoon, and I believe Advo might have  
9 some designations as well.

10                  MR. MCLAUGHLIN: That's correct, Mr.  
11 Chairman.

12                  CHAIRMAN OMAS: Without objection. So  
13 ordered.

14                  Okay. This now brings us to oral cross-  
15 examination. Two parties have requested oral cross.

16   (The document referred to was  
17 marked for identification as  
18 Exhibit No. USPS/VP-T-2-1  
19 through 5.)

20   CROSS-EXAMINATION

21                  BY MR. KOETTING:

22                  Q     Mr. Haldi, I've handed you a copy of your  
23 response to Postal Service Interrogatories  
24 USPS/VP-T-2-1 through 5. If you were asked those  
25 questions orally today would your answers be the same?

1           A     Yes, they would be.

2                   MR. KOETTING:  With that, Mr. Chairman, the  
3     Postal Service moves that these interrogatory  
4     responses be admitted into evidence and transcribed.

5                   CHAIRMAN OMAS:  Without objection.

6                                   (The document referred to,  
7                                   previously identified as  
8                                   Exhibit No. USPS/VP-T-2-1  
9                                   through 5, was received in  
10                                  evidence.)

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**Response of Valpak Witness John Haldi  
to Interrogatory of Postal Service**

**USPS/VP-T2-1.**

If you cannot confirm any of the following, please explain fully.

- a. Please confirm that your own testimony (pg. 63) indicates that DALs not delivered by city or rural carriers could be delivered either to P.O. boxes, or by highway contract carriers.
- b. Please confirm that the recommendation on page 17 of your testimony, that the Commission assume that 99 percent of DALs are delivered by city or rural carriers, is based exclusively on the assumption that 1 percent of DALs are delivered to P.O. boxes.
- c. Please confirm that your 99 percent recommendation therefore fails to account for DALs delivered by highway contract carriers.

**RESPONSE:**

- a. Confirmed. The various ways of delivering DALs described in my testimony are identical to those recognized by witness Kelley, although my distribution differs somewhat from his.
- b. Not confirmed. The 1 percent of all DALs not delivered by city or rural carriers are assumed to be delivered either to P.O. Boxes or by Highway Contract Carriers. Specifically, I assume that 0.2 percent are delivered by Highway Contract Carriers, and 0.8 percent are delivered to P.O. Boxes, as shown in my response to ADVO/VP-T2-2, Attachment 2, cells E15 and E14, respectively. The 0.8 percent assumed to be delivered to P.O. Boxes was based on the 0.77 percent (rounded) that Valpak mailed to P.O. Boxes; see my testimony, page 63, line 17.
- c. Not applicable.

**Response of Valpak Witness John Haldi  
to Interrogatory of Postal Service**

**USPS/VP-T2-2.**

Please refer to the statement on page 14 of your testimony that DALs are counted as letters “in both the city and rural carrier cost systems.”

a. Please confirm that the citation provided to support this statement is to witness Lewis’s response to VP/USPS-T30-20(c), (Tr. 6/2377-78).

b. Please confirm that the subject of that question to witness Lewis was the Piece Count Recording System (PCRS).

c. Is it your contention that the PCRS is a part of either the city or rural carrier cost systems? If so, please explain your understanding of the relationship between PCRS and the city and rural carrier cost systems.

**RESPONSE:**

a. Confirmed that my footnote no. 10 cites the response to VP/USPS-T30-20(c),

Tr. 6/2377-78.

b. Confirmed.

c. No. My footnote no. 10 also should have included references to Postal Service responses to VP/USPS-T5-7(b) and VP/USPS-T43-25 in Docket No. R2001-1.

**Response of Valpak Witness John Haldi  
to Interrogatory of Postal Service**

**USPS/VP-T2-3.**

Please refer to footnote 17 on page 20 of your testimony, which cites the response of witness Lewis to VP/USPS-T30-15 (Tr. 6/2372), and which alleges that certain costs relating to DALs are likely to be incorrectly attributed to saturation letters.

a. Please confirm that, despite the reference in your footnote to “[s]uch transportation costs,” there is no mention of transportation costs in that interrogatory response of witness Lewis.

b. Please state your understanding of the cost segment in which such “transportation costs” are likely to be incurred.

c. Please state your understanding of how the costs in that cost segment are distributed, and specifically explain how the distribution would change if DALs being backhauled to plants were considered letters or flats.

**RESPONSE:**

- a. Confirmed. It is my impression that witness Lewis is an operations expert, not a cost analyst or cost expert. My footnote did not intend any criticism of witness Lewis.
- b. It is my understanding that the labor component of local transportation costs between facilities is in Cost Segment 8, Vehicle Service Drivers, along with other costs (*e.g.*, costs of owning and operating vehicles) associated with local transportation piggybacked on the labor cost.
- c. According the USPS-LR-K-1, “[t]he volume variable costs of VSD labor are distributed to classes and subclasses of mail in the same proportions as cubic feet of total (local and non-local) mail, obtained from Revenue, Pieces and Weight (RPW) statistics (adjusted to include cubic feet for Mailgrams).” (USPS-LR-K-1, p. 8-3, para. 8.1.4.) It thus would appear that the distribution of transportation costs in this segment is totally invariant with respect to the

**Response of Valpak Witness John Haldi  
to Interrogatory of Postal Service**

volume of each subclass that actually receives, or is provided with, local transportation; *i.e.*, ECR saturation mail does not incur any additional transportation cost regardless of how many DALs (or letters) are provided with round-trip transportation between DDUs and facilities where mail is DPS'd.

**Response of Valpak Witness John Haldi  
to Interrogatory of Postal Service**

**USPS/VP-T2-4.**

On page 21 of your testimony, you indicate that labor costs for saturation letters are in the BCS and OCR cost pools (in addition to the BCS/DBCS MODS costs pool).

a. Please confirm that the clerk and mailhandler labor costs attributed to Saturation letters for the BCS and OCR cost pools for FY 2004 are \$76,000 and \$153,000, respectively. (See USPS-LR-K-84, spreadsheet FY04 ECR Mail Proc Costs.xls, sheet Summary.) If you cannot confirm, please provide the costs which you reference in the above passage and provide complete citations to such costs.

b. Please confirm that the FY 2004 cost per piece for Saturation letters associated with this labor costs for the BCS and OCR cost pools is less than one-hundredth of a cent. [Total Saturation letter labor costs for BCS and OCR cost pools of \$229,000 (\$76,000 + \$153,000) divided by the FY 2004 volumes for Saturation letters of 3.444 billion = 0.00664 cents per piece.] If you do not confirm, then please provide a corrected figure and explain how you derived it.

**RESPONSE:**

- a. Confirmed that the direct costs attributed to saturation letters in the BCS and OCR cost pools in the reference cited are \$76,000 and \$153,000, respectively.
- b. Confirmed for FY 2004. If the Postal Service succeeds in getting mailers to use heavier cardstock for their DALs, and the viability of DPSing DALs continues to improve, as discussed by witness Lewis at Tr. 6/2431-33, then these costs also would be growing.

**Response of Valpak Witness John Haldi  
to Interrogatory of Postal Service**

**USPS/VP-T2-5.**

Please refer to page 21 of your testimony, where you state: "All saturation letters are required to be barcoded by mailers, whereas no such requirement exists for DALs, which may or may not be barcoded. It therefore is easy to comprehend why DALs with no barcodes would be processed on BCS or OCR equipment, but impossible to comprehend why any pre-barcoded saturation letters would be processed on such equipment."

- a. Is it your contention that all (i.e. 100 percent of) ECR Saturation letters have a perfectly accurate and readable delivery point barcode?
- b. If not, might this explain why some saturation letters might be processed on BCS and/or OCR equipment? Please explain fully.

**RESPONSE:**

- a. No.
- b. Yes.

1 CHAIRMAN OMAS: Mr. McLaughlin?  
2 (The document referred to was  
3 marked for identification as  
4 Exhibit No. Advo/VP-T-2-17  
5 through 26.)

6 CROSS-EXAMINATION

7 BY MR. MCLAUGHLIN:

8 Q Mr. Haldi, I'm going to be handing you  
9 copies of your responses to Advo/VP-T-2-17 through 26,  
10 and I would ask you if you were asked those questions  
11 today would your answers be the same?

12 A Do these include the errata filed yesterday?

13 Q I better double check on that.

14 A I think 25 had some changes to it, didn't  
15 it? Let's look. I think it was 25 that had the  
16 changes.

17 Yes. Yes. It's got the responses. It's  
18 got that in there. That's fine.

19 (Pause.)

20 CHAIRMAN OMAS: Mr. McLaughlin?

21 BY MR. MCLAUGHLIN:

22 Q Mr. Haldi, do those identified responses  
23 include the errata that you filed yesterday?

24 A Yes, they do.

25 Q So my question still stands. Would your

1 answers be the same?

2 A Yes, they would be.

3 MR. MCLAUGHLIN: Mr. Chairman, I would ask  
4 that these be received into evidence and transcribed  
5 in the record.

6 CHAIRMAN OMAS: Without objection.

7 (The document referred to,  
8 previously identified as  
9 Exhibit No. Advo/VP-T-2-17  
10 through 26, was received in  
11 evidence.)

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**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-17.**

The 2004 billing determinants for commercial ECR saturation letter mail (LR-K-77, "Standard Mail BD2004.xls," pages G 2-2) show that 66.0 percent of saturation letters were dropped shipped to the destination SCF, 21.6 percent to the destination delivery office, and the remaining 12.4 percent at either the destination BMC or no destination entry.

- a. Please confirm that in 2004, 99 percent of Valpak's saturation coupon envelope mail was drop shipped to the destination SCF, and that only a fraction of a percent was entered at a destination delivery office. If not, please provide the correct figures.
- b. Please confirm that Valpak's destination-SCF-entered volume of approximately 500 million pieces constitutes more than one-fourth of the total 1.836 billion commercial saturation letters shown in the 2004 billing determinants as being entered at destination SCFs. If not, please provide the figures you believe to be correct and explain your basis.
- c. Please confirm that, at an average weight of 2.5 ounces per piece as indicated at page 5 of your testimony, Valpak's destination-SCF-entered volume in 2004 weighed approximately 78 million pounds. If not, please provide the average piece weight and total weight of Valpak's saturation letter volume entered at destination SCFs in 2004.
- d. Please confirm that Valpak's destination SCF letters constitute more than two-thirds of the total 114 million pounds of saturation letters shown in the 2004 billing determinants (page G 2-2) as being entered at destination SCFs. If not, please provide the figures you believe to be correct and explain your basis.
- e. Please explain your understanding of the nature of the 21.6 percent of commercial saturation letter volume that is entered at destination delivery units.

**RESPONSE:**

- a. Confirmed.
- b. Confirmed, but see response to part c, below.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

- c. Confirmed. Note, however, that aggregate data and simple averages can be deceptive. When computing and reporting total volume mailed, as in my testimony, Valpak normally does not distinguish between (i) letters that weigh less than 3.3 ounces, (ii) letters that weigh between 3.3 – 3.5 ounces, and (iv) letter-shaped pieces that weigh more than 3.5 ounces. From the perspective of the billing determinants, however, the last category, letter-shaped pieces weighing more than 3.5 ounces pay the non-letter rate and the billing determinants record these pieces as non-letters. Further, it is my impression that the second category, letters that weigh between 3.3 – 3.5 ounces, also are excluded from the volume of letters in the billing determinants (see response to VP/USPS-T2-2, alternative attachment B).

In 2004, the average weight of all of Valpak's letter mail was 2.34 ounces (which is about 6 percent less than the 2.5 ounces for all letter-shaped pieces cited in my testimony), and the total weight was 73.1 million pounds.

- d. Not confirmed. On the assumption that the total weight of 114 million pounds reported in the billing determinants is for letters that weighed less than 3.3 ounces, Valpak's letters under 3.3 ounces weighed 64.2 million pounds, which represented about 56 percent of the total weight.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

- e. Valpak enters about 1.0 percent of its mail at DDUs. By deduction, mailers other than Valpak entered almost all of the 1.376 billion ECR saturation letters (weighing under 3.3 ounces) at DDUs, and that mail weighed approximately 45 million pounds, which is an average weight of 0.5247 ounces. This average weight is between 4 and 12 percent under the average weights of commercial ECR saturation letters entered at DDUs, BMCs, or with no destination entry, which were, respectively, 0.5933 ounces, 0.5692 ounces, and 0.5442 ounces. Beyond these observations, I have no further understanding of non-Valpak ECR saturation letter mail entered at DDUs, as I have not specifically studied DDU-entered ECR saturation letter mail.

**Response of Valpak Witness Haldi  
to Interrogatory of Advo, Inc.**

**Revised 8/24/05**

**ADVO/VP-T2-18.**

The 2004 billing determinants for nonprofit ECR saturation letter mail ("Standard Mail BD2004.xls," page G 4-2) show that (1) 45 percent of nonprofit letters were dropped [sic] shipped to the destination delivery office; (2) such nonprofit letters comprise one-third of all saturation DDU letters; and (3) commercial plus nonprofit DDU letters constitute 26.1 percent of total saturation letters. Please explain your understanding of the nature of the nonprofit saturation letter volume that is entered at destination delivery units.

**RESPONSE:**

I have no specific knowledge concerning which nonprofit organizations send Nonprofit ECR saturation letter mail, or for what purpose, nor which of those nonprofit organizations opt to use DDU entry for their Nonprofit ECR saturation mail. It would be my expectation, however, that most Nonprofit saturation letters consist generally of solicitations. Further, such solicitations that use the saturation rate presumably would be from nonprofit organizations with broad-based local appeal; *e.g.*, hospitals soliciting donations from within their catchment area. The fact that much of such mail is generated locally would help explain why <sup>45</sup>~~37~~ percent is entered at DDUs.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-19.**

Please assume that on a given day there are no saturation mailings available for delivery on a particular city delivery route. Also, assume for the purpose of this question that all saturation mailings being discussed are lower cost to handle as extra bundles rather than as cased/DPS'd delivery volume. In that circumstance, please confirm that the "marginal" cost to deliver a saturation mailing on that route-day is the extra bundle cost. If you cannot confirm, explain why not.

**RESPONSE:**

Your question concerns the marginal cost of a saturation mailing which you ask me to assume does not exist. The question cannot be answered. However, if such a letter or flat saturation mailing were to materialize, and were to be handled as a third bundle, the marginal cost to deliver it is the cost of delivering it as a third bundle, by definition. Please see my responses to ADVO/VP-T2-20, 21, 22, and 24 for further discussion of issues raised by this question.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-20.**

Please assume that on a given day there is one saturation mailing available for delivery on a particular city delivery route. Also, assume for the purpose of this question that all saturation mailings being discussed are lower cost to handle as extra bundles rather than as cased/DPS'd delivery volume. If a second saturation mailing were added that could be collated with the first or carried out as a second tray, then please confirm that the marginal cost to deliver on that route-day is the extra bundle/tray cost. If you cannot confirm, explain why not.

**RESPONSE:**

On those routes or route segments where the second saturation mailing in fact is handled as an extra bundle — *i.e.*, is NOT collated — then the marginal cost would be the extra cost of handling an additional bundle/tray in-office and on the street. Note, however, whenever carriers collate the second saturation mailing with the first, the in-office unit cost of handling two saturation mailings then exceeds by many times the unit in-office cost of handling only one saturation mailing — *i.e.*, by the cost of collating all individual pieces in the two mailings — and in turn that would reflect sharply increasing marginal cost.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-21.**

Please assume that on a given day there is more than one saturation mailing available for delivery on a particular city delivery route. Also, assume for the purpose of this question that all saturation mailings being discussed are lower cost to handle as extra bundles rather than as cased/DPS'd delivery volume. If another saturation mailing were added that day, but which could be deferred for delivery as an extra bundle on the next day when there are otherwise no saturation mailings available for delivery, then please confirm that the marginal cost to deliver that additional saturation mailing is the extra bundle cost. If you cannot confirm, explain why not.

**RESPONSE:**

Confirmed that under the above-stated assumptions, with which I do not take exception, deferral to the next day and extra bundle treatment would be the procedure with the lowest marginal cost, which would be the extra bundle cost. Of course, sometimes the other saturation mailing cannot be deferred to achieve desired levels of service. Also, deferring a saturation mailing to another day can result in multiple third bundles on the next day.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-22.**

On page 35, footnote 44 of your testimony, you state that scarcity rent that can be extracted from a constrained low-cost production option. Please confirm that, in a competitive market system assuming little product differentiation, that [sic] scarcity rent can increase the low-cost producer's product price no more than the price its competitors are charging for the same product. If you cannot, please explain why not.

