

OFFICE OF THE SECRETARY
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 2005

Docket No. R2005-1

JOINT INITIAL BRIEF OF
AMERICAN BANKERS ASSOCIATION
AND NATIONAL ASSOCIATION OF PRESORT MAILERS
(September 26, 2005)

Henry A. Hart, Esq.
Reed Smith LLP
1301 K Street N.W.
Suite 1100 - East Tower
Washington, DC 20005
Ph: 202-414-9225
Fax: 202-414-9299

Counsel for
National Association
of Presort Mailers

Irving D. Warden
Assoc. General Counsel
American Bankers Association
1120 Connecticut Ave., NW
Washington, DC 20036
Ph: 202-663-5027
Fax: 202-828-4548

Counsel for
American Bankers Association

TABLE OF CONTENTS

Statement of the Case

Argument

I.	The Across The Board Approach Proposed by the Postal Service Results In Rates Which Are Supported By The Record In This Unique Case And Are Fully Consistent With The Pricing Criteria Of 39 U.S.C. §3622(b)	1
II.	Application Of Reasoned Administrative Judgment To The Record In This Case Should Result In Recommendation Of The Rates Proposed By the Postal Service and Agreed to By the Numerous Settlement Parties.	4
A.	The Impact of FCLM Nonautomated Presort Tally Errors in the Postal Service’s Case Does Not Prevent Recommendation of the Postal Service’s Proposal.....	4
1.	FCLM Nonautomated Presort Tally Errors Confirm That Machinable Nonautomated Presort Should Not Have Been Used By the Postal Service as a Proxy for FCLM BMM Delivery Costs	5
2.	The FCLM Nonautomated Presort Cost Tally Errors Have No Significant Impact on Costs Measured for FCLM Automated 3-Digit or 5-Digit.....	6
3.	The FCLM Nonautomated Presort Tally Errors May Well Have Caused Costs for FCLM Mixed AADC and AADC to Have Been Understated	7
B.	The FCLM Automated Discounts Proposed by the Postal Service are Fully Supported by Cost Avoidance In the Record When Measured in a Manner Consistent with Commission Precedent.....	8
C.	Automated FCLM Cost Avoidance When Measured In a Manner Consistent with Commission Precedent Exceeds the Automated FCLM Discounts Proposed by the Postal Service, But is Nevertheless a Conservative Measure of Cost Avoidance.....	10

1.	Use of ALL Nonautomation Presort Letters as a Proxy for FCLM BMM Delivery Costs Understates Cost Avoidance.....	10
2.	Use of FCLM BMM as a Benchmark to Measure Automated FCLM Cost Avoidance Understates Cost Avoidance.....	13
3.	The Postal Service’s Workshare Cost Avoidance Calculations Exclude the Effect of Transportation and Several Other Tasks Performed by Workshare Mailers, Thereby Understating Cost Avoidance.....	13
4.	USPS Cost Avoidance Figures are Based Upon an Allocation of Costs which Allocate Less Costs to Worksharing Related Cost Pools than in Previous Cases, Thereby Understating Cost Avoidance	14
5.	Increasing Postal Service Labor Costs Intuitively Suggest that Workshare Cost Avoidance is Not Decreasing and is Understated	15
6.	The Increasing CRA Gap Between FCM Single Piece Mail Processing and Delivery Costs and FCM Presort Mail Processing and Delivery Costs Implies that FCM Workshare Cost Avoidance is Not Decreasing and is Understated	16
D.	The Incremental Measurement of Cost Avoidance Pass Throughs For FCLM Automated 3-Digit is Flawed and Should Be Given No Weight In Setting the Discount For FCLM Automated 3-Digit	17
III.	Any Increase In FCLM Automated Rates Above that Proposed by the Postal Service Would Exacerbate The Existing Excessive Cost Coverage for First Class Mail In General And For Automated FCLM In Particular	20
	<u>Proposed Findings and Conclusions</u>	22

TABLE OF AUTHORITIES

STATUTES

39 U.S.C. § 3622(b) passim

OTHER AUTHORITIES

The Postal Civil Service Retirement System Funding Reform Act of 2003 (Public Law 108-18)..... 1

Rate and Service Changes to Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation, Docket No. MC2004-3, Order Establishing Procedural Framework For Reconsideration, August 23, 2005, at 14. 4

Statement of the Case

The Postal Service filed this case on April 8, 2005, requesting an increase in rates and fees necessary to generate approximately \$3.1 billion of additional revenue to cover an escrow financial obligation which had been imposed upon it by The Postal Civil Service Retirement System Funding Reform Act of 2003 (Public Law 108-18). No party other than the Postal Service filed Direct Testimony in the case, except for ValPak.

From the outset, the Postal Service attempted to resolve this case by settlement; and the overwhelming majority of parties in this case, including the American Bankers Association (“ABA”) and the National Association of Presort Mailers (“NAPM”), have joined in a settlement which agrees to all of the rates and fees proposed by the Postal Service. On September 23, 2005 the Postal Service filed the settlement Stipulation and Agreement along with signed signature pages for the Postal Service and 35 other settlement parties.

Argument

- I. The Across The Board Approach Proposed by the Postal Service Results In Rates Which Are Supported By The Record In This Unique Case And Are Fully Consistent With The Pricing Criteria Of 39 U.S.C. §3622(b).

The Postal Service’s submission in this case calls for an across-the-board (ATB) rate increase that, with few exceptions, results in approximately the same percentage increase in rates for each rate category. ABA and NAPM believe that this ATB increase is appropriate for the unique circumstances of this case and meets all the statutory requirements for an omnibus postal rate increase. We therefore urge the Commission to adopt the rates requested by the Postal Service in their entirety.

The governing statutes certainly do not prohibit an ATB approach in this case, as long as the resulting rates reflect due consideration of the pricing criteria at 39 U.S.C. § 3622(b.) Indeed, the primary witness in opposition to an ATB rate increase, Valpak witness Mitchell, did not argue that the ATB approach was in violation of any principle of law. Postal Service pricing witness Robinson specifically and sufficiently addressed in

her testimony how each of the criteria of 39 U.S.C. § 3622(b) are met by the Postal Service proposal.¹ We refer the Commission to such Robinson testimony, but also offer the comments below on a few of the most pertinent subsections of 39 U.S.C. § 3622(b) to further demonstrate that the Postal Service's ATB proposal fully complies with the statutory pricing criteria.

The requirement of subsection (b) (1) for "fair and equitable" rates is clearly met by the ATB approach in this unique case. In as much as the escrow costs that necessitated these proposed rate increases cannot be attributed to specific classes, it is manifestly fair and equitable to spread the necessary increases across all classes and categories of mail equally. The existence of a settlement joined by 36 of the 46 parties is proof of the innate fairness and equity of the ATB approach in this case. None of these settlement parties would have agreed to rates that were unfair to their interests.

Subsection (b) (3) requires that each class bear its attributable cost. There is no testimony in the record suggesting that this requirement has not been met. In particular, as concerns First Class, for the 2006 Test Year, First Class mail as a whole would have a 227.2% cost coverage and First Class presort and automation letters would have a 331.8% cost coverage.²

Subsection (b) (6) mandates that rates reflect "the degree of preparation of mail for delivery into the postal system performed by the mailer and its effects on reducing costs to the Postal Service." The record reflects that this requirement has been met. Issues of costs and workshare cost savings for the types of First-Class Mail that ABA and NAPM are particularly concerned with are addressed in this brief at Sections II and III below.

In subsection (b) (4), the statute mandates that the Commission consider the effect of rate increases on "...the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than

¹ Direct Testimony of USPS witness Robinson (USPS T27) at page 11 et seq.)

² Robinson Direct Testimony (USPS –T27) at Exhibit USPS 27B(revised 6/10/2005)

letters.” Again, the existence of a settlement agreement signed by 36 of the 46 parties can be considered as evidence that the effect of the proposed increases is acceptable to the wide variety of parties that have signed the settlement agreement, and that this requirement of Subsection (b)(4) has been met.

Furthermore, the most obvious positive effect of an ATB increase in this case is that it prevents any of the named groups from bearing a disproportionate share of the burden of the higher revenue requirement. Valpak witness Mitchell criticizes the Postal Service ATB approach in this case arguing that it, “virtually neglects all current cost relationships and builds without review on rates built on now-badly-out-of-date costs.”³ What witness Mitchell fails to take into account is that, consistent with Subsection (b)(4), in recommending postal rates the Commission should consider demand conditions in the market place, not just supply or cost conditions. The across-the-board approach in this case is one way of keeping relative rates for postal services about the same in the current context of extreme risk and uncertainty surrounding the future demand for and direction of postal services. It is important to avoid a substantial loss of First Class payments mail and transactions mail to electronic payments systems and the internet. This consideration mitigates against any rate increase, especially within First Class. Thus, contrary to ValPak witness Mitchell’s thesis, Standard ECR mailers are not the only mailers who can argue that they should not receive a 5.4% increase in this case; however ABA and NAPM believe that in the unique circumstances of this case the across-the-board 5.4% rate increase proposed by the Postal Service is fair to all parties concerned.

Faced with a postal deficit caused by an escrow requirement that clearly cannot be attributed by subclass, the Postal Service and a considerable number of intervenors concluded that this is not the right case in which to address relative rate relationships among postal subclasses or within them. They concluded after substantial deliberation and discovery on the Postal Service’s case that (1) the across-the-board approach is

³ Direct Testimony of Valpak witness Mitchell (VP-T-1) at page 4, lines 9-11 (9 Tr. 5270).

the fairest way to address the immediate issue presented by the escrow requirement, and (2) the issue of relative rate relationships is best left to the next rate case. At that time, hopefully the Postal Service will have better market demand information than it appears to possess at the current time, as well as better cost information than that provided in this case.

Subsection (9) allows the Commission to take into account “such other factors as the Commission deems appropriate.” In light of the Commission’s “...longstanding policy favoring the settlement of important issues through negotiations among participants...,”⁴ the existence of the settlement agreement is a factor the Commission should take into consideration in approving this rate request.

Another subsection (9) “other factor” which the Commission should consider as supporting the ATB approach is the uncertainties presented by the pending Postal Reform Legislation. Such uncertainties also mitigate against changing relative rate relationships at the present time.

In summary, ABA and NAPM submit for the reasons cited above, that the ATB approach taken by the Postal Service clearly complies in this case with the letter and the spirit of the statutory guidance.

II. Application Of Reasoned Administrative Judgment To The Record In This Case Should Result In Recommendation Of The Rates Proposed By the Postal Service and Agreed to By the Numerous Settlement Parties.