**RESPONSE:**

The discussion in my testimony, including the footnote which you cite, was in terms of inputs, or factors of production, not products or outputs, which is the subject of this interrogatory. For the sake of clarity and insight into scarcity rent and opportunity cost, I shall address both.

First, let me address scarcity rent for a firm's products, or outputs. Many firms attempt to differentiate their products with the goal of obtaining a higher price, and in an effort to be fully responsive to your question, any such higher price will be considered here as a scarcity rent. Examples would include luxury cars such as Mercedes-Benz, patented prescription pharmaceutical products, *haute couture* fashion designers, and even select upscale restaurants with celebrity chefs. To the extent that such firms succeed at the game of product differentiation, they earn extra profits in the form of scarcity rent. We can contrast markets marked by product differentiation with varying degrees of success to the other extreme, namely, commodity markets. In a commodity market, no product has any meaningful differentiation from similar producers, and no commodity product achieves a higher price or an extra profit based on product differentiation. This can be illustrated by the oil market. Oil comes in different grades, and different grades command different prices. On any given day,

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to Interrogatory of Advo, Inc.**

however, all oil of the same grade commands the same price. Of late, the demand for oil has exceeded supply, so the price of oil has gone up. This means that all oil producers are receiving extra profits, which can be thought of as a scarcity rent, but no producer receives a price (or scarcity rent) for its product that exceeds the price received by producers of the same grade of oil.

Now let us consider opportunity cost and scarcity rents as these concepts apply to inputs, or factors of production. Even in commodity markets that could be considered perfectly competitive, it is possible for one producer to have some factor of production that enables it to have a lower cost than other producers. Continuing with the example of oil, some producer may be able to pump oil at \$5 a barrel, while the cost of pumping oil to other producers of the same grade is, say, \$20 a barrel. The reason that both producers co-exist, of course, is that the capacity to pump low-cost oil is limited, and the low-cost producer cannot supply the entire market. If capacity of the low-cost producer were not limited, it would supply all the oil. However, since capacity is limited, the low-cost producer will get a scarcity rent of \$15 a barrel over the higher-cost producers, even though there is no product differentiation and both sell their oil for the same price. The fact that some oil is produced at \$5 a barrel is not — and would not be — reflected in the market price so long as the demand for oil causes the price to exceed \$20 a barrel.

The Postal Service is in a similar situation with respect to its low-cost, extra-bundle option for handling saturation mail. So long as the volume of saturation mailings is less than the extra-bundle capacity, all saturation mailings of letters, flats and parcels should be taken

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

directly to the street. When the extra-bundle capacity is exceeded, however, and it is no longer possible to take all saturation mailings directly to the street. At that point, an opportunity cost arises from using the limited capacity of the low-cost option for a subset of the available saturation mailings, and the limited capacity of the low-cost option should command a scarcity rent.

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to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-23.**

On pages 37-38 of your testimony, you state: “Every saturation mailing is presorted by line of travel or walk sequence, and therefore qualifies for extra bundle delivery, regardless of whether the mailing consists of letters, addressed flats, flats/covers with DALs, or parcels with DALs.” On page 39, you use the term “qualified candidates for the extra-bundle option. . . .” Please explain what you mean by the terms “qualifies” and “qualified.”

**RESPONSE:**

Let me suggest an alternative way to state this proposition. For “qualifies,” as it appears in the above-quoted statement on pages 37-38, you could substitute “is a potential candidate.” For “qualified,” as it appears in the above-quoted statement on page 39, you could substitute “potential,” so that the beginning of my statement would read, “Among the potential candidates for the extra-bundle option . . . .”

The first statement which you quote defines the set of mailings that, at least potentially, could be taken directly to the street using the extra-bundle option. That is, every mailing in this set satisfies both the density and the presort requirements that enable carriers to assemble mail efficiently from extra bundles for final delivery into an addressee’s mailbox. The chief distinction between mailings that qualify — or are potential candidates — for extra bundle treatment is the density requirement. Mailings that fail to meet the minimum density requirement must, perforce, be cased.

The extra-bundle option, when utilized, is the Postal Service’s lowest cost procedure for handling mail that is a potential candidate — or qualifies — for extra-bundle treatment. Absent any understanding of constraints on the extra-bundle option, one could expect that **all** saturation mail **always** would be taken directly to the street and **never be cased (or DPS’d)**.

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to Interrogatory of Advo, Inc.**

The evidence does not support any such expectation in a world without capacity constraints, however, because a reasonable interpretation of the fact that the Postal Service records some casing costs for both saturation letters and flats is that some bundles (or trays) of saturation mail are cased (or collated) by carriers rather than being taken directly to the street. The fact that all saturation mailings of the four different types described **could** be taken directly to the street using the extra bundle option does not mean that all saturation mailings of the different types described **will be** taken directly to the street using the extra bundle option. For mail **not** taken directly to the street, the cost consequences of course are quite different, and that is why it is necessary to distinguish between what could occur, based on the potential qualification, and what does occur as a result of real world capacity constraints.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-24.**

On Table 4 of your testimony you calculate a [sic] marginal city carrier direct costs for saturation letters and flats.

- (a) Please confirm that your estimated “marginal” costs for letters and flats are the costs for mail that is manually cased by the carrier and taken out as cased mail. If you cannot, please explain why not.
- (b) Since these are the costs for manually cased mail, does that mean you believe that, during BY2004, if an additional (i.e., “marginal”) saturation letter or flat mailing had been added to any city route on any delivery day of the year, the carrier would have been required to case the mailing due to lack of capacity to handle another bundle or tray on any portion of the route either on that day or by deferral to the next day? Please explain.

**RESPONSE:**

- a. Confirmed.
- b. No. Any one of several possible outcomes could occur. First, since the Postal Service incurred casing costs for both saturation letters and flats in Base Year 2004, one distinct possibility is that the Postal Service indeed might find it necessary to incur the additional cost necessary to case an additional saturation letter or flat mailing such as that stipulated in your question, which I will refer to here as Mailing X. A second possibility is that Mailing X can and would be taken directly to the street, **but only if** Mailing X is given priority over some other saturation mailing — Y, say — that then must be cased (or DPS'd if Mailing Y consists of saturation letters), in which event the Postal Service would find it necessary to incur an additional cost to case (or DPS) Mailing Y

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on account of Mailing X. Yet a third possibility is that Mailing X might be collated with some other Mailing Y, if the additional cost of collation is less expensive than the additional cost of casing either Mailing X or Y and taking the other mailing directly to the street. A fourth possibility is, as you suggest, that, on some city routes on some delivery days, Mailing X might be taken directly to the street as an extra bundle, either on the day it arrives at the DDU or after being deferred, without either bumping any other mailing or being collated with any other mailing. In this last case, delivery of the additional Mailing X on those routes and on that particular delivery day would incur a low marginal cost.

Assuming, *arguendo*, that the four above-described possibilities encompass all possible ways of handling an additional saturation Mailing X, I have no way of estimating the likelihood that any of the four possibilities described will turn out to be the way that such an additional mailing is in fact handled. Furthermore, even if such likelihoods could be estimated, multiplying the cost of each possible handling procedure by the applicable likelihood and then summing would result in a weighted average expected cost. The fact that the Postal Service consistently records some casing costs for both saturation letters and flats, and frequently does not take all available saturation mail directly to the street, suggests that the Postal Service does have an effective capacity constraint

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on the low-cost extra bundle option, and, in consequence thereof, it is faced with an increasing marginal cost. A weighted average cost such as that just described should not be construed as any sort of marginal cost that I would advocate using when establishing rates for the different categories of saturation mail, and neither the possibility nor the likelihood of handling an additional saturation mailing in the manner described is a pertinent consideration.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-25.**

Please refer to your response to ADVO/VP-T2-1, part (c), where you discuss your Attachment 2.

- a. You state that “the total combined volume of letters and DALs delivered by city and rural carriers, 6.795 billion in cell F12, reflects exactly the volume of DALs as estimated by the Postal Service in USPS-LR-K-67 – nothing more, and nothing less.” Please explain how the 3.375 billion USPS estimate of DALs (cited at page 15 of your testimony), and your 5.4 billion estimate of DALs at page 76 of your testimony, relates to the 6.795 billion DALs cited in your response.
- b. You also state that “. . . the totals in column F are not any kind of control totals derived from RPW (or any other reliable independent source). . . .” Please explain what your criteria are for a “control total” or “other reliable independent source” for determining the sum of saturation letter-shapes that are delivered on city and rural routes.

**RESPONSE:**

- a. I find your question confusing in several respects. First, my response to ADVO/VP-T2-1 does not have any attachments, and I assume that you intended to refer to ADVO/VP-T2-2. Second, the portion of the sentence which you cite refers to Attachment **1** in my response to ADVO/VP-T2-1, **not** Attachment **2**. The sentence cited begins with the (omitted) phrase “As Attachment 1 clearly shows, . . .” Third, the figure of 6.795 billion is found in cell F12 of Attachment 1 (**not** Attachment 2), and in Attachment 2 referred to in your introduction, the figure in corresponding cell F12 is 9.229 billion; the figure 6.795 billion is **not** contained anywhere in Attachment 2. Fourth, my response does **not** cite to 6.795 billion DALs, as your final sentence seem to suggest

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explicitly refers to a **combined** total of 6.795 billion **letters and DALs**, and 6.795 billion is the **sum of** 3.883 billion **letters** (in cell C12) and 2.912 billion **DALs** (in cell D12).

The “3.375 billion USPS estimate of DALs” referred to in your question can be found in cell D19 of Attachment 1, which also contains the 6.795 billion figure in cell F12. The 5.4 billion estimate of DALs at page 76 of my testimony is found in cell D19 of Attachment 2, which neither contains nor refers to the combined figure of 6.795 billion letters and DALs. My estimate of 5.4 billion DALs and the combined figure of 6.795 billion letters and DALs appear in separate attachments and are not related.

- b. For most classes, subclasses and rate categories of mail, a close, essentially one-to-one, correspondence exists between (i) the number of pieces recorded by the RPW System when the mail is entered, (ii) the number of pieces processed, and (iii) the number of pieces subsequently delivered to addressees. In other words, after the RPW System records a piece of bulk mail as having been entered, that piece typically receives (i) more or less processing (depending on the degree of presortation), (ii) more or less transportation (depending on the point of entry), and (iii) delivery to the addressee, via one of the customary delivery modes (*i.e.*, by a city, rural or highway contract carrier, or to a P.O. Box). This close

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correspondence with respect to pieces recorded on entry, pieces processed and pieces delivered is so basic that sometimes it may be taken for granted.

And when the above-discussed close correspondence obtains, as it does most of the time, an estimate of the number of pieces delivered by each mode can be checked against the number of pieces recorded by the RPW as having been entered. Similarly, an estimate of pieces processed in different ways also can be checked against the number of pieces recorded by the RPW as having been entered. It is not uncommon to use the RPW data as a “control total,” and see slight adjustments made in other independent estimates in order to conform to the RPW data.

Unfortunately, the above-described situation, which is so common for most categories of mail, is not applicable to DALs. It is undisputed that each year the Postal Service receives billions of DALs, all of which must be (i) handled separately when cased or DPS'd, and (ii) fingered separately when delivered with the accompanying cover, yet the Postal Service's RPW System has absolutely no record of how many DALs are entered. And, although the Postal Service maintains various records on the number of pieces of mail processed in various ways, it is equally unfortunate that the Postal Service has no records or data concerning the number of DALs that are cased, DPS'd, or taken directly to

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the street. Moreover, even if the Postal Service did have some crude estimates of the volume of DALs processed in each possible manner, those estimates clearly could not be checked against, or compared with, a non-existent RPW total. Finally, the estimated volume of DALs delivered by each of the various possible modes is dealt with in my two attachments that accompanied my response to ADVO/VP-T2-2.

Attachment 1 shows the Postal Service's estimate of the volume of DALs delivered by each mode, Attachment 2 shows my estimate of the volume of DALs delivered by each mode, and Attachment 3, which is being submitted as errata to my response to ADVO/VP-T2-2, shows my revised estimate of the volume of DALs and letters delivered by each mode. In Attachment 1, the entries in cells F9 and F10 presumably are derived, respectively, from the few weeks of sample data in the CCS and RCS that have been expanded (or "blown up") to an annual basis. Responses to VP/ADVO-1-3 make it abundantly clear that (i) the USPS figures in cells F9 and F10 of Attachment 1 are not correct, and (ii) an independent check, or control total, on such estimates is very much needed. As RPW data on the volume of DALs is non-existent, however, the RPW cannot serve as an independent check, or control total, on the estimated volume delivered by each mode. To sum up, in order for the Postal Service to meet my criteria for a "control total" or "other reliable independent source" for

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determining the sum of saturation letter-shaped pieces (*i.e.*, letters and DALs) that are delivered on city and rural routes, it needs to have a reliable estimate of the number of DALs that are entered. I have urged the Postal Service to modify the forms used for entering bulk mail so as to record whether the volume entered is accompanied by DALs, but as of yet this advice has not been taken.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-26.**

Please refer to your discussion at pages 75-76 and Table A-8 of your testimony.

- a. Your Table A-8 shows separate entries and volumes for “Mail South” and “Others, allied with Advo.” Is it your belief that MailSouth is not a part of the A.N.N.E. network of regional shared mail companies discussed at page 74 of your testimony, whose volumes you estimated under the caption “Others, allied with Advo.”
- b. If MailSouth is and has been, in fact, a part of the A.N.N.E. network, please confirm that your inclusion of a separate estimate of MailSouth’s volumes in your Table A-8 would double-count its volumes with those you estimated under “Others, allied with Advo.” If you cannot confirm, explain why not.

**RESPONSE:**

- a. The MailSouth press release that I received said nothing about MailSouth being a participant in Advo’s A.N.N.E network. To the best of my knowledge, Advo’s Form 10-K does not list the other independent firms that are part of Advo’s A.N.N.E. network. Consequently, based on this, I opted to treat MailSouth as an independent that is not part of “Others, allied with Advo.”
- b. Confirmed, if MailSouth in fact is and has been a part of the A.N.N.E. network.

1 CHAIRMAN OMAS: And now this bring us to  
2 oral cross-examination. Two parties have requested  
3 oral cross, Advo, Inc. and the United States Postal  
4 Service.

5 Mr. McLaughlin, would you like to begin?

6 MR. MCLAUGHLIN: Thank, you, Mr. Chairman.

7 CROSS-EXAMINATION

8 BY MR. MCLAUGHLIN:

9 Q Let's just start with Advo Interrogatory 18  
10 to you that we just had in our hands just a moment ago  
11 up there, which you had done on errata on.

12 I take it in the original answer you had  
13 questioned some of the numbers that we had placed in  
14 our interrogatory. Is that correct?

15 A Yes. I constructed a spreadsheet, and I  
16 mistranscribed some numbers.

17 Q No. I understood that.

18 A Yes.

19 Q I don't have any problem with your response  
20 except for the very last sentence where you talk about  
21 37 percent of non-profit mail being entered at DDUs.  
22 Wasn't that your original answer, and shouldn't that  
23 be instead changed to 45 percent?

24 A Yes, it should be.

25 MR. MCLAUGHLIN: Mr. Chairman, should that

1 just be made in notation on the interrogatories?

2 CHAIRMAN OMAS: Yes.

3 MR. MCLAUGHLIN: Yes. I think we ought to  
4 do it now just so we don't forget about it later on.

5 THE WITNESS: Yes. Yes.

6 (Pause.)

7 MR. MCLAUGHLIN: Mr. Chairman, I do have one  
8 other matter. This is a question that had been  
9 originally directed to Mr. Haldi and then had been  
10 redirected to Valpak, and that related to the  
11 relationship between Valpak and Cox Newspapers.

12 The question had asked whether or not Valpak  
13 -- it asked for the relationship between the two.  
14 After receiving Valpak's answer I went to the Cox  
15 Newspapers website, and the Cox Newspapers website  
16 states that Cox Target Media, provider of Valpak  
17 Network products, is a subsidiary of Cox Newspapers  
18 owned by Cox Enterprises.

19 That statement on the website is  
20 inconsistent with the response in the interrogatory,  
21 and I would like to get that clarified.

22 CHAIRMAN OMAS: Mr. Olson?

23 MR. OLSON: Mr. Chairman, when we had the  
24 interrogatory to respond to we spoke with in-house  
25 counsel of Cox Target Media in Largo, Florida, who

1 gave us the information as we reported it.

2 We'll go back and suggest this other  
3 information from the website, and I believe Mr.  
4 McLaughlin has another website reference.

5 MR. MCLAUGHLIN: There are actually three  
6 websites. There's the Valpak website, there's the Cox  
7 Target Media website, and there's the Cox Newspapers  
8 website. All three of those refer to a relationship  
9 directly through Cox Target Media with Valpak.

10 MR. OLSON: And as strange as it may seem,  
11 this doesn't surprise me in the slightest in that  
12 every time I've had to answer these questions before  
13 or put information into Dr. Haldi's testimony, the  
14 corporate structure at Cox has changed with some 400  
15 companies.

16 I usually have to get the information from a  
17 general counsel in Georgia. This time we got it from  
18 in-house counsel. We'll try to clarify it and have  
19 the websites conform to reality or the interrogatories  
20 conform to reality for sure. I think they do now, but  
21 we'll take a look at it.

22 CHAIRMAN OMAS: Mr. McLaughlin, is that  
23 sufficient?

24 MR. MCLAUGHLIN: That's sufficient. I just  
25 need the answer, whatever the answer may be.

1 CHAIRMAN OMAS: All right. Thank you.

2 And you'll provide that, Mr. Olson?

3 MR. OLSON: Absolutely.

4 CHAIRMAN OMAS: Thank you. You may proceed.

5 BY MR. MCLAUGHLIN:

6 Q Mr. Haldi, I'd now like to turn you to the  
7 pages we just discussed a little while ago, page 80  
8 Revised and page 81 Revised.

9 CHAIRMAN OMAS: Mr. McLaughlin, would you  
10 speak into the mike please?

11 BY MR. MCLAUGHLIN:

12 Q Are you there?

13 A Yes.

14 Q These purport to represent volumes of  
15 saturation detached label mailings. Is that correct?

16 A That's the way I read the website. Yes,  
17 sir.

18 Q Okay. When did you first discover this  
19 information?

20 A I'm trying to remember whether it was last  
21 Friday or last Monday, but it was within the last five  
22 days.

23 Q By last Monday do you mean this Monday?

24 A I mean the day before yesterday. Yes, the  
25 day before yesterday.

1 Q Why did you wait until Wednesday at 4:30 to  
2 provide this information? Excuse me. I guess it was  
3 yesterday at 4:30. Excuse me.

4 A Today is Wednesday, isn't it?

5 Q Yes. Yesterday at 4:30.

6 A Because I'd just become aware of it.  
7 Somebody called my attention to the fact that it was  
8 there, so I went to the website and looked it up.

9 In the process of correcting my testimony to  
10 incorporate the latest information from Advo I decided  
11 to incorporate this other information of which I had  
12 just become aware.

13 Q On the eve of the hearing?

14 A Excuse me?

15 Q On the eve of the hearing?

16 A Correct. Correct.

17 Q The source for this information, which  
18 includes a number of mailers, is something called  
19 echo-media.com. Is that correct?

20 A That's correct. Well, that's the website.

21 Q That's the website.

22 A The firm is Echo Media, and the website is  
23 echo-media.com.

24 Q Okay. Did you do any checking of the  
25 information that you got from the website?

1           A     No. I took it at face value. Now, let me  
2 elaborate. I have no idea whether any of these  
3 companies listed are part of Advo's A.N.N.E. network.

4                     To the extent that they are the way Mail  
5 South appears to have been as was brought to my  
6 attention by one of your interrogatories, they would  
7 be duplicative of the data that we received from Advo  
8 dealing with their A.N.N.E network.

9                     MR. MCLAUGHLIN: By the way, for the  
10 reporter's sake the term A.N.N.E. stands for Advo  
11 National Network Extension, and it's basically an  
12 arrangement between Advo and other regional shared  
13 mailers that allow cross selling into other regions.

14                    THE WITNESS: And it's always been A period,  
15 N period, N period, E period.

16                    MR. MCLAUGHLIN: That's correct. That's the  
17 way it has been spelled, so if the reporter could try  
18 to follow that convention.

19                    BY MR. MCLAUGHLIN:

20            Q     So you didn't check any further on any of  
21 these companies to see what the nature of their  
22 mailings was?

23            A     No.

24            Q     You didn't go to Google or go to the  
25 company's website or try to check any other

1 information to validate the numbers that you have  
2 there?

3 A I really didn't have enough time to do that.  
4 If you look at the echo-media.com website, some of  
5 these are listed as DALs. It's an advertising firm.  
6 They sell advertising. They say these are DALs.

7 Others are listed as inserts or shoppers.  
8 They don't explicitly say they have DALs, but they  
9 likely -- as noted on Table A-10, they likely use DALs  
10 if they're distributed by the mail.

11 Q I'd like to go through these two tables.  
12 Let's start with your Table A-10 that appears on page  
13 81 Revised.

14 A Yes.

15 Q Do you see that?

16 A Yes.

17 Q Let's start with the one right at the top,  
18 Atlanta Savings & Values.

19 A Right.

20 Q You didn't do any checking to find out what  
21 that company was?

22 A No, I didn't.

23 Q Do you know who the owner of that company  
24 is?

25 A No, I do not.

1 Q Would you be interested to know that the  
2 owner is the Atlanta Journal Constitution Newspaper  
3 that is owned by Cox Media or, excuse me, owned by  
4 Cox? Would that surprise you?

5 A Not totally.

6 MR. MCLAUGHLIN: I have some cross-  
7 examination exhibits I'd like to hand out.

8 I might add, Mr. Haldi, that your late  
9 revisions wrecked my evening last night.

10 CHAIRMAN OMAS: Would you say that again?

11 MR. MCLAUGHLIN: Wrecked my evening last  
12 night.

13 CHAIRMAN OMAS: Wrecked it.

14 THE WITNESS: I didn't understand it. Could  
15 you repeat it? I'm having a little trouble with the  
16 noise up here.

17 BY MR. MCLAUGHLIN:

18 Q Are you serious?

19 A Well, no. The background noise.

20 Q It was really irrelevant. Do you see the  
21 cross-examination exhibit that is in color?

22 A Yes.

23 Q Does this appear to come from the Equitable  
24 Media dot com website?

25 A It does indeed. Yes.

1 Q This does refer to Atlanta Savings & Values?

2 A Yes, it does.

3 Q It refers to an annual circulation of 52  
4 million?

5 A Yes, it does.

6 Q It does state there that this is owned by  
7 the *Atlanta Journal Constitution* does it not?

8 A It says that. Yes.

9 Q Does it also state that it is distributed  
10 inside both the *Atlanta Journal Constitution* and the  
11 *Atlanta Journal Constitution's* mail TMC program?

12 A Yes, it does.

13 Q Would that make it sound to you as though  
14 this is a TMC program in the sense that this is not a  
15 saturation mailing?

16 A (No response.)

17 Q You know what a TMC program is?

18 A Total marketing coverage?

19 Q Yes. Do you know what that is?

20 A That's where they mail the people who don't  
21 subscribe to the newspaper I believe.

22 Q Right. The TMC portion is the nonsubscriber  
23 portion, right?

24 A Right.

25 Q So would this lead you to believe that this

1 is a lawn saturation mailing?

2 A It would. Yes.

3 Q In fact, if you look at the second exhibit  
4 that's captioned AJC specialty advertising, the AJC  
5 standing for *Atlanta Journal Constitution* --

6 A Yes.

7 Q -- do you see where it says Atlanta Savings  
8 & Values? The second item down.

9 A Yes. Yes. I see it now.

10 Q There it states that it's delivered with the  
11 *Sunday Atlanta Journal Constitution*, 650,000 pieces,  
12 and that 350,000 are mailed. Is that correct?

13 A That's what it says.

14 Q Are detached labels permissible with lawn  
15 saturation mail?

16 A I don't believe so.

17 Q So this would not be a detached label  
18 mailing would it?

19 A Might not be.

20 Q Might not be?

21 A Probably not.

22 Q How could it be?

23 A I don't think it would be.

24 Q Then you agree that should be crossed-off  
25 your list?

1 A I would agree.

2 Q Can we do that?

3 A Yes.

4 (The documents referred to  
5 were marked for  
6 identification as Exhibit  
7 Nos. ADVO-XE-1 and ADVO-XE-  
8 2.)

9 MR. MCLAUGHLIN: Mr. Chairman, I'd like to  
10 identify the first one, the colored chart, as ADVO-XE-  
11 1 and the second one captioned *Atlanta Journal*  
12 *Constitution* specialty advertising as ADVO-XE-2.  
13 Somebody may have to keep track of my numbering here  
14 so I don't mess things up.

15 I'm handing two copies of these to the  
16 reporter. I do intend to offer all these into  
17 evidence at a later date, but for the moment I take  
18 it, Mr. Chairman, they should just be designated as  
19 cross-examination exhibits?

20 CHAIRMAN OMAS: That's correct.

21 BY MR. MCLAUGHLIN:

22 Q For the moment, I'm going to skip the next  
23 on your Table A-10, cap medium. I will come back to  
24 cap medium. I'm going to go to the *Cincinnati Reach*.  
25 Do you see that?

1 A Yes.

2 Q You don't know anything about that  
3 publication do you?

4 A No, I don't.

5 (The document referred to was  
6 marked for identification as  
7 Exhibit No. ADV0-XE-3.)

8 BY MR. MCLAUGHLIN:

9 Q I have another cross-examination exhibit  
10 that I'd like to distribute. Do you see that cross-  
11 examination exhibit?

12 A Yes, I do.

13 Q Do you notice that there's a picture of the  
14 *Cincinnati Reach* publication on the -- by the way,  
15 this is Echo Media's website again. Is that correct?

16 A Yes, it is.

17 Q The volume annual circulation is 7,800,000,  
18 the same as you show in your Table A-10?

19 A Yes.

20 Q So this is the same company?

21 A I believe it is.

22 Q Would you look at the picture of the *Reach*  
23 publication?

24 A Yes.

25 Q What do you notice about that picture?

- 1           A     It has an address label on it.
- 2           Q     It's on piece address isn't it?
- 3           A     Excuse me?
- 4           Q     Does that look like an on piece address?
- 5           A     It does indeed.
- 6           Q     So this is not a detached label mailing?
- 7           A     It would not appear to be.
- 8           Q     So in that case the *Cincinnati Reach* should
- 9           be scratched off of the list. Is that correct?
- 10          A     Correct.
- 11                 MR. MCLAUGHLIN: Mr. Chairman, I almost
- 12           forgot there to --
- 13                 CHAIRMAN OMAS: Yes. That would be ADVO --
- 14                 MR. MCLAUGHLIN: That would be ADVO-XE-3.
- 15           Thank you.
- 16                 BY MR. MCLAUGHLIN:
- 17          Q     Are you ready for the next one?
- 18          A     I'm ready.
- 19          Q     The name struck me as unusual. The
- 20           *Cleveland Plain Dealer* statements. Have you ever
- 21           heard of the *Cleveland Plain Dealer*?
- 22          A     I think it's a newspaper isn't it?
- 23          Q     Is that a newspaper?
- 24          A     I think it is.
- 25          Q     That's the largest newspaper in Cleveland

1 isn't it?

2 A I've been to Cleveland once in my life for -

3 -

4 Q Well, I will represent to you it's the  
5 largest newspaper in Cleveland.

6 A I'll accept that.

7 Q Does the name *Cleveland Plain Dealer*  
8 statement sound funny for a mailing program?

9 A (No response.)

10 Q It didn't peak your curiosity did it?

11 A No.

12 Q I have other cross-examination exhibits  
13 here. First of all, this is echo-media.com. Is that  
14 correct?

15 A Yes. It says that.

16 Q The annual circulation is 1.8 million?

17 A Yes, it does.

18 Q Which is the same number you show in your  
19 appendix?

20 A Yes, it is.

21 Q It states here that the *Cleveland Plain*  
22 *Dealer* newspaper billing statements deliver  
23 advertisers' preprinter inserts along with invoices  
24 that are mailed to newspaper subscribers. Does that  
25 appear to you to be a detached label saturation ECR

1 mailing?

2 A No, it does not.

3 Q Wouldn't that appear to be a first-class  
4 mailing?

5 A If it enclosed statement information it  
6 should be. Yes.

7 Q So that should be stricken off of the list  
8 as well. Is that right?

9 A That's right.

10 MR. MCLAUGHLIN: Mr. Chairman, at some point  
11 here I do want to have physical strike outs of these  
12 things in the record because otherwise I think it will  
13 be very confusing, particularly because the revised  
14 testimony that's there already has underlines and I  
15 think it would be very difficult to follow what is  
16 being stricken and what's not unless there are cross-  
17 outs of these numbers.

18 CHAIRMAN OMAS: Well, I think what we'll do  
19 is when you finish with your cross-examinations we'll  
20 go through the list and we will say they're to be  
21 stricken from the revised testimony on page 81. Does  
22 that meet with your approval?

23 (The document referred to was  
24 marked for identification as  
25 Exhibit No. ADV0-XE-4.)

1 MR. MCLAUGHLIN: Yes. We can figure that  
2 when we get there. This is No. 4. Is that correct,  
3 Mr. Chairman?

4 CHAIRMAN OMAS: That's correct.

5 BY MR. MCLAUGHLIN:

6 Q Let's skip one down and go to Echo Land  
7 Piper Shoppers/Morris. Do you see that?

8 A Yes. I see it.

9 Q You didn't investigate anything at all about  
10 who this company is. Is that correct?

11 A No, I did not.

12 Q Now, I was curious because the very next one  
13 is Flashes Shoppers/Morris, followed by a Heartland  
14 Shoppers/Morris, and then a Jasper O'Cady Sun  
15 Shoppers/Morris. Then down toward the very bottom  
16 Hope Shoppers/Morris, Tipoff Shoppers/Morris, Town and  
17 Country News/Morris. Do you see all those?

18 A Yes, I do.

19 Q Do you also see another item there called  
20 Morris Communications Shoppers that's sort of in the  
21 middle of those?

22 A I see it. Yes.

23 Q Does the Morris Communications Shoppers  
24 number seem to be substantially larger than any of the  
25 individual numbers that I just read to you?

1           A     It stands out as much bigger.

2           Q     Would you take it as a statement of fact  
3     that each of these companies is a Morris  
4     Communications Shopper?

5           A     It would seem to be identified with Morris.  
6     Yes.

7           Q     That the Morris Communications Shoppers  
8     number includes those totals in there?

9           A     That I don't know whether it does or  
10    doesn't.

11          Q     Well, Mr. Haldi, you were the one that put  
12    this together. Did you check their website?

13          A     I took it off the website. Yes.

14          Q     Did you check the Echo Media website?

15          A     Yes. That's where I got it from, the Echo  
16    Media website. Excuse me. If you mean did I check  
17    the Morris website, the answer is no. Did I check the  
18    Echo Media website, the answer is yes.

19          Q     Do you realize that Morris Communications  
20    Shoppers has eight shoppers?

21          A     (No response.)

22          Q     I'll make that statement. They have eight  
23    shoppers.

24          A     I'll accept that.

25          Q     That each of these ones that you've

1 identified here are Morris Communications Shoppers?

2 A They appear to be.

3 Q Well, I will make that representation to  
4 you. Do you have any reason to doubt that?

5 A No.

6 Q Would you agree in that case that including  
7 all of those shoppers that have the /Morris behind  
8 them would be duplication?

9 A If the Morris Communications Shoppers  
10 includes all those it would be duplicative. Yes.

11 Q Well, you are the one that presented this.  
12 You can go to their website to confirm if you want to.

13 A Well, I didn't have time in this case.

14 Q So you can't state yourself whether this is  
15 duplication or not?

16 A I wouldn't --

17 Q If I told you flat out that each of these  
18 shoppers with the /Morris behind it is a Morris  
19 Communications Shopper would you accept that?