A. The Impact of FCLM Nonautomated Presort Tally Errors in the Postal Service’s Case Does Not Prevent Recommendation of the Postal Service’s Proposal

⁴ Rate and Service Changes to Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation, Docket No. MC2004-3, Order Establishing Procedural Framework For Reconsideration, August 23, 2005, at 14.

As pointed out by the Commission in its POIR No.1, Question 1, the Postal Service cost avoidance figures under the USPS methodology (LR- K-48) and under the Commission methodology (LR-K-110) produce a counter intuitive negative cost avoidance for FCM non automation presort of 1.431 cents and 1.652 cents respectively. USPS witness Abdiraham explains this abnormality in his response to POIR No.1, Question 1 as being due to problems which occurred in the R2000-1 cost methodologies whereby certain FCLM **automated** pieces were included in the tallies as **non automation** presort letters, thereby incorrectly increasing the costs measured for FCLM nonautomation presort letters. Abdiraham confirmed that this error was carried forward into the cost avoidance calculations presented by him in this case.⁵

Initially ABA & NAPM note that while we believe that there are certain problems with the cost data introduced by the Postal Service in this case, these problems are not grounds for rejecting the proposed across-the-board rates. When properly analyzed as described below, the USPS cost data along with other rate making criteria do provide sufficient support for each of the workshared rates proposed for FCLM by the Postal Service.

We submit that the problems with the Postal Service FCLM nonautomated presort cost pools will have the impact described below.

1. The FCLM Nonautomated Presort Tally Errors Further Confirm That Machinable Nonautomated Presort Should Not Have Been Used By the Postal Service as a Proxy for FCLM BMM Delivery Costs

The process of costing low – volume FCLM non-automation presort letters has been problematic for the Postal Service in the past two rate cases, as it has attempted to create no fewer than eight subcategories of non-automation presort letters out of a small and declining volume of mail. It has then, out of a total volume of 1.95

⁵ Response of USPS witness Abdiraham (USPS T21) to POIR No 1, Question 1 at 4 Tr. 1074.

billion⁶ non-auto presort letters, attempted, through “modeling,” to correctly capture the unit mail processing and delivery costs for the 156.5 million pieces⁷ that it claims are the mail pieces most likely to convert to automation at the margin, namely “Nonautomation Machinable Presort Letters”. Now, with the admission of sampling errors resulting from the inclusion of automation letters in IOCS tallies for CRA cost estimates of nonautomation presort letters, the Commission must recognize that this already small and declining volume of FCLM nonautomation machinable mail has a significantly flawed cost measurement. This fact dictates against use of the FCLM nonautomation machinable mail as a proxy for delivery costs of FCLM BMM, as was done by the Postal Service.

2. The FCLM Nonautomated Presort Tally Errors Have No Significant Impact on Costs Measured for FCLM Automated 3-Digit or 5-Digit

While relevant to the accuracy of the cost avoidance figures for FCLM non automated presort, this error in cost of FCLM nonautomated presort cost models should have no significant impact on the cost avoidance figures of the higher volume FCLM automated rate categories of 3-Digit and 5-Digit.

Initially we note that it is highly unlikely that the automation letter tallies being erroneously included in the nonautomation presort letter costs come from the 3-Digit and 5-Digit automation presort letters submitted to the Postal Service by worksharing mailers. These barcoded and highly sorted mailstreams avoid many of the processing steps that are likely to be sampled in the IOCS tallies at issue; therefore, FCLM automated 3-Digit and 5-Digit are unlikely to be mixed in with any category of nonautomation letter mail for those IOCS tallies. Rather, if any automation mail is mixed in with non-automation presort letter mail, it is likely to be the small-volume residual mail USPS classifies as mixed AADC or AADC letters. Furthermore because

6 R2005-1, LR-K-48 (revised 05/23/05), excel file LR-K-48FCLTRS-RevisedV4 , worksheet "Volumes" at page 52

7 Id.

of the extremely low volume of non automated presort mail and the extremely high volume of FCLM automated 3-Digit and 5-Digit mail, even if the entire overstatement of FCLM nonautomated presort costs were transferred to automated FCLM 3-Digit and 5-Digit, it would have a negligible per piece cost effect. To put the size of this error in perspective, one could take the cost avoidance measured for FCLM nonautomated presort when the USPS was using the BY 1998 data, which was before the tallying error occurred. At that point in time, the cost avoidance for FCLM nonautomated presort was .09 cents.⁸ One could then increase the cost avoidance of FCLM non automated presort in this case from the negative 1.652 cents shown in LR-K-110 under the Commission methodology to the positive .09 cent cost avoidance shown in the BY 1998 data. This would require a reduction of costs of FCLM nonautomated presort by 1.742 cents per piece. If one multiplies this 1.742 cents per piece by the 1,123,189,000 of volume for FCLM nonautomated presort in the 2006 Test Year (after rates),⁹ the total decrease in cost of FCLM non-auto presort would be \$19,565,952. Even if one were to add this \$19,562,952 cost to FCLM automated 3-Digit and 5-Digit mail, in light of the 40.03 billion volume of such mail in the 2006 Test Year (after rates),¹⁰ this would result in an increased cost avoidance for FCLM automated 3-Digit and 5-Digit mail of less than 1/100th of 1 cent per piece.