20 A That I would accept. Yes.

21 Q If that's the case wouldn't those numbers  
22 all be duplicative and included in the 27.819?

23 A They could be included. Yes. May well be  
24 included.

25 Q Do you agree that all of those numbers

1 should be stricken except for the Morris  
2 Communications Shopper?

3 A I'll agree to strike them.

4 Q Now, Morris Communications Shopper, I  
5 happened to go to their website and the website is  
6 <http://morriscomm.com/overview/index.fhtml>. That's  
7 the website address. I take it you did not visit that  
8 website address?

9 A Excuse me?

10 Q You did not see that website address?

11 A No.

12 Q On that page there is a welcome video that  
13 is when you open it up entitled orientation.wmv. WMV  
14 is a video file. Is that correct? Are you familiar  
15 with the extension .wmv?

16 A No, I'm not.

17 Q I will represent to you that's a Windows  
18 Media video extension for a video presentation and it  
19 is an orientation on Morris Communications, the  
20 company. It's a fairly lengthy video and at nine  
21 minutes and thirty-six seconds into the video the  
22 video starts talking about the Morris free community  
23 papers for shoppers.

24 You can obviously view the video yourself or  
25 any of the Commissioners can as well. A couple of

1 seconds later into the video at nine minutes and  
2 fifty-two seconds into the video it shows a lawn  
3 postal service carrier placing a poly-bagged item into  
4 a black tube near the street that is adjacent to a  
5 mailbox.

6 The carrier is not putting this poly-bagged  
7 item into the mailbox, but into a tube and the tube  
8 has the word *shopper* on the side of it here. Does  
9 that sound to you like postal delivery?

10 A Your description does not sound like a  
11 postal delivery.

12 Q Does it sound like shopper tube delivery?

13 A Could be. Sounds like it.

14 Q Private delivery?

15 A Sounds like it.

16 Q Then just a couple of seconds later there is  
17 a switch to a different scene of this nonpostal  
18 service carrier standing at a residential doorstep and  
19 hanging a poly-bag onto the doorknob. Do postal  
20 service carriers hang poly-bags on the doorknob?

21 A Not to my knowledge.

22 Q Does that sound like a private delivery  
23 carrier to you?

24 A Sounds like it.

25 Q If that is a private delivery carrier it

1 would not be saturation mail DALs would it?

2 A It would not be.

3 Q In that case, Morris Communications Shoppers  
4 should come off as well?

5 A All right.

6 (The document referred to was  
7 marked for identification as  
8 Exhibit No. ADV0-XE-5.)

9 BY MR. MCLAUGHLIN:

10 Q You can of course look at the video  
11 yourself. I think we're kind of getting through this  
12 list here on Table A-10. Let's go down to the next  
13 one we haven't talked about yet, *Phoenix Saguaro Gold*.  
14 I have another cross-examination exhibit. Now, this  
15 is an echo-media.com web page?

16 A Yes.

17 Q *Phoenix Saguaro Gold*. Annual circulation  
18 6,762,000. Is that correct?

19 A Correct.

20 Q That's the same number shown in your --

21 A That's correct.

22 Q -- appendix there? Would you look at the  
23 picture of the publication?

24 A Yes. I see it.

25 Q What do you see in the lower left-hand

1 corner?

2 A Looks like a space for an address label.

3 Q Would that suggest to you that this is not a  
4 detached label mailing?

5 A It would be suggestive of that. Yes.

6 Q Would it be more than suggestive?

7 A It would indicate it's not an detached  
8 label.

9 Q So this should be taken off the list as  
10 well.

11 A All right.

12 MR. MCLAUGHLIN: Are we up to five, Mr.  
13 Chairman?

14 CHAIRMAN OMAS: Yes, we are.

15 (The document referred to was  
16 marked for identification as  
17 Exhibit No. ADV0-XE-6.)

18 BY MR. MCLAUGHLIN:

19 Q I think that the last one we have on Table  
20 A-10 that we haven't dealt with is the *Phoenix Value*  
21 *Clipper*. Now, we had just looked at the *Phoenix*  
22 *Saguaro Gold* and we now have the *Phoenix Value*  
23 *Clipper*. Do they appear to be sort of similar in  
24 format in terms of the type of publication?

25 A They do.

1 Q A magazine type of format?

2 A Yes. A magazine layout.

3 Q Now, I'll go a little easy on you here.  
4 There is not a clear address space here, a blocked out  
5 address space is there?

6 A I don't see any.

7 Q You do see that there is a substantial  
8 amount of unused space sort of in the middle of the  
9 page there?

10 A Yes.

11 Q That could be used for an address?

12 A It could be.

13 Q So in this case it's ambiguous as to whether  
14 this is mailed with on piece addressing or with a  
15 detached label. Would that be a fair statement?

16 A Fair statement.

17 MR. MCLAUGHLIN: So I will not ask you to  
18 strike that one out. We'll leave that on the list,  
19 but perhaps with a question mark behind it.

20 Let's see here. Is this six?

21 CHAIRMAN OMAS: Six.

22 BY MR. MCLAUGHLIN:

23 Q Well, we're done with Table A-10. Let's now  
24 go up to Table A-9. I'd like to start with -- excuse  
25 me. Let me start with *El Pennysaver*. Do you see

1 that? The fourth one down.

2 A Yes.

3 (The documents referred to  
4 were marked for  
5 identification as Exhibit  
6 Nos. ADVO-XE-7 and ADVO-XE-  
7 8.)

8 BY MR. MCLAUGHLIN:

9 Q I have two cross-examination exhibits here.  
10 Now, are both these documents echo-media.com  
11 documents?

12 A Yes, they are.

13 Q One says *El Pennysaver* and one says *LA*  
14 *Pennysaver*. By the way, *El* is spelled E-L, as in the  
15 Spanish E-L. Do you see what it says there in the  
16 second sentence of the *El Pennysaver* document?

17 A Yes.

18 Q Does it say *El Pennysaver* is a version of  
19 the *LA Pennysaver* and is included in its total  
20 circulation?

21 A Yes.

22 Q Do you see that?

23 A Yeah.

24 Q The *LA Pennysaver* is the *Harte-Hanks LA*  
25 *Pennysaver* is it not?

1 A Yes, it is.

2 Q So the 9.7 million *Harte-Hanks* includes the  
3 1.1 million shown in *El Pennysaver*?

4 A Yes, it would.

5 Q You have separately included *Harte-Hanks* as  
6 a volume count outside of this Table 9 that we're  
7 talking about. Is that right?

8 A That's correct. They're included in my  
9 Table A-8.

10 Q So that would mean that *El Pennysaver* should  
11 come off of this list because it's already included  
12 somewhere else in your testimony. Is that correct?

13 A It would appear to be duplicative. Yes.

14 Q I almost forgot, is it seven?

15 A Which is seven and which is eight?

16 CHAIRMAN OMAS: Excuse me. El, E-L, is  
17 ADVO-XE-7 and LA is ADVO-XE-8.

18 MR. MCLAUGHLIN: I just realized, Mr.  
19 Chairman, I'm writing all these ADVO-XEs probably on  
20 the wrong end here because they may end up getting in  
21 the spine.

22 CHAIRMAN OMAS: As long as they're  
23 documented.

24 MR. MCLAUGHLIN: So we're at seven and  
25 eight. Is that right?

1 CHAIRMAN OMAS: Correct.

2 BY MR. MCLAUGHLIN:

3 Q The next one there is *Focus on Results* and  
4 at this point I'd like to bring in a number of these.  
5 You mentioned earlier that you were aware that you may  
6 have included some A.N.N.E members, that's A-N-N-E, in  
7 your list because you were not sure who A.N.N.E  
8 members were?

9 A That's correct.

10 Q Let me read off the ones here that are  
11 A.N.N.E members for you.

12 A All right.

13 Q Start with *Focus on Results*, a couple more  
14 down is *Marketflect*, two more down is *National Mail*  
15 *It*, three or four more down is *Stonecreek Mailbox*  
16 *Shopper*, next one down is *Target Direct*, the next one  
17 down is *Target Marketing of Maine*, and two more down  
18 is *ValuMail*.

19 Would you accept that all of those are  
20 A.N.N.E members whose volumes are included in Advo's  
21 response to your interrogatory, I believe it was No.  
22 4?

23 A Three.

24 Q Whichever one dealt with --

25 A No. 3.

1 Q Okay. So in that case all of those volumes  
2 for those mailers should come off this chart. Is that  
3 right?

4 A I would accept that. Yes.

5 Q That cuts us down here quite a bit, so don't  
6 have to go through each one individually. The next  
7 one after *Focus on Results* is one that I had trouble  
8 with, *Greentree Marketing*. I did Google searches, I  
9 did everything I could possibly do to try to find  
10 anything about this company and I simply couldn't find  
11 anything else anywhere.

12 Do you have any idea who that company is or  
13 what they mail? I tried both an Internet Explorer  
14 search and a Google search for different kinds of  
15 names. Do you have any idea?

16 A The only thing I have is the sheet on  
17 *Greentree* from the Echo Media website.

18 Q How does it describe *Greentree*?

19 A *Greentree Marketing* mails a four page, full-  
20 color wrap called Smart Mail to C&D markets in North  
21 Carolina. *Greentree's* wrap has been delivered to this  
22 region for over 20 years and is well-known and well-  
23 accepted by those communities. It's on page  
24 advertising and DALs are dominated by local  
25 advertisers while inserts are comprised of local and

1 national clients.

2 Q Well, I did miss that one. So that is a DAL  
3 mailer then. We'll leave that one there. Let's go  
4 down to the *Maryland/Virginia Pennysaver*. Are you  
5 aware that the *Maryland/Virginia Pennysaver* which  
6 serves this area does not use detached labels, but  
7 uses on piece addressing?

8 A The Echo Media doesn't say whether it does  
9 or doesn't. It does say it reaches -- the shopper  
10 publication offers total market saturation reaching  
11 100 percent of the homes in its mailing area. It  
12 doesn't say whether it uses DALs or not.

13 Q If I represented to you that it does not use  
14 DALs, that it uses on piece addressing and that Mr.  
15 Bernard Bradpiece, who has testified here before the  
16 Commission, is the owner of that publication would you  
17 accept that?

18 A I'll accept that. Yes.

19 Q So *Maryland/Virginia Pennysaver* should not  
20 be here then. Let's go down a couple of more. We've  
21 already hit *National Mail*. It's an A.N.N.E member.  
22 Let's go down to the one that says *Reader's Digest*  
23 label carrier program. When you saw this name did it  
24 ring any kind of bells?

25 A Does what?



1 second-class or periodicals publication and not an ECR  
2 saturation detached label mailing?

3 A Could be.

4 Q Could be?

5 A If it has the *Reader's Digest* in it I assume  
6 it would be entered at --

7 A Doesn't it say that this goes to *Reader's*  
8 *Digest* subscribers and this is the address card and  
9 poly-bag for distributing the *Reader's Digest* to  
10 subscribers? Is that what it says?

11 A That's what it says. Yes.

12 Q Is there any conceivable way that could be a  
13 saturation ECR detached label mailing?

14 A Doesn't sound like it.

15 Q Doesn't sound like it?

16 A No. I'll agree it's not.

17 Q So that should come off as well?

18 A Yeah. Let's take it off if it was --

19 MR. MCLAUGHLIN: Are we at --

20 CHAIRMAN OMAS: ADVO-XE-9.

21 THE WITNESS: Is that Exhibit No. ADVO-EX-9  
22 or Exhibit No. ADVO-XE-10? Where are we at?

23 BY MR. MCLAUGHLIN:

24 Q The next one, *Reading Merchandiser*. First  
25 of all, *Reading Merchandiser*, is that kind of a funny

1 name?

2 A I don't know if it's *reading* as in reading  
3 something or *reading* as in Reading, Pennsylvania.

4 Q I believe the answer is it's Reading,  
5 Pennsylvania. Now, Mr. Haldi, the document I just  
6 handed you I will represent to you is taken from the -  
7 - I'm going to give a long title for this publication.  
8 It's taken from the *2004-2005 Media Guide and*  
9 *Membership Directory for Mid-Atlantic Community Papers*  
10 *Association*. You got that?

11 A Okay.

12 Q If you look on that page there are four  
13 squares there. Do you notice the first three squares  
14 deal with the greater Reading area? That one's one,  
15 two and three.

16 A Right.

17 Q Do you notice that if you added up the  
18 circulation of those three zones that it's quite  
19 close, very close in fact, to the 5,053,000, line 32,  
20 that you show for the *Reading Merchandiser*?

21 A Well, subject to check I'll accept that.

22 Q Okay. Do you see in each of the blocks  
23 about a little over halfway down there's something  
24 called circulation information?

25 A Yes.

1 Q In each case, doesn't it show that virtually  
2 all of the volume is home delivery volume as opposed  
3 to mailed volume?

4 A It indicates that. Yes.

5 Q Mailed volume is zero in each case isn't it?

6 A Correct.

7 Q So this is delivered privately and not  
8 through the mail. Is that correct?

9 A Yes.

10 Q So this should be taken off the list?

11 A All right.

12 MR. MCLAUGHLIN: Help me.

13 CHAIRMAN OMAS: Exhibit No. ADVO-XE-10.

14 (The document referred to was  
15 marked for identification as  
16 Exhibit No. ADVO-XE-10.)

17 MR. MCLAUGHLIN: Thank you.

18 CHAIRMAN OMAS: You're welcome.

19 BY MR. MCLAUGHLIN:

20 Q On the next one, Mr. Haldi, I'm not going to  
21 actually stick in another cross-examination exhibit.  
22 I do want to show you something that could otherwise  
23 be a cross-examination exhibit. The reason I'm not  
24 marking it as a cross-examination exhibit is because  
25 it's perhaps ambiguous.

1           Do you see that this is also Echo Media  
2 again and you would confirm that this is the same  
3 publication as the value pages that you list in your  
4 document. Is that right?

5           A     Yes.

6           Q     Do you see that there is a potential  
7 addressing area either side of the Taster's Choice  
8 spot there, but it's ambiguous, though, as to whether  
9 it's actually an address area or whether this could be  
10 a DAL mailing?

11          A     Well, it's described as a wrap, but I  
12 suppose you can put addresses on wraps, too.

13          Q     So I won't take this off the list, but it is  
14 not certain that this is a detached label publication.  
15 Is that correct?

16          A     Correct.

17          Q     Now, finally there's something there called  
18 at the very end Wal-Mart C&D country wrap. Do you see  
19 that?

20          A     Yes.

21          Q     If I told you that is mail by Advo and is  
22 included in Advo-1 numbers in an amount just virtually  
23 identical to that would you accept that?

24          A     Okay. Subject to check I'll accept that.  
25 Yes.

1           Q     In fact, I had the number here somewhere and  
2     now I have misplaced the number that is included for  
3     that program in the Advo package, but in that case  
4     that would not be there either as well in this table.  
5     Is that right?

6           A     Say it --

7           Q     If it's included in the Advo-1 interrogatory  
8     response it should not be included here. Is that  
9     right?

10          A     What's the Advo-1 response?

11          Q     That's the response to Val-Pak's Advo-1.

12          A     Yes. If that's included, yes.

13          Q     Now, let's see here. We're getting close to  
14     the end of this. I have prepared a spreadsheet which  
15     lists all of the items shown in your Table A-9 and A-  
16     10. Let me hand that out. Now, the spreadsheet that  
17     lists in Column 1 all of the publications you've  
18     listed lists in Column 2 all of the volumes that you  
19     have shown in your two tables.

20                 Then the last three columns, one column is  
21     A.N.N.E, and then the middle column is other and the  
22     third column is for explanation. Do you see that?

23          A     Right.

24                 MR. MCLAUGHLIN: I'm not quite sure of the  
25     best way to proceed with this, Mr. Chairman.

1           The witness has already I think confirmed  
2 everything that is in here except for the ones of  
3 course that were question marks that we have not  
4 excluded from his count, but I would like to have this  
5 entered as a cross-examination exhibit and give the  
6 witness an opportunity to take a look at it and see if  
7 he has any disagreement with the exhibit in light of  
8 the cross-examination and the other cross-examination  
9 exhibits. Would that be appropriate?