3. The FCLM Nonautomated Presort Tally Errors May Well Have Caused Costs for FCLM Mixed AADC and AADC to Have Been Understated

As explained above, because FCLM nonautomated presort mail is mixed in more often with FCLM Mixed AADC and AADC than it is with the more finely sorted FCLM 3-Digit or 5-Digit, it is very likely that most all of any improper FCLM nonautomated presort tallies were in fact attributable to FCLM Mixed AADC and AADC

⁸ R2000-1, LR-I-62, excel file, appi.xls, worksheet "LETTER SUMMARY", at page I1.

⁹ Direct Testimony of Thress (USPS-T-7) at Attachment A, page 354, (2006, Test Year after – rate volumes).

¹⁰ Id.

mail. Because of the much lower volumes of these residual automated rate categories [2.8 billion pieces and 2.5 billion pieces respectively are projected in Test Year 2006 (after rates)],¹¹ it is clear that transfer of the overstated FCLM nonautomated presort costs to these FCLM Mixed AADC and AADC rate categories increases their costs above what the Postal Service has estimated them to be in this case. This distortion in cost estimates for FCLM automated Mixed AADC and AADC in turn dictates against giving any weight to the above-100% incremental pass through of cost avoidance which results for FCLM automated 3-Digit under the Postal Service proposal.

B. The FCLM Automated Discounts Proposed by the Postal Service are Fully Supported by Cost Avoidance In the Record When Measured in a Manner Consistent with Commission Precedent

The Commission has consistently calculated cost avoidance of work share mail on the basis that Postal Service labor costs are 100% volume variable. There is no basis in the record in this case to stray from this longstanding and effective Commission principle, and to do so would be particularly inappropriate in a case such as this which will be resolved in large part by settlement pursuant to an expedited hearing schedule.

The Postal Service has filed as part of a library reference in this case, Worksharing Related Unit Costs and Worksharing Related Unit Cost Savings for First Class Mail Presort Letters using the Commission's 100% volume variable labor costs methodology.¹² Taking these cost avoidance figures which result from use of the Commission's 100% volume variable labor costs methodology, and adjusting them further to use the same delivery costs proxy for Bulk Metered Mail ("BMM") as was used by the Commission in the last litigated rate case (i.e., using ALL Nonautomated Presort

11 Id.

12 USPS LR-K-110 at page 194 (as revised 05/24/05)

Letters instead of Nonautomated Machinable Presort Letters) yields the following cost avoidance for the following FCLM automated rate categories:¹³

TABLE I

	<u>Cost Avoidance</u> ¹⁴	<u>Settlement Discounts</u>
FCLM Automation Mixed AADC Letters	8.645 cents	6.4 cents
FCLM Automation AADC Letters	9.744 cents	7.3 cents
FCLM Automation 3-Digit Letters	10.155 cents	8.2 cents
FCLM Automation 5-Digit Letters	11.480 cents	9.7 cents

As can be seen from Table I above, use of the Commission 100% volume variable labor costs methodology and the delivery costs proxy most recently utilized by the Commission demonstrates that cost avoidance for each of the FCLM automated rate categories is well in excess of the respective discounts proposed by the Postal Service for such rate category.

There is no sound basis for The Postal Service's use of Nonautomated Machinable Presort Letters as a proxy to measure the delivery costs of the FCLM BMM benchmark. This is a result-oriented proxy which is based upon dubious modeled cost

¹³ The calculations in Table 1 were confirmed by the Postal Service in its institutional response to Interrogatory ABA & NAPM/USPS/T-21-55 redirected from Abdiraham. 8 Tr. 3943.

¹⁴ In response to interrogatory MMA/USPS-T21-41(d) (revised 06/24/05) at 4 Tr. 1015, Mr. Abdirahman stated that had he used the latest Commission-approved methodology for deriving First Class workshare cost avoidance, the results would have been FCLM automated cost avoidance of 8.237 cents for Mixed AADC, 9.336 cents for AADC, 9.747 cents for 3-Digit, and 11.072 cents for 5-Digit. These cost avoidance figures are about 0.4 cents lower than those in Table 1 above, apparently in large part because they use only one third of single piece metered mail prep and cancellation costs. (Abdirahman response to interrogatory MMA/USPS-T21-41(B)(c) at 4 Tr. 1014); however they are still well in excess of the FCLM automated rate discounts proposed by the Postal Service.

exercises and which moreover is based upon a very low volume of mail. The sampling errors discussed above in the calculation of FCLM nonautomated presort costs clearly spilled over into the nonautomation machinable presort letters subcategory, with the result that it can not be relied upon as a proxy for FCLM BMM delivery costs. Even though the BMM delivery costs proxy, ALL Nonautomated Presort Letters, used by the Commission in the most recent litigated rate case, R2000-1 (and utilized in Table 1 above) is also affected by the FCLM nonautomated presort sampling errors, it at least has more volume than the subcategory of Nonautomated Machinable Presort Letters, and also has the advantage of being consistent with Commission precedent.

The BMM delivery cost proxy utilized by the Postal Service (Nonautomated Machinable Presort Letters) has a 3.875 cent per piece cost which is 2.514 cents lower than the per piece cost of ALL Nonautomated Presort Letters (which is the proxy most recently used by the Commission). Therefore the proxy used by the Postal Service understates cost avoidance for each of the FCLM automated rate categories by at least 2.514 cents.

- C. Automated FCLM Cost Avoidance When Measured In a Manner Consistent with Commission Precedent Exceeds the Automated FCLM Discounts Proposed by the Postal Service, But is Nevertheless a Conservative Measure of Cost Avoidance.
 - 1. Use of ALL Nonautomation Presort Letters as a Proxy for FCLM BMM Delivery Costs Understates Cost Avoidance

ABA and NAPM submit that a more appropriate FCLM BMM delivery costs proxy than ALL nonautomation presort letters would be either (i) FCLM single piece letter delivery costs, or (ii) a percentage of FCLM single piece delivery costs equal to that percentage of FCLM single piece mail processing costs which are equal to FCLM BMM mail processing costs.

Both of the above alternative proxies for FCLM BMM delivery costs have the advantage of not having been distorted by the sampling errors affecting the FCLM nonautomated presort mail.

Furthermore, they are both based upon FCLM single piece which has much more similar cost characteristics to FCLM BMM than does FCLM nonautomated presort. The record in this case indicates that on a mail processing cost pool-by-cost pool basis, unit costs for FCLM BMM behave more like single piece than like non-auto presort. In its cross examination of USPS witness, Marc Smith, ABA & NAPM presented Mr. Smith with a statistical analysis.¹⁵ That analysis asked the following question: cost pool by cost pool, considered individually and grouped together, what CRA rate category do FCLM BMM mail processing costs most resemble, non-automation presort or single piece? The answer was that on a cost pool by cost pool basis, mail processing costs for FCLM single piece metered letters (i.e., BMM) exhibit statistically insignificant differences from those for FCLM single piece letters.

It is only reasonable to infer that in office delivery costs of FCLM single piece and FCLM BMM are impacted by automation in the same manner as are mail processing costs of FCLM single piece and FCLM BMM. In an automated mail processing plant environment, the unit delivery costs that are relevant for benchmarking and cost avoidance calculation purposes are those in-office carrier costs that are saved by virtue of mail processing automation machinery. The fact that these happen at the tail end of the mail processing environment on DBCS machinery does not mean they are logistically apart from the automation environment. Thus, one would expect the relevant delivery costs for FCLM BMM to be most similar to delivery costs for FCLM single piece, in the same way that mail processing costs for FCLM BMM are most similar to mail processing costs for FCLM single piece.

For this reason it would be more reasonable to use the delivery cost of single piece FCLM as a proxy for BMM delivery costs than it would be to use either the

¹⁵ ABA & NAPM/USPS/T-13 Cross Examination Exhibit #2 at 7 Tr. 2692

FCLM Nonautomation Machinable Presort Letters proxy as the Postal Service does in its proposal, or the ALL Nonautomated Presort Letters proxy (as the Commission did in R2000-1 and as was done in Table I above). Alternatively, it would be reasonable to use as a proxy for FCLM BMM delivery costs, that percentage of FCLM single piece delivery costs which is the same percentage as FCLM BMM mail processing costs are of FCLM single piece mail processing costs.

Table 2 below, takes the FCLM automated rate category cost avoidance figures from Table 1 above (which utilizes Commission 100 % volume variable labor costs methodology and the ALL Nonautomated Presort Letters proxy for BMM delivery costs), and shows how those avoided costs would increase by using either of these two alternative single piece-based proxies for BMM delivery costs. This Table 2 demonstrates that the cost avoidance figures in Table 1 are conservative.

TABLE 2

	<u>Cost Avoidance 1*</u>	<u>Cost Avoidance 2**</u>	<u>Cost Avoidance 3***</u>	<u>Settlement Discounts</u>
FCLM Automation Mixed AADC Letters	8.645 cents	9.024 cents	9.348 cents	6.4 cents
FCLM Automation AADC Letters	9.744 cents	10.123 cents	10.447 cents	7.3 cents
FCLM Automation 3-Digit Letters	10.155 cents	10.534 cents	10.858 cents	8.2 cents
FCLM Automation 5-Digit Letters	11.480 cents	11.859 cents	12.183 cents	9.7 cents

* From Table 1 – Uses as delivery cost proxy for BMM, “ALL Nonautomated Presort Letters” which is 6.486 cents per piece¹⁶

** From Table 1 except uses as delivery cost proxy for BMM, “That % of FCLM single piece delivery costs which equals the % of FCLM single piece mail processing

16 USPS LR –K-110 (revised 05/24/05), page 1 of 94.

costs which equal FCLM BMM mail processing costs.” This results in proxy of 6.865 cents.¹⁷

*** From Table 1 except uses as delivery cost proxy for BMM, 7.189 cents FCLM single piece delivery cost.¹⁸

2. Use of FCLM BMM as a Benchmark to Measure Automated FCLM Cost Avoidance Understates Cost Avoidance.

Any justification for use of FCLM BMM as the benchmark for measuring cost avoidance of automated FCLM is substantially undercut by the inability of the Postal Service to demonstrate that any significant volume of such mail exists. The fact that the Postal Service had to use single piece metered FCLM costs as a proxy for the cost of FCLM BMM, underscores this point.¹⁹ The proper benchmark is all single piece FCLM. This is the true “candidate” mail which the discount structure should encourage mailers to workshare.

3. The Postal Service’s Workshare Cost Avoidance Calculations Exclude the Effect of Transportation and Several other Tasks Performed by Workshare Mailers, Thereby Understating Cost Avoidance.

Postal Service witness Abdiraham confirmed in his interrogatory responses of record that his measurement of FCLM workshare cost avoidance excludes the effect of several cost saving tasks performed by workshare mailers. In particular, Mr. Abdiraham expressly acknowledged (i) that any savings in transportation costs

¹⁷ In Test Year 2006 FCLM BMM mail processing costs are projected to be 10.906 cents or 95.49 % of FCLM single piece mail processing costs of 11.421 cents (USPS LR-K-53.). Taking 95.49% of the FCLM single piece delivery costs of 7.189 cents would yield a delivery cost proxy for FCLM BMM of 6.865 cents.