10           CHAIRMAN OMAS: Mr. Olson?

11           MR. OLSON: Mr. Chairman, perhaps we can  
12 look at it during the break.

13           CHAIRMAN OMAS: I was just going to say, are  
14 you pretty much finished with this part of your cross?

15           MR. MCLAUGHLIN: Yes. Yes. This is the  
16 last part of this.

17           CHAIRMAN OMAS: Okay. So this is the end?

18           MR. MCLAUGHLIN: This is the end dealing  
19 with this part. Yes.

20           CHAIRMAN OMAS: Before you go on. Well, why  
21 don't we take a break for lunch and let's come back at  
22 1:30, okay? Thank you.

23           Did you want cross-examination Exhibit No.  
24 ADVO-XE-11?

25           MR. MCLAUGHLIN: Yes, I do.

1                   CHAIRMAN OMAS: That would be Exhibit No.  
2           ADVO-XE-11.

3                                   (The document referred to was  
4                                   marked for identification as  
5                                   Exhibit No. ADVO-XE-11.)

6                   (Whereupon, at 12:25 p.m., the hearing in  
7           the above-entitled matter was recessed, to reconvene  
8           at 1:30 p.m., this same day, Wednesday, August 24,  
9           2005.)

10           //  
11           //  
12           //  
13           //  
14           //  
15           //  
16           //  
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21           //  
22           //  
23           //  
24           //  
25           //



1 MR. MCLAUGHLIN: Mr. Chairman, somebody did  
2 mention that to me over the break and I forgot to  
3 mention that, that Cap Media is in fact an A.N.N.E  
4 member. Also, I would make one slight amendment. I  
5 think on *Greentree Marketing* we determined that was  
6 DAL and I would cross-off the question marks under  
7 *explanation*.

8 Is that okay with you?

9 MR. OLSON: Yes.

10 MR. MCLAUGHLIN: Mr. Chairman, I'm going to  
11 do that on the copy I handed to the reporter.

12 CHAIRMAN OMAS: All right. Thank you.

13 MR. MCLAUGHLIN: With that, Mr. Chairman,  
14 I'd move that Exhibit Nos. ADVO-XE-1 through ADVO-XE-  
15 11 be received into evidence and transcribed.

16 CHAIRMAN OMAS: Without objection.

17 (The documents referred to,  
18 previously identified as  
19 Exhibit Nos. ADVO-XE-1  
20 through ADVO-XE-11, were  
21 received in evidence.)

22 //

23 //

24 //

25 //

# Atlanta Savings & Values



The Atlanta Savings & Values is a four page, full color wrap that is mailed weekly to consumers in the Atlanta area. It is distributed inside both the Atlanta Journal- Constitution and the AJC's mailed TMC program. Atlanta Savings & Values reaches 1,000,000 households each week. A wide variety of advertising opportunities exist weekly in this publication for full and half page advertisements.

8/28/2005	1,000,000
9/4/2005	1,000,000
9/11/2005	1,000,000
9/18/2005	1,000,000
9/25/2005	1,000,000
10/2/2005	1,000,000
10/9/2005	1,000,000
10/16/2005	1,000,000
10/23/2005	1,000,000
10/30/2005	1,000,000
11/6/2005	1,000,000
11/13/2005	1,000,000

\*Only shows next 12 dates

Annual Circulation: 52,000,000  
Unduplicated Circ: 1,000,000  
Frequency: 52 X Year

Metro HH Segment  
Broadcast Mailing  
State(s): GA  
Market: Atlanta



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# specialty advertising

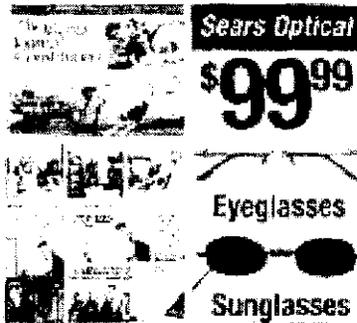
Trying to reach customers in specific zones or ZIP codes? Place your advertising message in one of these Atlanta Journal-Constitution advertising vehicles and watch it hit its target! It's the perfect complement to a strong newspaper advertising program.



▲ ad bags



▲ atlanta savings & values



▲ comic wrap/gatefold



▲ tv week vertical wrap

## ad bags

Subscribers will see your ad first — even before they take the paper out of the bag — with your printed message on the outside of our newspaper delivery wrapper. Product samples can also be included.

## atlanta savings & values | SUNDAY | MONDAY

Join the party with this full-color, multi-page, multi-advertiser freestanding insert. This program offers circulation of a million homes (650,000 delivered with the Sunday AJC; 350,000 delivered with the REACH shared mail program) plus zoned advertising options.

## print and deliver

No preprints? Ask your AJC representative to print it for you and insert it for geographically targeted distribution or full market coverage. Choose from a wide variety of sizes, paper stocks and ink colors. Commercial or specialty services are also available.

## comics wraparounds & gatefolds | SUNDAY

Full of color and fun to read, the comics are an ideal place for advertising that appeals to children and their parents.

## single advertiser sections

Sole sponsorship of advertorial insert sections for news, sports and feature sections give your advertising message the impact of editorial coverage. This can allow you to target your prospects by zone while strategically increasing your share of market.

## tv week vertical wrap | SUNDAY

Place your ad where many newspaper readers will keep it near their televisions and refer to it every day of the week, in a full-color wrap around our TV Week section! It's one of the Sunday paper's most visible advertising opportunities.

## ad deadlines

Deadlines vary by day of the week and edition.

For information on specialty advertising, ask your account executive, or call 404-526-5179.

To learn more on jacket and other direct marketing opportunities, call 770-509-4064.

The Atlanta Journal-Constitution

ajc.com

# Cincinnati Reach



Reach Magazine is a full size coupon magazine that is direct mailed to the consumer in the greater Cincinnati market. This magazine reaches 650,000 households per mailing. On-page and insert opportunities exist for retail and direct response advertisers. This full color glossy publication is a favorite for restaurants and local services. Because local the coupon values tend to last one month in this publication, this program has a long shelf life.

1/3/2005	650,000
1/31/2005	650,000
2/28/2005	650,000
3/28/2005	650,000
5/2/2005	650,000
5/30/2005	650,000
6/27/2005	650,000
8/1/2005	650,000
8/29/2005	650,000
10/3/2005	650,000
10/31/2005	650,000
11/28/2005	650,000

\*Only shows next 12 dates

Annual Circulation:	7,800,000
Unduplicated Circ:	650,000
Frequency:	12 X Year

Metro HH Segment  
Broadcast Mailing  
State(s): INKYOH  
Market: Cincinnati



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# leveland Plain Dealer Statements

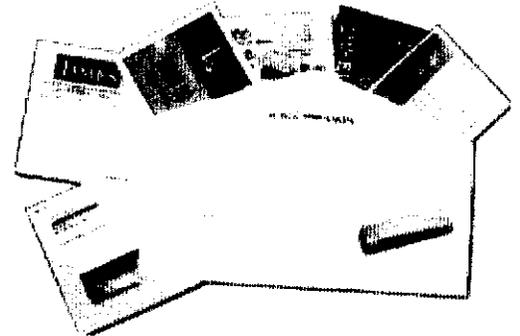


The Cleveland Plain Dealer newspaper billing statements deliver advertiser's pre-printed inserts along with invoices that are mailed to newspaper subscribers throughout the month. By reaching consumers in their homes, and with the implied endorsement of an important bill, advertisers are insured a high opening rate. Only two advertisers can run in each month, so there is very little clutter.

10/1/2004	150,000
11/1/2004	150,000
12/1/2004	150,000
1/1/2005	150,000
2/1/2005	150,000
3/1/2005	150,000
4/1/2005	150,000
5/1/2005	150,000
6/1/2005	150,000
7/1/2005	150,000
8/1/2005	150,000
9/1/2005	150,000
*Only shows next 12 dates	

Annual Circulation:	1,800,000
Unduplicated Circ:	150,000
Frequency:	12 X Year

Average Income:	\$68,254
Metro HH Segment	
Name List Mailing	
State(s):	OH
Market:	Cleveland



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# Phoenix Saguaro Gold

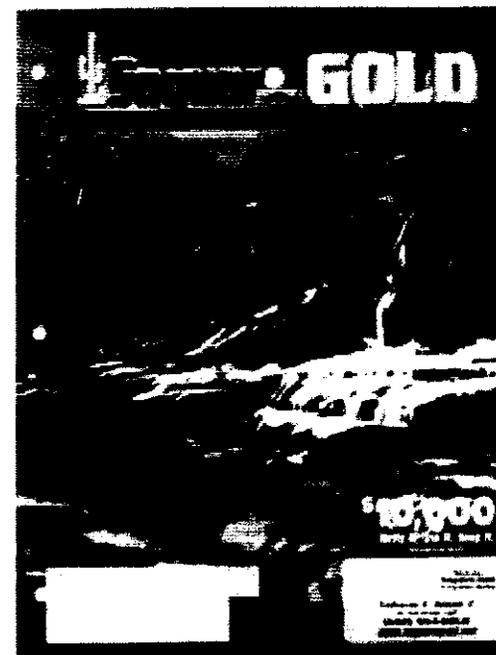


Saguaro Gold is a full color glossy coupon magazine that mails to over 960,000 households in the Phoenix market. With the largest circulation in Phoenix, Saguaro Gold has many ways of purchasing advertising space to target your audience better: full circulation and up to 14 separate zones. Full page, half page and insert opportunities exist. Retail, home services and direct response offers welcome.

1/3/2005	966,000
2/7/2005	966,000
3/21/2005	966,000
5/9/2005	966,000
7/4/2005	966,000
8/8/2005	966,000
9/19/2005	966,000
11/14/2005	966,000

Annual Circulation:	6,762,000
Unduplicated Circ:	966,000
Frequency:	7 X Year

Metro HH Segment  
 Broadcast Mailing  
 State(s): AZ  
 Market: Phoenix



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# Phoenix Value Clipper

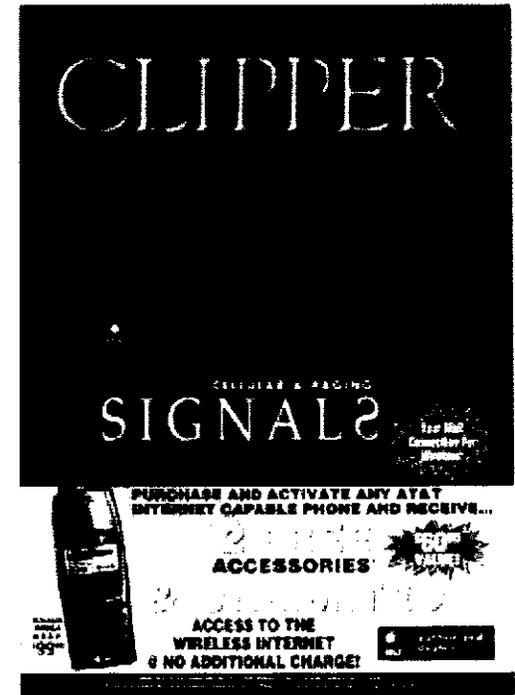


The Phoenix Value Clipper is a four color, glossy coupon magazine that is mailed to over 850,000 households in the greater Phoenix area. Mailing eleven times a year, the Value Clipper is a reliable vehicle for local and national retail advertisers as well as direct response offers. The Value Clipper offer opportunities to advertise on page (full and half pages available) and inserts. Advertising space can be purchased by full circulation or by zone.

11/3/2004	855,000
12/1/2004	855,000
1/3/2005	855,000
2/7/2005	855,000
3/7/2005	855,000
4/4/2005	855,000
5/2/2005	855,000
6/6/2005	855,000
7/5/2005	855,000
8/8/2005	855,000
9/6/2005	855,000
10/3/2005	855,000
*Only shows next 12 dates	

Annual Circulation: 9,435,514  
 Unduplicated Circ: 855,000  
 Frequency: 11 X Year

Metro HH Segment  
 Broadcast Mailing  
 State(s): AZ  
 Market: Phoenix



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## El Pennysaver

El Pennysaver is the Spanish language version of the LA Pennysaver, targeting zones where the Hispanic population is high. El Pennysaver is a version of the LA Pennysaver and is included in its total circulation. However, El Pennysaver can be bought separately in order to segment out the Hispanic population throughout California. El Pennysaver is a weekly advertising shopper that is saturation-mailed to homes and apartments throughout California. Direct response opportunities include DAL's, pre-printed inserts, and on-page placement with Pensando En Ti a 2-4 page FSI, which is inserted inside this shopper. El Pennysaver features various on-page and insert advertisements for national and local retailers.

InHome	Date	Circulation
	8/24/2005	1,100,000
	8/31/2005	1,100,000
	9/7/2005	1,100,000
	9/14/2005	1,100,000
	9/21/2005	1,100,000
	9/28/2005	1,100,000
	10/5/2005	1,100,000
	10/12/2005	1,100,000
	10/19/2005	1,100,000
	10/26/2005	1,100,000
	11/2/2005	1,100,000
	11/9/2005	1,100,000

\*Only shows next 12 dates

Circulation and Frequency
Annual Circulation: 57,200,000
Unduplicated Circ: 1,100,000
Frequency: 52 X Year

Demographics
Hispanic Segment
Metro HH Segment



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## LA Pennysaver



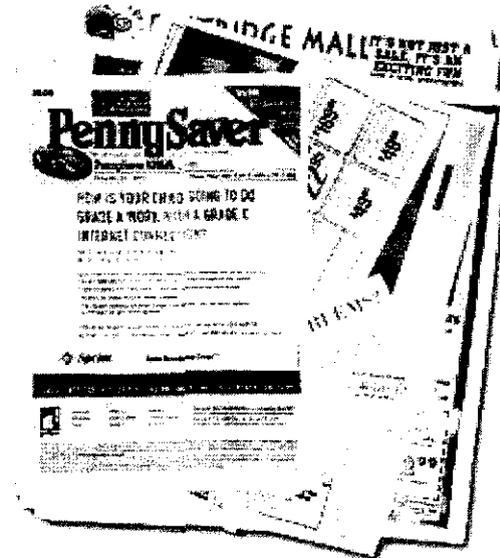
The Harte-Hanks LA Pennysaver is a weekly advertising shopper that is saturation-mailed to homes and apartments throughout California, from the greater San Francisco area southward, through Los Angeles, Sacramento, and San Diego. Advertising opportunities include pre-prints, DAL's, and on-page placement with the Marquee, a 2-4 page FSI, which is inserted inside of the shopper.

InHome	Date	Circulation
	8/24/2005	9,783,143
	8/31/2005	9,783,143
	9/7/2005	9,783,143
	9/14/2005	9,783,143
	9/21/2005	9,783,143
	9/28/2005	9,783,143
	10/5/2005	9,783,143
	10/12/2005	9,783,143
	10/19/2005	9,783,143
	10/26/2005	9,783,143
	11/2/2005	9,783,143
	11/9/2005	9,783,143

\*Only shows next 12 dates

Circulation and Frequency
Annual Circulation: 508,723,436
Unduplicated Circ: 9,783,143
Frequency: 52 X Year

Demographics
Metro HH Segment
Broadcast Mailing
State(s): CA



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# Reader's Digest - Label Carrier Program

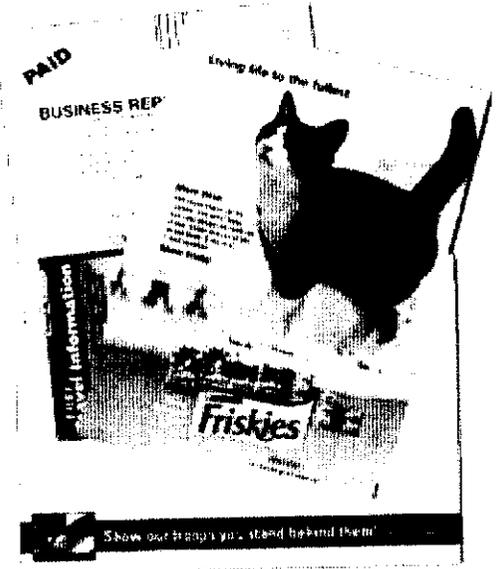


Each polybagged issue of Reader's Digest contains an address card, the first item that greets the subscriber upon opening the package. In addition to carrying the subscriber's name and address, the card contains a "teaser" line at the bottom. This line invites the reader to turn over the card. Once there, you have an opportunity to send a strong message to the reader; it could be a brand message, coupon, an invitation directing the consumer to a web site, reply card or any message you choose.