¹⁸ The FCLM single piece delivery costs in Test Year 2006 are projected to be 7.189 cents USPS LR-K-67 (revised 06/09/05)

¹⁹ Abdirahman response to interrogatory ABA & NAPM/USPS-T21-27 at 4 Tr.933.

from workshare mailers would not be captured in his mail processing cost models;²⁰ (ii) that his mail processing models do not capture plant loading savings which occur when the Postal Service is able to send trucks to a mailer's plant and the mail is loaded on the truck which then bypasses the local mail processing plant and travels directly to an airport or a distant postal facility;²¹ and (iii) that his mail processing cost models did not capture savings from workshare mailing activities such as postage verification, electronic transmission of weight and volume data to postal data centers, electronic transmissions of all postage paperwork, and presorting of trays of mail prior to placing them onto pallets, including use of the Automated Mail Processing System.²²

Therefore, the Postal Service FCLM automated rate category cost avoidance estimates, as well as the ABA and NAPM adjustments to those estimates at Tables 1 and 2 above, must be viewed as a conservative measure of cost avoidance.

4. USPS Cost Avoidance Figures are Based Upon an Allocation of Costs which Allocate Less Costs to Worksharing Related Cost Pools than in Previous Cases, Thereby Understating Cost Avoidance.

If there has been one constant in the Postal Service approach to measuring workshare cost avoidance over the past several rate cases, it is the propensity to utilize a costing methodology which shrinks the resulting measurement of cost avoidance compared to the previous case. The Postal Service has been extremely reluctant to give up on a methodology which results in a reduced measure of cost avoidance, for example its practice of attributing costs with less than 100% volume variable labor costs, even where such method has been repeatedly rejected by the Commission. However, there is apparently no end to the imagination of the Postal Service when it comes to "refining" its methodology for measuring workshare cost

20 Abdiraham response to interrogatory MMA/USPS-T-21-19 and 24 at 4 Tr. 979 and 983.

21 Abdiraham response to interrogatory MMA/USPS- T-21-19 at 4 Tr.979.

22 Abdiraham response to interrogatory MMA/USPS- T-21-12(A) and 23 at 4 Tr.974 and 982.

avoidance, if that “refinement” will result in a reduced measure of workshare cost avoidance.

An example in this case of the Postal Service’s preference for a narrow measure of cost avoidance is its transfer of several mail processing cost pools to the category of “Non Worksharing Related Fixed”, and its creation of new cost pools to which mail processing costs are placed and then transferred into the Non Worksharing Related Fixed category. Of course transfer of cost pools into this Non Worksharing Related Fixed category results in a reduction of measured workshare cost avoidance, since any cost differential between workshare mail and non workshare mail in such cost pools is excluded from the calculation of workshare cost avoidance.

The record in this proceeding demonstrates that the total costs for cost pools placed by Postal Service witness Abdirahman into the Workshare Related Proportional category decreased from 2.138 cents in R2000-1 to 1.886 cents in R2005-1; and that the total costs for cost pools placed by Postal Service witness Abdirahman into the Non Worksharing Related Fixed category increased from 0.313 cents in R2000-1 to 0.506 in R2005-1.²³ This transfer of cost pools resulted in a lower measurement of workshare cost avoidance.

ABA and NAPM’s modifications (Tables 1 and 2 above) to the Postal Service’s cost avoidance measures in this case are conservative in that they simply accept the Abdirahman cost pool re-classifications.

5. Increasing Postal Service Labor Costs Intuitively Suggest that Workshare Cost Avoidance is Not Decreasing and is Understated.

USPS witness Marc Smith confirmed that Postal Service wage rates are increasing at a rate well above the rate of inflation.²⁴ Mr. Smith also conceded that the

²³ ABA & NAPM cross examination of USPS witness Marc Smith (USPS T13) and ABA & NAPM/USPS-T13 cross examination exhibit # 4 at 7 Tr. 2708.

²⁴ Responses of USPS witness Marc Smith to Interrogatories ABA & NAPM/USPS-T 21-40(b) and 30 redirected from Abdiraham at 7 Tr. 2613 and 2599; ABA & NAPM cross examination of USPS

Continued on following page

most substantial portion of the Postal Service mail processing and delivery costs were labor costs.²⁵

Faced with evidence that labor costs, the most substantial portion of Postal Service mail processing and delivery costs, are projected to increase at a rate well in excess of the rate of inflation, it is most reasonable to infer that Postal Service costs in general and workshare cost avoidance in particular are increasing, and that the cost avoidance estimates of the Postal Service in this case are conservative.

6. The Increasing CRA Gap Between FCM Single Piece Mail Processing and Delivery Costs and FCM Presort Mail Processing and Delivery Costs Implies that FCM Workshare Cost Avoidance is Not Decreasing and is Understated.