1/1/2005	1,000,000
2/1/2005	1,000,000
3/1/2005	1,000,000
4/1/2005	1,000,000
5/1/2005	1,000,000
6/1/2005	1,000,000
7/1/2005	1,000,000
8/1/2005	1,000,000
9/1/2005	1,000,000
10/1/2005	1,000,000
11/1/2005	1,000,000
12/1/2005	1,000,000
*Only shows next 12 dates	

Annual Circulation:	1,000,000
Unduplicated Circ:	1,000,000
Frequency:	12 X Year

Average Income:	\$50,259
Average Age:	49
Percent Female:	59
Reading Segment	
Name List Mailing	



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**PENNSYLVANIA**

28

LEBANON  
TYPE: SHOPPER (90%/10%)  
FREQUENCY: WEEKLY



GREATER READING AREA ZONE 1

**KAPP ADVERTISING SERVICE, INC**

Years Established: 1971  
PO BOX 840  
LEBANON, PA 17042  
PHONE: 717/273-8127  
FAX: 717/273-0420  
EMAIL: sales@themerchandiser.com  
WEBSITE: www.themerchandiser.com

**PERSONNEL INFORMATION**  
PUBLISHER: ROBERT KAPP  
GEN. MGR: VALERIE STOKES  
ADVERTISING CONTACT: JAMES SNYDER  
CIRCULATION CONTACT: JOANNE WALKINSHAW

**CIRCULATION INFORMATION**

EDITIONS: .....	1	PAID: .....	0
HOME DELIVERY: .....	29,188	PAID SINGLE: .....	0
CONTROLLED BULK: .....	798	OFFICE FILES: .....	25
MAILED: .....	0	RETURNED/UNCLAIMED: .....	0
RESTOCK/OFFICE COPIES: .....	281	TOTAL CIRCULATION: .....	30,177
OTHER: .....	0	SUBSCRIPTION: .....	N/A

**DISTRIBUTION INFORMATION**

PUBLICATION DAY: ..... WED.  
CIRCULATION TIME: ..... ALL DAY  
INSERTS: ..... YES  
**DEADLINES**  
DISPLAY DEADLINE: ..... WED.  
CLASSIFIED DEADLINE: ..... WED.  
EDITORIAL DEADLINE: .....

**PUBLICATION MECHANICALS**  
FORMAT: ..... TABLOID  
AVERAGE PAGE COUNT: ..... 40  
# OF COLUMNS & DEPTH: ..... 5 X 16  
COLUMN WIDTH IN INCHES: ..... 1.94  
FULL PAGE: ..... 10.25 X 16  
ELECTRONIC: ..... Y/MULTI AD  
PROCESS COLOR? ..... YES

**PENNSYLVANIA**

28

LEBANON  
TYPE: SHOPPER (90%/10%)  
FREQUENCY: WEEKLY



GREATER READING AREA ZONE 3

**KAPP ADVERTISING SERVICE, INC**

Years Established: 1971  
PO BOX 840  
LEBANON, PA 17042  
PHONE: 717/273-8127  
FAX: 717/273-0420  
EMAIL: sales@themerchandiser.com  
WEBSITE: www.themerchandiser.com

**PERSONNEL INFORMATION**  
PUBLISHER: ROBERT KAPP  
GEN. MGR: VALERIE STOKES  
ADVERTISING CONTACT: JAMES SNYDER  
CIRCULATION CONTACT: JOANNE WALKINSHAW

**CIRCULATION INFORMATION**

EDITIONS: .....	1	PAID: .....	0
HOME DELIVERY: .....	28,691	PAID SINGLE: .....	0
CONTROLLED BULK: .....	373	OFFICE FILES: .....	25
MAILED: .....	0	RETURNED/UNCLAIMED: .....	0
RESTOCK/OFFICE COPIES: .....	404	TOTAL CIRCULATION: .....	29,468
OTHER: .....	0	SUBSCRIPTION: .....	N/A

**DISTRIBUTION INFORMATION**

PUBLICATION DAY: ..... WED.  
CIRCULATION TIME: ..... ALL DAY  
INSERTS: ..... YES  
**DEADLINES**  
DISPLAY DEADLINE: ..... WED.  
CLASSIFIED DEADLINE: ..... WED.  
EDITORIAL DEADLINE: .....

**PUBLICATION MECHANICALS**  
FORMAT: ..... TABLOID  
AVERAGE PAGE COUNT: ..... 40  
# OF COLUMNS & DEPTH: ..... 5 X 16  
COLUMN WIDTH IN INCHES: ..... 1.94  
FULL PAGE: ..... 10.25 X 16  
ELECTRONIC: ..... Y/MULTI AD  
PROCESS COLOR? ..... YES

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**PENNSYLVANIA**

28

LEBANON  
TYPE: SHOPPER (90%/10%)  
FREQUENCY: WEEKLY



GREATER READING AREA ZONE 2

**KAPP ADVERTISING SERVICE, INC**

Years Established: 1971  
PO BOX 840  
LEBANON, PA 17042  
PHONE: 717/273-8127  
FAX: 717/273-0420  
EMAIL: sales@themerchandiser.com  
WEBSITE: www.themerchandiser.com

**PERSONNEL INFORMATION**  
PUBLISHER: ROBERT KAPP  
GEN. MGR: VALERIE STOKES  
ADVERTISING CONTACT: JAMES SNYDER  
CIRCULATION CONTACT: JOANNE WALKINSHAW

**CIRCULATION INFORMATION**

EDITIONS: .....	1	PAID: .....	0
HOME DELIVERY: .....	38,970	PAID SINGLE: .....	0
CONTROLLED BULK: .....	1,249	OFFICE FILES: .....	25
MAILED: .....	0	RETURNED/UNCLAIMED: .....	0
RESTOCK/OFFICE COPIES: .....	725	TOTAL CIRCULATION: .....	38,944
OTHER: .....	0	SUBSCRIPTION: .....	N/A

**DISTRIBUTION INFORMATION**

PUBLICATION DAY: ..... WED.  
CIRCULATION TIME: ..... ALL DAY  
INSERTS: ..... YES  
**DEADLINES**  
DISPLAY DEADLINE: ..... WED.  
CLASSIFIED DEADLINE: ..... WED.  
EDITORIAL DEADLINE: .....

**PUBLICATION MECHANICALS**  
FORMAT: ..... TABLOID  
AVERAGE PAGE COUNT: ..... 40  
# OF COLUMNS & DEPTH: ..... 5 X 16  
COLUMN WIDTH IN INCHES: ..... 1.94  
FULL PAGE: ..... 10.25 X 16  
ELECTRONIC: ..... Y/MULTI AD  
PROCESS COLOR? ..... YES

**PENNSYLVANIA**

28

LEBANON  
TYPE: SHOPPER (90%/10%)  
FREQUENCY: WEEKLY



HANOVER AREA

**KAPP ADVERTISING SERVICE, INC**

Years Established: 1974  
PO BOX 840  
LEBANON, PA 17042  
PHONE: 717/273-8127  
FAX: 717/272-0420  
EMAIL: sales@themerchandiser.com  
WEBSITE: www.themerchandiser.com

**PERSONNEL INFORMATION**  
PUBLISHER: ROBERT KAPP  
GEN. MGR: VALERIE STOKES  
ADVERTISING CONTACT: JAMES SNYDER  
CIRCULATION CONTACT: JOANNE WALKINSHAW

**CIRCULATION INFORMATION**

EDITIONS: .....	1	PAID: .....	0
HOME DELIVERY: .....	38,591	PAID SINGLE: .....	0
CONTROLLED BULK: .....	344	OFFICE FILES: .....	25
MAILED: .....	0	RETURNED/UNCLAIMED: .....	0
RESTOCK/OFFICE COPIES: .....	602	TOTAL CIRCULATION: .....	38,537
OTHER: .....	0	SUBSCRIPTION: .....	N/A

**DISTRIBUTION INFORMATION**

PUBLICATION DAY: ..... WED.  
CIRCULATION TIME: ..... ALL DAY  
INSERTS: ..... YES  
**DEADLINES**  
DISPLAY DEADLINE: ..... FRI  
CLASSIFIED DEADLINE: ..... FRI  
EDITORIAL DEADLINE: .....

**PUBLICATION MECHANICALS**  
FORMAT: ..... TABLOID  
AVERAGE PAGE COUNT: ..... 40  
# OF COLUMNS & DEPTH: ..... 5 X 16  
COLUMN WIDTH IN INCHES: ..... 1.94  
FULL PAGE: ..... 10.25 X 16  
ELECTRONIC: ..... Y/MULTI AD  
PROCESS COLOR? ..... YES

ADVO-XE-11

HALDI TABLE A-9	HALDI	KNOWN OVERSTATEMENT		
		A.N.N.E.	Other	Explanation
Abilene Money Clip	1,242,696			
Crookston Shopper	561,600			
EI Flyer	12,090,000			
EI Pennysaver	57,200,000		57,200,000	Duplicates Harte-Hanks
Focus on Results	13,708,164	13,708,164		Included in A.N.N.E.
Green Tree Marketing	3,613,464			???
Mail-Net	53,834,040			
Market Select	5,252,000	5,252,000		Included in A.N.N.E.
Maryland/Virginia Pennysaver	66,652,300		66,652,300	No DAL
National Mail It	26,573,696	26,573,696		Included in A.N.N.E.
Pittsburg Pennysaver	37,107,380			
Readers Digest Label Carrier Program	1,000,000		1,000,000	Periodical - No DAL
Reading Merchandiser	5,053,932		5,053,932	Private delivery
Stone Creek Mailbox Shopper	2,408,688	2,408,688		Included in A.N.N.E.
Target Direct	2,822,112	2,822,112		Included in A.N.N.E.
Target Marketing of Maine	7,220,076	7,220,076		Included in A.N.N.E.
Tucson Shopper	14,235,832			
Value pages	18,700,000			
ValuMail	24,365,544	24,365,544		Included in A.N.N.E.
Wal-Mart C&D County Wrap	32,843,965		32,843,965	Included in Advo total
<b>HALDI TOTAL</b>	<b>386,485,489</b>	<b>82,350,280</b>	<b>162,750,197</b>	
<b>ADJUSTED TOTAL</b>	<b>141,385,012</b>			

HALDI TABLE A-10	HALDI	KNOWN OVERSTATEMENT		
		A.N.N.E.	Other	Explanation
Atlanta Savings & Values	52,000,000		52,000,000	Nonsaturation TMC
Cap Media	25,537,668	25,537,668		Included in A.N.N.E.
Cincinnati Reach	7,800,000		7,800,000	No DAL
Cleveland Plain Dealer Statements	1,800,000		1,800,000	1st Class Ltr - No DAL
Dallas Ad Pages	9,060,000			
Echoland-Piper Shoppers/Morris	1,391,000		1,391,000	Duplicates Morris
Flashes Shoppers/Morris	8,241,012		8,241,012	Duplicates Morris
Heartland Shoppers/Morris	7,698,756		7,698,756	Duplicates Morris
Jasper-Okatie Sun Shoppers/Morris	226,200		226,200	Duplicates Morris
Morris Communications Shoppers	27,819,584		27,819,584	Private Delivery
Phoenix Saguaro Gold	6,762,000		6,762,000	No DAL
Phoenix Value Clipper	9,435,514			???
Polk Shoppers/Morris	4,598,100		4,598,100	Duplicates Morris
Tip-Off Shoppers/Morris	1,000,636		1,000,636	Duplicates Morris
Town & Country News/ Morris	520,000		520,000	Duplicates Morris
<b>HALDI TOTAL</b>	<b>163,890,470</b>	<b>25,537,668</b>	<b>119,857,288</b>	
<b>DJUSTED TOTAL</b>	<b>18,495,514</b>			

1 BY MR. MCLAUGHLIN:

2 Q Now, I'd like to have you turn to page 73.

3 A I'm sorry. What page?

4 Q Page 73.

5 A I'm there.

6 Q Do you see from approximately line 11 down  
7 through 17 your discussing Advo's statements in its  
8 SEC Form 10-K report --

9 A Yes.

10 Q -- compared to the volume data that we  
11 provided on I believe it was Monday in this  
12 proceeding?

13 A Yes.

14 Q You state, however, perhaps at odds with a  
15 statement in its Form 10-K Advo reports that in 2004  
16 it mailed basically 3.145 billion DALs with its  
17 Shopwise products which represents an average of only  
18 60.5 million per week. Do you see that statement?

19 A Yes. I see it.

20 Q Are you implying that maybe Advo is  
21 misleading either the Commission or the SEC?

22 A I'm just saying that the two segments are  
23 not wholly consistent.

24 Q They are not wholly consistent. They're not  
25 reconcilable?

1 A They may be reconcilable.

2 Q Well, let's go through and see. I think  
3 what we have to do here is go back and figure out how  
4 you figured these numbers out. Let's go up to  
5 starting on line 11. Advo's core product, a shared  
6 advertising program called *Shopwise*, and then you  
7 quote from the SEC report "reaches approximately 78  
8 million households, primarily on a weekly basis." Do  
9 you see that statement?

10 A Yes.

11 Q Now, then when you go down here and  
12 calculate the 60.5 million pieces per week off of the  
13 new volume data that Advo has provided how did you  
14 calculate that?

15 A I divided by 52.

16 Q You divided by 52. Why did you do that?

17 A Well, usually 52 weeks in a year.

18 Q So in other words you assumed that every one  
19 of Advo's mail pieces is mailed weekly?

20 A No. I just said 3.145 billion averages 60.5  
21 million pieces per week.

22 Q Let's take a look at line 13. This is after  
23 you quote from Advo's statement to the effect that  
24 Advo's statement says approximately 78 million  
25 households, primarily on a weekly basis. Do you see

1 that?

2 A Yes.

3 Q The very next sentence is yours. Is that  
4 right?

5 A That's correct.

6 Q It says this program alone would distribute  
7 approximately 4.06 billion pieces a year. How did you  
8 derive the 4.06 billion pieces a year?

9 A I multiplied 78 by 52.

10 Q So your assumption was that Advo didn't mean  
11 *primarily* on a weekly basis, it meant *entirely* on a  
12 weekly basis?

13 A No. That's why I said *approximately*.

14 Q Approximately. Okay. Did you also assume  
15 that the 78 million households listed in the SEC  
16 report were solely saturation mail households? Didn't  
17 you necessarily assume that?

18 A I guess I did. Yes.

19 Q You didn't think about it, though, did you?

20 A I didn't think hard on it because my  
21 impression was that the *Shopwise* product was a  
22 saturation product.

23 Q You obviously got Advo's response to your  
24 interrogatories didn't you?

25 A (Nonverbal response.)

1 MR. MCLAUGHLIN: Excuse me. I apologize to  
2 the Commissioners. I do not have a copy of Advo's  
3 response to Val-Pak Interrogatory No. 1. It's  
4 obviously on the docket or on the computers.

5 BY MR. MCLAUGHLIN:

6 Q Take a look at VP/ADVO-1(b).

7 A I don't have a copy of that with me. Maybe  
8 my counsel can share a copy with me. Okay. Yes. I  
9 have it now.

10 Q So it's your understanding of the 3.145  
11 billion in 2004, that is saturation mail with DALs,  
12 right?

13 A No. It says including weekly and nonweekly.  
14 I don't know whether weekly or nonweekly is saturation  
15 or not.

16 Q Well, to use the DAL it has to be  
17 saturation, right?

18 A Yes.

19 Q So this is weekly and nonweekly saturation  
20 mail using a detached label, right?

21 A Right.

22 Q Will you read the very next sentence?

23 A About 15 percent of Advo's total volumes  
24 were distributed without DALs by a nonsaturation and  
25 private delivery.

1 Q Nonsaturation mail?

2 A Yes. Sorry.

3 Q Nonsaturation mail?

4 A Correct. Nonsaturation *mail* and private  
5 delivery. Correct.

6 Q So you should have had reason to know that  
7 there was nonsaturation mail in Advo's program?

8 A All right.

9 Q You didn't assume that did you when you did  
10 your calculations?

11 A No.

12 Q In fact, couldn't you have approximated that  
13 volume a little bit from the information we gave you?  
14 At least get a ballpark on it?