Measured on a consistent basis from rate case to rate case, the differences between FCM single piece mail processing and delivery costs and FCM presort mail processing and delivery costs continue to increase, thereby implying that workshare savings for the FCM automated rate categories are also increasing. The Cost and Revenue Analysis (“CRA”) conducted annually by the Postal Service is a matter of public record. The record in this case contains a chart of the First Class Total Unit Attributable costs from 1992 through the projected 2006 Test Year.²⁶ This chart demonstrates that the difference in attributable costs for FCM single piece and FCM presort, as measured by the CRA, has continuously increased since 1992, and continues to increase into the projected 2006 Test Year in this case. The record in this case also contains a cross examination exhibit which clearly demonstrates that the difference between First Class Delivery Unit Attributable Costs of FCM single piece

Continued from previous page

witness Mark Smith (USPS-T13) at 7 Tr. Page 2667, line 23- page 2668, line 17 and at 2668, line 22- page 2669, line 16

25 ABA & NAPM cross examination of USPS witness Mark Smith (USPS-T13) at 7 Tr. Page 2669, line 5- page 2670, line 3.

26 ABA & NAPM/USPS-T13 cross examination exhibit # 3 at 7 Tr. 2698.

and of FCM presort, as measured by the CRA, has continuously increased from 1992 through the projected 2006 Test Year.²⁷

The CRA provides a relatively consistent measure of mail processing costs and delivery costs for FCM single piece and FCM presort. As such it is yet another factor upon which the Commission can reasonably rely to conclude that workshare cost avoidance has increased sufficiently to support the modest increase in FCM workshare discounts which would result under the Postal Service proposal.

D. The Incremental Measurement of Cost Avoidance Pass Throughs For FCLM Automated 3-Digit is Flawed and Should Be Given No Weight In Setting the Discount For FCLM Automated 3-Digit.

In its POIR No. 3, Question 1 and POIR No. 6, Question 7 the Commission indicated an interest in the percentage pass throughs of cost avoidance reflected in the FCLM automated rate category discounts proposed by the Postal Service. In particular, the Commission Request focused on the percentage pass throughs that would result if such pass throughs were measured on an “incremental basis” under which the percentage pass through for a particular FCLM automated rate category is measured solely on the increase in cost avoidance and increase in discount over the immediately previous FCLM automated rate category. In his response to POIR No. 3, Question 1, Postal Service witness Taufique confirmed that if such an incremental analysis were applied to cost avoidance figures utilizing the Commission methodology at LR-K-110, this would result in a 219% pass through of cost avoidance for FCLM automated 3-Digit over the immediately previous rate category of FCLM automated AADC. ²⁸

However, we submit that for several reasons, the incremental percentage pass through which results for FCLM automated 3-Digit should not be given significant weight by the Commission in this proceeding. As explained below, the FCLM automated

²⁷ ABA & NAPM/USPS -T16 cross examination exhibit # 1 at 7 Tr. 2953.

²⁸ Response of USPS witness Taufique (USPS-T28) to POIR No. 3, Question 1 (revised 05/24/05) at 3 Tr.608.

AADC category upon which the 3-Digit increment is measured is a very low volume residual mail category the costs for which have been understated by the Postal Service due to spill over from the sampling errors in FCLM nonautomated presort.

Initially we note that FCLM automated 3-Digit is the key FCLM automated rate category, in that its volume of 22.74 billion pieces projected for Test Year 2006 (after rates) is almost half of the total FCLM automated volume and more than 5 billion pieces higher than the next highest volume FCLM rate category (5-Digit).²⁹ By contrast, FCLM AADC, which is the category against which the FCLM automated 3-Digit would be measured under the incremental pass through methodology, has a very low volume of 2.57 billion pieces projected for the 2006 Test Year (after rates).³⁰ It makes no sense to base the discount for this key FCLM automated rate category of 3-Digit on the relatively low volume FCLM automated AADC rate category.

Furthermore, the FCLM AADC category is a residual category of mail. Under the Domestic Mail Manual at Section 235.6.8(e), in order to qualify for FCLM automated rates, the mailer must sort to the 3-Digit level to the extent that the mailer has the requisite volume of 3-Digit mail. It is only the residual mail (i.e., mail to ZIPs for which the mailer has fewer than 150 pieces) that ends up by default as FCLM AADC mail. Similarly, Mixed AADC mail is made up of mailpieces for which the mailer has insufficient volume to create an AADC tray. Mailers are not free to choose to “upgrade” FCLM automated from Mixed AADC to AADC, or from AADC to 3-Digit. Rather mailers are required to deliver mail sorted to the 3-Digit level to the extent that they have the requisite volume of 3-Digit mail. Therefore, in no sense can FCLM AADC mail be seen as the “candidate” mail most likely to be upgraded to FCLM 3-Digit. FCLM automated AADC and Mixed AADC mail are simply residual default mail for locations for which the mailer did not have the required 150 pieces to make up a tray. For this reason, FCLM

²⁹ Direct Testimony of Thress, USPS-T-7 at Attachment A, page 354 (2006 Test Year after-rate volumes).

³⁰ [id.]

automated AADC is not an appropriate benchmark upon which to set the FCLM automated 3-Digit rate.

USPS witness Taufique pointed out in his response to POIR No. 6, Question 7 that one of the advantages of measuring pass throughs on a cumulative basis (i.e., measuring pass throughs on the full amount of work sharing performed between the BMM benchmark and a given rate category) is that such a measure is independent of the pass throughs of the previous level.³¹ This is particularly important in the case of the pass through for FCLM automated 3-Digit, where measuring its pass through on a cumulative basis avoids basing the rate for the most important FCLM rate category on the basis of a very low volume residual rate category (i.e., FCLM automated AADC). It is even more important to do so in this case, since any overestimation of mail processing costs of FCLM non-automated presort (as identified by USPS witness Abdiraham in response to POIR No.1, Question 1³²) should have been attributed in large part to FCLM automated AADC³³ (i.e., costs of FCLM automated AADC are understated in this respect).

The danger of relying solely upon the incremental approach to calculate pass throughs was confirmed by USPS witness Taufique in his response to an ABA&NAPM interrogatory.³⁴ In that interrogatory response, Mr. Taufique confirmed the result of a simple adjustment to a hypothetical example of cost avoidance which had been set forth by the Commission in its POIR No. 6, Question 7. That Commission hypothetical example set forth cost avoidance and discounts for rate categories B and C; and in that example Category C would have had a 300% pass through if measured under the

31 Response of USPS witness Taufique (USPS T28) to POIR No. 6, Question 7 at 3 Tr.616.

32 Response of USPS witness Abdirahman (USPS T21) to POIR No. 1, Question 1 at 4 Tr.1074

33 As explained at Section II(A)(3) above, because FCLM automated Mixed AADC and AADC have the least degree of sortation of the automated rate categories, they are mixed in with FCLM nonautomated presort more often than are the other FCLM automated rate categories. Therefore it is likely that most of any FCLM automated mail which was mis-tallied as nonautomated presort was in fact FCLM automated Mixed AADC or AADC.

34 Response of USPS witness Taufique to interrogatory ABA & NAPM/USPS -T28-3(revised as of 6/27/05) at 3Tr.559

incremental method, but only a 100% pass through if measured under the cumulative method. Interrogatory ABA&NAPM/USPS-T28-3 presented a revised hypothetical which showed that by merely correcting the work sharing cost of category B to increase by 2 cents, the pass through for rate category C became 100% regardless of whether measured on an incremental or a cumulative basis. In other words, the ABA&NAPM interrogatory hypothetical demonstrated that extremely high incremental pass throughs (i.e., 300%) in a particular rate category may be due totally to a costing error in the previous rate category upon which the incremental pass through was calculated. This may well be the case for the 219% incremental pass through for FCLM automated 3-Digit, since that pass through is based upon FCLM automated AADC which is a low volume residual rate category whose cost may well have been understated due to an overstatement of costs of FCLM non-automated presort mail.

For the foregoing reasons, the cumulative method of calculating pass throughs provides a more reliable and meaningful measure of the pass through for FCLM automated 3-Digit than does the incremental approach. USPS witness Taufique's response to POIR-No. 3, Question 1 (revised 5/24/05) ³⁵ shows a 107% pass through for FCLM automated 3-Digit when measured on such a cumulative basis utilizing LR-K-110. Taking the Cost avoidance shown at Table 1 above, and measuring the pass through of FCLM automated 3-Digit on this cumulative basis, yields a pass through for FCLM automated 3-Digit of only 81% (8.2 cents discount/10.155 cost avoidance).

III. Any Increase In FCLM Automated Rates Above that Proposed by the Postal Service Would Exacerbate The Existing Excessive Cost Coverage for First Class Mail In General And For Automated FCLM In Particular.

ABA and NAPM support the rates proposed by the USPS in this case without change. Postal Service witness Robinson has provided a fully sufficient explanation as to why the rates proposed by the Postal Service meet the statutory criteria of 39 U.S.C.

35 3 Tr. 608

§3622.³⁶ And there is absolutely no testimony in the record to suggest that any of the First Class mail rates proposed by the Postal Service are not appropriate.

For the foregoing reasons, we do not believe that it would be appropriate for the Commission to recommend rates other than those proposed by the Postal Service. Nevertheless, if the Commission is considering any modification to the Postal Service proposal, we urge the Commission to recognize that any increase in the rates proposed by the Postal Service for FCLM automated rate categories would exacerbate the existing problem of an excessive cost coverage for FCLM in general and for FCLM automated rate categories in particular.

Postal Service witness Robinson calculates that in the 2006 Test Year, before implementation of the proposed postal rates in this case, First Class Presort and Automated Letters would have a cost coverage of 312.8% and Total First Class mail would have a cost coverage of 215.5%; and in Test Year 2006 after implementation of the rates proposed by the Postal Service in this case, cost coverage for First Class Presort and Automated Letters and for Total First Class mail would increase to 331.8% and 227.2 % respectively.³⁷ Any increase in the rates proposed by the Postal Service for the FCLM automated rate categories would only worsen the already excessive cost coverage for First Class mail in general and for FCLM automated rate categories in particular.

We also note that if the Commission were to adjust the FCLM automated 3-Digit rate higher than the amount proposed by the Postal Service, and to thereby cut the discount implied by that rate, this would increase the risk of further diversion of such mail to electronic payments and internet transactions. Protection of the volume of this high cost coverage mail is of paramount importance for the financial well being of the Postal Service. We submit that there is no evidence in the record in this case which

³⁶ Direct Testimony of USPS witness Robinson (USPS T27) at page 11 et seq.

³⁷ Testimony of USPS witness Robinson (USPS T-27) (Exhibits USPS 27 A and USPS 27 B, revised 06/10/05).

could justify increasing the rate of FCLM automated 3 Digit beyond the across the board level proposed by the Postal Service and agreed to by the numerous settlement parties.

Proposed Findings and Conclusions

For the foregoing reasons, ABA and NAPM propose that the Commission recommend adoption of all rates proposed by the Postal Service and supported by the numerous settlement parties herein.