15 A I think you did somewhere give me the volume  
16 of private delivery didn't you?

17 Q Correct. So you could have backed that out  
18 couldn't you?

19 A I could have backed that out. Yes.

20 Q Then you could have applied that to the  
21 total volume to figure out aggregate volumes?

22 A Yes.

23 Q Let me represent to you that had you done  
24 so. Actually you wouldn't have got quite the number  
25 I'm going to give you because the percentages we gave

1 you in response are rounded numbers, you understand --

2 A Uh-huh.

3 Q -- so when you're subtracting a round number  
4 from a rounded number it's off by a percentage or two.  
5 Let me represent to you that in 2004 Advo mailed seven  
6 million weekly nonsaturation mail pieces without a  
7 DAL. If you wish to you can go back through the  
8 numbers we gave you and plug those in and you'll see  
9 that is certainly a ballpark figure, okay?

10 A Okay.

11 Q So that means that if the 78 million  
12 includes nonsaturation households if you wanted to get  
13 saturation households you would back out that seven  
14 million wouldn't you?

15 A Yeah.

16 Q So that gets you down to 71 million  
17 saturation households?

18 A Right.

19 Q The saturation households are not just  
20 weekly, but also include monthly don't they?

21 A They could. Yes.

22 Q If I told you that roughly 22 percent were  
23 monthly, and that the monthly circulation was about 15  
24 million, and the weekly circulation was about 56  
25 million, would 15 million plus 56 million equal 71

1 million?

2 A Yes.

3 Q Would 71 million plus seven million  
4 nonsaturation households equal 78 million?

5 A Yes.

6 Q Would that then rationalize Advo's SEC  
7 statement of 78 million households primarily on a  
8 weekly basis with the numbers that we gave in Advo-1  
9 of 3.145 billion saturation DAL?

10 A Yes.

11 Q Now, you also have a footnote 70. This is  
12 one that my client particularly wanted me to ask you  
13 about because they are somewhat sensitive about their  
14 Missing Children program. You're suggesting here  
15 Advo's website states the Missing Child piece on a DAL  
16 reaches up to 85 million homes a week.

17 You then suggest that on this basis the  
18 annual volume of DALs from Advo alone is as much as  
19 4.4 billion pieces. Do you see that?

20 A Yes.

21 Q You calculated that the same way you did the  
22 earlier numbers where you assumed everything was -- in  
23 other words, you assumed 52 times a year and you  
24 basically multiplied 85 million homes times 52 to get  
25 your 4.4 billion figure, right?

1 A (Nonverbal response.)

2 Q Are you aware that for a couple of the  
3 A.N.N.E members that Advo does the ordering of  
4 detached labels for them and that those labels include  
5 the missing child picture and logo?

6 A I have no knowledge as to Advo's internal  
7 practices with it's A.N.N.E members.

8 Q Now, those are A.N.N.E mailings, but Advo  
9 procures the cards --

10 A Yeah.

11 Q -- and it has the picture of the missing  
12 child on it as a way of expanding their reach of the  
13 missing child program.

14 A Right.

15 Q Could that explain the 85 million homes per  
16 week?

17 A I'd have to compare the 78 versus the  
18 A.N.N.E mailings, but it might. Yes.

19 Q You can do that on your own.

20 A Yeah.

21 Q I think you'll find that difference is  
22 easily accommodated within the A.N.N.E volume.

23 A Right.

24 Q I don't want to be picky, but I'm going to  
25 be slightly picky here. I'd like to refer you to your

1 response to Advo-VP-T2-25. Your response there starts  
2 off saying I find your question confusing in several  
3 respects. It goes on to say that we cited to the  
4 wrong documents and wrong attachments. Do you see  
5 that?

6 A Yes.

7 Q Are you aware that the very day that Advo  
8 filed that interrogatory that I called your counsel to  
9 give him the corrections for the correct citations the  
10 very day that we filed the interrogatory?

11 A No. I was not made aware of that.

12 Q So it may have been that the question you  
13 saw was confusing, but I would also state that you  
14 were not aware that your counsel and I agreed that  
15 there was no need to file an errata because we could  
16 just take care of it informally.

17 A I was not informed of that, but I endeavored  
18 to answer the question anyway.

19 Q No, no, no. I understand. Now, I asked Mr.  
20 Mitchell some questions about the saturation coupon  
21 envelope industry, and he appeared to have relatively  
22 little knowledge about that industry. Do you know  
23 whether Val-Pak is the largest of the coupon envelope  
24 mailers in the country?

25 A There's two answers to that. One is, in

1 terms of some kind of an industry survey, I do not  
2 know. I know that Val-Pak believes it's the largest,  
3 and on page 9 of my testimony, I list other  
4 competitors, including the one believed by Val-Pak to  
5 be the second largest.

6 Q Do you know how those mailers compare in  
7 relative size?

8 A That, I don't know.

9 MR. McLAUGHLIN: Okay. Mr. Chairman, I'm  
10 done. Thank you very much.

11 CHAIRMAN OMAS: Thank you, Mr. McLaughlin.  
12 Mr. Koetting?

13 MR. KOETTING: Thank you, Mr. Chairman.

14 CROSS-EXAMINATION

15 BY MR. KOETTING:

16 Q Good afternoon, Dr. Haldi.

17 A Good afternoon, Mr. Koetting.

18 Q I would like to focus on Section 3D of your  
19 testimony, which is pages 14 through 17, and your  
20 response to Advo No. 2, the revised response. That's  
21 just to sort of fill you in on my general focus.

22 At that part of your testimony, you are  
23 discussing volumes of DALs. Correct?

24 A Correct.

25 Q And we've had quite a bit of discussion,

1 both this morning and after lunch, regarding some of  
2 the volume numbers regarding DALs in your testimony  
3 and your appendices. Correct?

4 A Correct.

5 Q I want to step back up a little bit from  
6 perhaps the trees and see if we can talk about the  
7 forest a bit.

8 The first question is, why is it that we  
9 care about the volume of DALs in this proceeding?

10 A Why do we care about the volume of DALs?

11 Q Correct.

12 A Because my understanding is that DALs must  
13 be handled as pieces by city carriers when they  
14 deliver the mail and as pieces by rural carriers when  
15 they deliver the mail, and, for that matter, they may  
16 be handled as pieces if they are cased, and to the  
17 extent that they are DPS, they are also handled as  
18 pieces, and those handlings all involve costs.  
19 Historically, for the last 10 years, it would appear  
20 that they have been counted as letters, and the costs  
21 of handling those pieces have been charged to lettered  
22 mail.

23 Q So the fundamental point I'm trying to get  
24 at here, which you've just touched on, is what we're  
25 worried about here is cost attribution and

1 distribution. It's not volumes, per se; it's the  
2 effect on the cost attribution. Correct?

3 A That's an important part of it, yes. I  
4 think most mail has handling costs, and the more the  
5 volume, the more the costs of handling the mail.

6 Q In order to make use of the volume numbers  
7 that you presented in your testimony and your  
8 interrogatory responses, those have to be converted to  
9 costs. Correct? The Commission doesn't recommend  
10 volumes; they recommend rates based on costs.

11 A That's correct.

12 Q Is it true that in none of the materials  
13 that you presented to the Commission, either in your  
14 testimony or in your interrogatory responses, you have  
15 actually calculated any new costs based on the new  
16 volumes you have suggested?

17 A That is correct.

18 Q And just for the sake of completeness, Mr.  
19 Mitchell doesn't do that either.

20 A That's correct

21 Q So when is that supposed to happen during  
22 this process, that some people take these different  
23 volume estimates and convert them into costs that can  
24 be used for rate-making?

25 A Well, my understanding of the new study on

1 city carrier costs is that there is a cost of what  
2 Witness Bradley references to as "sequenced mail," a  
3 term I'm not particularly happy with because I think  
4 all saturation mail is sequenced, but by "sequence,"  
5 he means saturation mail that bypasses casing and is  
6 taken directly to the street, and he calculates a pool  
7 of costs, and that pool of costs includes saturation  
8 letters, saturation flats and the DALs that go with  
9 unaddressed flats, as well as the addressed saturation  
10 flats.

11 One of the problems he has then is to  
12 allocate that pool of costs between the various  
13 components that make up that pool, and my  
14 understanding -- I didn't follow through all of the  
15 allocation of costs of that cost pool, but my  
16 understanding is it's based on the volumes of each  
17 respective item believed to be handled in there. It's  
18 really based on letters and nonletters.

19 Q My question wasn't clear. The Postal  
20 Service has an estimate of DALs that's been presented  
21 in Witness Kelly's work and has presented a cost  
22 allocation based on that volume of DALs. Correct?

23 A That's my understanding, yes.

24 Q My point is you are now coming with an  
25 alternative estimation of the volume of DALs.

1 Correct?

2 A Correct.

3 Q Where is the cost allocation that goes with  
4 that? I think your answer was you haven't provided  
5 it, and Mr. Mitchell hasn't provided it, so my  
6 question is, where does that come from, then? Where  
7 will that happen in the rate-making process?

8 A I am not cognizant enough of Witness Kelly's  
9 library reference to change the volume of DALs and  
10 work through it to what the cost implications would  
11 be. I'm not able to manipulate that library reference  
12 to that end.

13 Q So how does anybody use the volume forecast  
14 that you've presented, then, if it hasn't been  
15 converted into new cost allocations?

16 A I would hope that the Commission would have  
17 that capability, and I would hope that Mr. Kelly would  
18 have that capability.

19 Q Presuming that the Postal Service's cost  
20 allocation is the one that it has already presented,  
21 you're suggesting, I take it, then that the Commission  
22 would be required to do those calculations themselves?

23 A Yes.

24 Q And even though those are calculations that  
25 you are unable to replicate or calculate, perform, the

1 Commission should be able to do that without anybody  
2 else's ability to test what they do on the record. Is  
3 that correct?

4 A I don't know if they have that capability or  
5 not. I would hope so.

6 Q Let's go back, and like I said, pull back  
7 from the trees a little bit and try to look at the  
8 forest, and let's start with the CRA, what we call the  
9 CRA, in Postal Service lexicon. There is a PRC  
10 version and the Postal Service version, and that, as I  
11 believe you would agree, contains the attribution and  
12 distribution of costs at what we call the "subclass  
13 level." It would include special services. It would  
14 also include, in some instances like single piece,  
15 first-class rate categories, but it's essentially line  
16 items at the subclass level. Are you familiar with  
17 that?

18 A Yes.

19 Q And that would be presented in the Postal  
20 Service's evidentiary presentation by the base year  
21 witness, Witness Meehan. Correct?

22 A Yes.

23 Q And the base year costs are split up into a  
24 variety of cost segments, including cost segment 7,  
25 for example, which is city carriers' street time. Do

1 you know how city carriers' street time costs that are  
2 determined to be volume variable are distributed?

3 A There was the old method, and then there is  
4 a new method. I say the "old method." I think,  
5 ultimately, they used the distribution of the pieces  
6 in the city carrier cost system as the distribution  
7 key, except that, again, -- I haven't tried to follow  
8 all of the different cost pools that Witness Bradley  
9 generates in his new study, but, ultimately, I think  
10 it depends on the city carrier cost system sample.

11 Q And we call that "CCS" for short.

12 A Yes.

13 Q Okay. And would you agree that the function  
14 of library reference USPS-LR-K67, with respect to cost  
15 segment 7, city carrier street time costs, is to  
16 disaggregate the subclass costs into finer categories  
17 for rate design of whatever other purposes?

18 A Yes. That's my understanding of what it  
19 tries to do.

20 MR. KOETTING: At this time, just for  
21 purposes of convenience, convenient reference, I'm  
22 going to pass out copies of Table 1 of Witness Kelly's  
23 testimony, USPS-T-16, which is also a table in library  
24 reference K67, just so everybody can follow along with  
25 the discussion in terms of how these things are being

1 disaggregated.

2 (Pause.)

3 BY MR. KOETTING:

4 Q You're certainly free to look at that as  
5 long as you want, but I'm not going to be referencing  
6 any particular numbers. The point that I wanted to  
7 make, again, to reiterate, is simply that what K67  
8 does is, for each of these subclasses or, again, the  
9 first-class, single-piece rate categories, it's  
10 starting with the CRA subclass cost for particular  
11 cost segment 7, 6, and 10, and it is disaggregating  
12 those subclass figures into these rows under the  
13 respective categories. Correct?

14 A Correct. I guess it's ultimately dividing  
15 by volumes because it's unit costs.

16 Q Correct. You are correct. You take the  
17 distribution, and then you divide by volumes, but  
18 prior to expressing it as a unit, you have to have a  
19 category total cost. Correct?

20 So we've already established that the  
21 subclass distribution key for cost segment 7 is CCS.  
22 Would you agree, then, that in not necessarily a  
23 perfect world, a less-imperfect world, the way the  
24 subclass costs would be distributed for each of these  
25 categories would be to have a CCS volume corresponding

1 to each of these rows in this table?

2 A Yes. I would assume there is a volume  
3 associated with each.

4 Q But, unfortunately, as we know from both  
5 Witness Kelly's testimony and your testimony, it's a  
6 little more complicated than simply taking CCS volumes  
7 for each row and distributing on that basis. Correct?

8 A Correct.

9 Q And if you flip over to the second page of  
10 Table 1, this would show the results for the category  
11 discussed in your testimony, which is standard ECR  
12 mail, and, in fact, in this particular portion of the  
13 table, Witness Kelly presents two possible unit costs  
14 based on two different distribution costs --  
15 correct? -- the top one being the city carrier and  
16 rural carrier cost included in the numerator of ECR  
17 saturation letters, and the bottom portion being the  
18 same cost included in the numerator of ECR saturation  
19 flats. Correct?

20 A That's what it says.

21 Q I would now like to turn to your  
22 attachment -- you have a set of attachments -- to your  
23 response to Advo Question 2, and in the revised  
24 version, there are three attachments.

25 A Let me say that I intended Attachment 3

1 essentially as a replacement for Attachment 2 based on  
2 updated information which I didn't have at the time I  
3 prepared Attachment 2, but to keep the record simple,  
4 I call it a new attachment.

5 Q Yes. I'm fine with that. That was a  
6 convenient way to amend your answer.

7 I would like to look at Attachment 1 to  
8 this, and although this is your attachment, in fact,  
9 all you're doing in this attachment is summarizing  
10 what the Postal Service has done in library reference  
11 case 67. Correct?

12 A That's the purpose of the attachment, yes.

13 Q And it, in fact, is a very convenient  
14 summary of that. I would, again talking about city  
15 carriers, just like to focus on what is row 9 in  
16 Attachment 1. When I asked you earlier on why volumes  
17 were important, this mismatch problem, in terms of  
18 sometimes the cost of DALs, because a DAL is letter  
19 shaped, would be included with ECR saturation letters  
20 when, in fact, those costs should be associated with  
21 ECR saturation flats. Correct?

22 A Well, I think we agree to that, although  
23 Witness Kelly's written testimony was rather moot as  
24 to saying that he was recommending the adoption of the  
25 costs that reflected the DAL adjustment. Nowhere did

1 he actually say this is the way it ought to be, but I  
2 hope that we agree to that.

3 Q I think that was cleared up on cross-  
4 examination by your counsel, but the record will speak  
5 for itself on that.

6 What's being addressed in this Attachment  
7 1 -- I call it Attachment 1, but it's really what's  
8 going on in this part of K67, is that some costs which  
9 have been distributed by CCS to ECR saturation letters  
10 actually relate to DALs and, therefore, need to be  
11 shifted to flats. Isn't that correct?

12 A I couldn't understand you. Say it again,  
13 please.

14 Q The problem being addressed is that some  
15 costs which have been distributed by CCS to letters  
16 actually relate to DALs; and, therefore, they need to  
17 be shifted to flats.

18 A Right.

19 Q So Attachment 1 represents the process by  
20 which K67 is attempting to figure out the share of CCS  
21 letters that are DALs in order to move that portion of  
22 ECR saturation letter costs to flats. Correct?

23 A Correct. That's the way I understand what's  
24 going on there.

25 Q And so in order to do that, you start with

1 the CCS letter total shaped volumes in column F, which  
2 is a 5114 figure, and then you take an exogenous  
3 estimate of the number of DALs, which is shown in  
4 column E -- that's where Witness Kelly got his from,  
5 the household diary, but that's not particularly  
6 relevant to what I'm focusing on now, simply an  
7 exogenous estimate of DALs, and you subtract that  
8 number of DALs from the total shown in column F in  
9 order to determine how many non-DAL, letter-shaped  
10 pieces are left from the CCS total that you started  
11 with in column F. Is that correct?

12 A Well, when you say I do that, if you look at  
13 the footnote for C-9, that's what the Postal Service  
14 does in the reference there, and I replicated what  
15 they did, I hope, faithfully.

16 Q So now the Postal Service has now split the  
17 CCS letter total of 5144 into two components, the DAL  
18 component of 2095 and the non-DAL component of 3048,  
19 and it now can determine the share of total ECR  
20 saturation, letter-shaped cost that gets shifted from  
21 letters to flats. Correct?

22 A I think that's what's going on, yes.

23 Q Okay. So now let's look at your Attachments  
24 2 and 3. Two is the one that you filed before you had  
25 the Advo figures, and then three is the comparable one

1 filed after you had the Advo figures. Correct?

2 A Correct.

3 Q Now, is it true that, again, sticking with  
4 the city carrier row, which, in Attachment 2, is once  
5 again row 9, and in Attachment 3, it, I think,  
6 switches to --

7 A In Attachment 3, it slipped to row 11.

8 Q -- right, row 11 -- that neither of those  
9 totals in column F tie back to the column F CCS total  
10 shown in Attachment 1. Is that correct?

11 A That is correct.

12 Q And in the text of your response to Advo  
13 2(c) -- Advo 2 was the interrogatory response to which  
14 these attachments were attached -- 2(c) is the last of  
15 the subparts -- at the very end of that response, --  
16 I'm sorry -- I should say your revised response, you  
17 explicitly reject the CCS estimate as flawed. Is that  
18 correct?

19 A That's correct.

20 Q But since CCS is the source of the cost pool  
21 that you were trying to split up between DALs and non-  
22 DALs, haven't you created a logical disconnect by  
23 rejecting the need to bring columns C and D of your  
24 Attachments 2 and 3 into line with the CCS column F  
25 total in Attachment 1?

1           A     As I understand -- repeat that, please.

2           Q     Sure.  Again, we started with the notion  
3     that the whole purpose of K67 is to take these  
4     subclass cost pools and disaggregate them into the  
5     rows shown in Table 1, and within the row for ECR  
6     saturation letters, you have a cost pool based on CCS.  
7     In Attachment 1, what you're trying to do is split  
8     that cost pool up between DALs and non-DALs, and yet  
9     in your Attachment 2, you are no longer tying your  
10    total to that cost pool, and isn't that a logical  
11    disconnect?

12          A     You're talking about the total in column F  
13    of my attachment.  Is that correct?

14          Q     That's correct.

15          A     Okay.  The reason I asked you to repeat it,  
16    I thought I heard you say "column 1" earlier, and that  
17    threw me.  But if you're referring to the total in  
18    column F, I do not interpret the number, 514493, on  
19    the city carrier row -- I'm looking now at Attachment  
20    1 --

21          Q     Right.

22          A     -- I do not interpret that as a cost figure.  
23    I interpret that as a number-of-pieces figure.

24          Q     But isn't that the number of pieces that's  
25    used to determine the share of costs that get

1 distributed to ECR letter-shaped, saturation pieces?

2 A That may be the pieces that they use, but if  
3 you have better evidence that that's the wrong number  
4 of pieces, I think they should find a way to revise  
5 those number of pieces if the aggregate total is  
6 important.

7 To the extent that you're talking about the  
8 percentage breakdown across the row, the percentage  
9 that letters comprise and the percentage that DALs  
10 comprise of that total, for purposes of splitting some  
11 total cost, then the aggregate number is what it is.

12 Q The aggregate number comes out of CCS, which  
13 is what is used to distribute, as we've already  
14 established, all city carrier street costs, both to  
15 subclasses and then in K67 below the subclass levels.  
16 Correct?

17 A I understand CCS is a sample. It's not a  
18 census of the pieces. It's a sample taken over a  
19 period of weeks. It's a random sample over a period  
20 of weeks over certain offices, and it's been blown up,  
21 I gather, to what they think is an annual figure in  
22 terms of volumes. We're dealing here with volumes,  
23 not costs, at this point.

24 Q So are you suggesting that the Commission  
25 should abandon using CCS to distribute city carrier

1 costs altogether?

2 A No, but I'm suggesting that they take a  
3 sample, and since they don't have any other data on  
4 DALs against which they can check the accuracy of that  
5 sample, -- the sampling system here is like a single-  
6 entry accounting system, which is prone to all kinds  
7 of error. That's why they use double-entry accounting  
8 systems for financial transactions.

9 For your other classes and subclasses of  
10 mail, you have an RPW system against which any kind of  
11 blow up of volumes can be checked, typically. You  
12 have an RPW statistics for first-class letters, and  
13 that even breaks down into subcategories, and for  
14 standard mail you have the same thing.

15 If you look at Attachment I, I pointed out,  
16 you have an RPW figure for the total volume of letter-  
17 shaped pieces that were entered in 2004, and that's  
18 3826244 shown at the bottom of that column C, and  
19 using the Postal Service procedure, they estimate that  
20 the volume of letters delivered by city and rural  
21 carriers exceeds that aggregate figure. They  
22 delivered more letters than were entered in the  
23 system, and presumably then none were delivered to  
24 P.O. boxes or highway contract routes.

25 One of the weaknesses I'm suggesting in the

1 whole data collection system is when it comes to the  
2 DALs, you have not data of what's entered, and that's,  
3 unfortunately, why I have to go to sources totally  
4 outside the Postal Service, as I've done, and I'm  
5 groping out here, that Mr. McLaughlin has taken issue  
6 with what I've gone out and dredge up off of Web sites  
7 because the Postal Service has no aggregate data on  
8 the volume of DALs that they are handling, and they  
9 have no way that they can check the volume of DALs and  
10 letters against what was entered into the mail  
11 network, the postal network.

12 Q Well, the Postal Service has made the  
13 adjustment that you have laid out in your Attachment 1  
14 on the basis of -- DALs. Correct?

15 A That's their adjustment. Correct.

16 Q And that adjustment ties back to the CCS  
17 cost pool that has gone to ECR saturation letters  
18 based on the exact same distribution key used to  
19 distribute all other city carrier costs to all other  
20 subclasses and categories. Correct?

21 A You can use that cost pool if you want the  
22 total cost, but when you allocate the cost between  
23 letters and DALs, I think you should look for a more  
24 accurate estimate of the volume of DALs.

25 Q When you have a distribution key that

1 estimates proportion for each of the various  
2 components, --

3 A Yeah.

4 Q -- that has to total to 100 percent.

5 Correct? The share of each component, when you add  
6 those together, they have to add to 100 percent.

7 Correct?

8 A Yes.

9 Q And the CCS number in column F of Attachment  
10 1 is the number that allows the CCS total to total to  
11 100 percent. Correct?

12 A That allocates the cost to the pool of DALs  
13 and letters. That gives you a cost figure which is  
14 used for the unit cost for your Table 1.

15 Q And what the Postal Service is trying to do  
16 in K67, as shown in your Attachment 1, is to figure  
17 out what portion of that needs to be shifted to DALs,  
18 leaving the rest of that cost pool to the non-DAL  
19 saturation letters but having a total cost pool that  
20 hasn't changed.

21 A All right.

22 Q Isn't it correct that your Attachments 2 and  
23 3 can't possibly achieve that function because they  
24 don't tie back to the CCS total the way Attachment 1  
25 does?

1           A     I don't see that at all. You have a cost  
2 allocated to letter-shaped, saturation mail, and now  
3 you have to allocate it between letters and DALs, and  
4 I should think you would want to use the most accurate  
5 data you can for the number of letters and the number  
6 of DALs that were delivered by both city and rural  
7 carriers. Let's just focus on city carriers. And I  
8 think, based on the information that we received on  
9 Monday from Advo, that your count of DALs is  
10 substantially off. In fact, Advo alone says they mail  
11 more DALs each year than Witness Kelly estimates.

12           Q     Right. But is it your suggestion that you  
13 cannot adjust the number of DALs shown in Attachment 1  
14 in column D without still reconciling back to the 5144  
15 figure in column F?

16           A     If you reduce the number of letters  
17 delivered by city carriers sufficiently, you could,  
18 yeah.

19           Q     And wouldn't that be consistent with the  
20 distribution based on CCS that is, indeed, the  
21 distribution key for all of cost segment 7 costs?

22           A     I don't know what you would do with the  
23 letters, then, that you take out of city carriers. I  
24 don't know where you put them. If you start off with  
25 5144 and come up with a number like -- take a round

1 number to make it easy -- come up with 3 billion DALs  
2 delivered by city carriers, then, three from five, you  
3 have only 2 billion letters delivered by city  
4 carriers. So the question is, where did those other  
5 letters go? You know the letters are in the system  
6 because you have RPW data for those letters.

7 Q But haven't you already criticized the fact  
8 that the implicit letter number here is higher than  
9 the RPW total? So you've got room for them in there,  
10 don't you?

11 A You've got some room, but I don't know how  
12 many letters go to P.O. boxes and highway contract  
13 routes.

14 Q I guess my fundamental question is, are you  
15 suggesting that the Commission should ignore the city  
16 carrier cost system numbers for purposes of  
17 distribution to subclass?

18 A No.

19 Q Should they ignore it in K67?

20 A They can adjust for the relative volume of  
21 DALs and letters.

22 Q How do they adjust the total shown in column  
23 F without creating a CCS total distribution that sums  
24 to greater than 100 percent?

25 A You've got a two-step process. You have a

1 distribution key for the pool of city carrier street  
2 costs, and even though you may believe that the 5144  
3 figure is wrong, you can use that because it sums to  
4 100 percent, or you could go back and change it, and  
5 then everything through all of the other pieces, they  
6 would sum, too, to 100 percent. But you would keep  
7 that pool of costs, and now you have to allocate that  
8 pool of costs as between DALs and letters.

9 Now, if you know that the 5144 figure, or  
10 let's take the two combined -- for rural carriers, if  
11 you know they are wrong, that's a good question: What  
12 do you do about it?

13 Q So your suggestion is that the Commission  
14 should jettison the city carrier cost system sampling  
15 estimates in preference to the types of DAL estimates  
16 you were discussing with Mr. McLaughlin this morning.

17 A You could do one of two things. You could  
18 keep the allocation of costs to letters, city carrier  
19 letters, the total allocation fixed, the total  
20 dollars, and you could change the allocation that's  
21 between DALs and letters based on the best data  
22 available.

23 Q And to return to my earlier question, when  
24 is that going to happen in this proceeding? Who is  
25 going to do that?

1           A       Well, the Commission works through all of  
2 the costs, as I understand it, in every case, and they  
3 reconcile the Commission costing with Postal Service  
4 costing, and oftentimes there seem to be differences.

5           MR. KOETTING: That's all I have, Mr.  
6 Chairman. Thank you, Dr. Haldi.

7           CHAIRMAN OMAS: Thank you, Mr. Koetting.

8           Is there anyone who wishes to follow up  
9 cross-examination?

10           (No response.)

11           CHAIRMAN OMAS: Are there any questions from  
12 the bench? Ms. Goldway?

13           MS. GOLDWAY: We had a very long session  
14 earlier today questioning some of the submissions that  
15 you've presented for the number of DALs that might be  
16 in the system that are greater than what the Postal  
17 Service presented. But it's my understanding that  
18 even if we were to remove the questionable listings  
19 that you have presented, that Advo itself presented a  
20 number for DALs that's higher than what the Postal  
21 Service submitted. Is that correct?

22           THE WITNESS: That is absolutely correct.  
23 The Advo number alone exceeds the Postal Service  
24 numbers, and the Advo number for pieces delivered by  
25 city and rural carriers exceeds the Postal Service

1 numbers substantially, and there is no question that  
2 Harte-Hanks is a major mailer of DALs in California  
3 and in Florida, and, in fact, if you were to look at  
4 the exhibit that Mr. McLaughlin left, -- I think it  
5 was number 11 -- we're still left with about 159  
6 million DALs, and this is just one Web site that I  
7 stumbled on which makes no effort to do a  
8 comprehensive study of the number of DALs that are  
9 entered into the postal system. They are simply  
10 representing certain advertising outlets and trying to  
11 sell advertising to and for them.

12           That's part of my whole problem is that we  
13 shouldn't have to be going to Web sites to try and  
14 search out who the mailers of DALs are. The Postal  
15 Service should be collecting some data. By their own  
16 admission, they have got 3.375 billion. Advo now  
17 tells us they mail more than that all by themselves.  
18 Can you imagine if they had this little data on the  
19 volume of first-class postcards were mailed, where we  
20 would be, trying to figure out cost, cost allocations  
21 and cost distributions?

22           Many times there's discussion -- in fact,  
23 there was a recent GAO report on the quality of data.  
24 When you have no data, it's kind of academic to talk  
25 about the quality of it. It's just a total void in

1 their whole data system until this time when they made  
2 an estimate.

3 MS. GOLDWAY: Their estimate was based on  
4 the household mail survey and a progression from that,  
5 but clearly if they had asked Advo, they could have  
6 gotten more accurate information. Just asking Advo  
7 and Harte-Hanks might be a way to do it. Do you have  
8 any suggestions as to how the Postal Service should be  
9 collecting this data?

10 THE WITNESS: Yes, ma'am, yes. I had a  
11 meeting years ago with the Postal Service, and then I  
12 followed up with a letter suggesting they try to  
13 collect some data.

14 What I would have them do, on the form where  
15 they enter the data, is have a little box to check  
16 where you enter the saturation flats -- there is a  
17 little box where you say if it's accompanied by DALs,  
18 so all they would have to do is put a little box on  
19 that form, and then they could go through and tabulate  
20 those. It's all entered electronically. They could  
21 tabulate at the end of the year and tell you how many  
22 DALs were entered based on that. They would know how  
23 many flats were there. If they say accompanied by  
24 DALs, you could total out the thing very easily.

25 MS. GOLDWAY: Except they often bring in

1 more flats than DALs. They have extra flats they  
2 bring in. But I guess you could factor, but you just  
3 think one --

4 THE WITNESS: They don't distinguish between  
5 saturation addressed flats and saturation flats  
6 unaddressed accompanied by DALs.

7 MS. GOLDWAY: And if they just did that on  
8 the form.

9 THE WITNESS: If they just did that on the  
10 entry form, they could collect the data. It's not a  
11 huge data collection effort.

12 MS. GOLDWAY: We do have on the record now  
13 some clear information that is, in fact, data. Right?

14 THE WITNESS: Now, for the first time, we  
15 have -- I would certainly interpret the data from Advo  
16 as authoritative, and nobody has challenged the data  
17 from Harte-Hanks, and we know there independents, and  
18 they are small independents -- they don't add up to a  
19 lot out there. I've got just a ball park estimate. I  
20 think it's a conservative estimate. But this is the  
21 first time that we've had real data on the record for  
22 DALs, and there's billions of them, billions.

23 MS. GOLDWAY: Thank you.

24 THE WITNESS: Thank you, Commissioner.

25 CHAIRMAN OMAS: Thank you. Mr. Olson, would

1 you like some time with your witness?

2 MR. OLSON: One minute, please.

3 CHAIRMAN OMAS: Yes.

4 (Pause.)

5 MR. OLSON: We have no questions, Mr.

6 Chairman.

7 CHAIRMAN OMAS: Thank you, Mr. Olson.

8 Dr. Haldi, that completes your testimony  
9 here today. We appreciate your appearance and your  
10 contribution to our record, and thank you once again,  
11 and you're excused.

12 THE WITNESS: Thank you, Mr. Chairman.

13 (The witness was excused.)

14 CHAIRMAN OMAS: This concludes today's  
15 hearings. Procedural dates for the additional  
16 processing in this docket will be established in  
17 Presiding Officer's Ruling No. 11. The next date is  
18 August 30, 2005, and participants are to give notice  
19 if they intend to file testimony in response to Val-  
20 Pak.

21 This hearing is adjourned, and we look  
22 forward to having you all in our new quarters next  
23 time we meet. Thank you again. After 20 years, we  
24 leave.

25 (Applause.)

1                   (Whereupon, at 2:35 p.m., the Commission  
2           hearing was adjourned.)  
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