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

POSTAL RATE AND FEE CHANGES, 2005 **Docket No. R2005-1**

Initial Brief Of
Major Mailers Association
In Support Of Stipulation And Agreement

Michael W. Hall
35396 Millville Road
Middleburg, Virginia 20117

Counsel For
Major Mailers Association

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Initial Brief Of Major Mailers Association In Support Of Stipulation And Agreement

Major Mailers Association ("MMA") hereby submits its initial brief in support of the First-Class workshare rates contained in the Stipulation and Agreement[1] ("S&A") filed by the Postal Service. MMA is a signatory to and strong supporter of the S&A.

The S&A enjoys broad support among the active participants in this proceeding and almost universal support of those parties that must pay the higher rates included in the S&A.

Statement Regarding MMA's Interest In This Proceeding

MMA is an association of quality First-Class Mailers, organized for the purpose of promoting fair and equitable postal rates, classifications, and rules. MMA has participated actively in all major rate and classification proceedings considered by the Commission during the last 15 years, since the R90-1 omnibus rate proceeding. MMA members are among the largest mailers of "workshare" First-Class Mail that is presorted, prebarcoded and properly prepared to maximize efficient handling by the Postal Service and minimize postal costs.

Within the last decade, MMA members have invested heavily in new equipment and technologies and partnered with the Postal Service on innovative mailing practices that provide substantial additional savings for the Service.

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[1] *See* Notice of the United States Postal Service Submitting Stipulation and Agreement, dated July 22, 2005. On August 3, the Postal Service filed a corrected Schedule 1000.

Statement Of The Case

On April 8, 2005, the Postal Service filed a request for increases in rates and fees sufficient to generate additional revenues of $3.1 billion annually.[2] The Postal Service's request identified a Congressional mandate pursuant to the Postal Civil Service Retirement System Funding Reform Act of 2003, Public Law 108-18, as the proximate cause of its omnibus rate increase filing. Specifically, the Postal Service pointed to the need "to meet a currently unavoidable financial obligation in Fiscal Year 2006," specifically the Public Law 108-18 requirement that the Service establish a special escrow and commence funding it at an annual level of approximately $3.1 billion during the 2006 fiscal year.[3] To raise the necessary additional revenues, the Postal Service proposed to raise all rates and fees 5.4% on a generally uniform, across-the-board basis. Included with the Postal Service's Request was a separate request for extraordinary, expedited procedures that would allow implementation of the increased rates as early as January 2006.[4]

By Order No. 1436,[5] issued two business days later, the Commission gave public notice of the Postal Service's April 8 Request and initiated this proceeding. In doing so, the Commission noted that this was not a "normal" omnibus rate proceeding:

> The Request is unique in that it is premised on several policy conclusions associated with funding a pending escrow obligation associated with Public Law 108-18. These conclusions entail, among others, a decision to seek a 5.4 percent across-the-board increase for most rates and fees…

Order No. 1436 at 2. Noting the Postal Service's request for "maximum expedition" and early implementation of new rates, the Commission authorized settlement negotiations "based in part on the Service's representations that substantial support for settlement already exists." Order No.1436 at 2-3. Order No. 1436 established several preliminary

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2 Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, dated April 8, 2005 ("Request").

3 Exhibit USPS-T-1 at 2 (Potter)

4 United States Postal Service Request for Expedition and Early Consideration of Procedures Facilitating Settlement Efforts dated April 8, 2005 ("Expedition Request").

5 Notice And Order On Postal Service Request For Changes In Domestic Postage Rates And Fees, Docket No. R2005-1, Order No. 1436, issued April 12, 2005 ("Order No. 1436").

procedures, including a date for filing comments on the Postal Service's Expedition Request, and set May 5, 2005 as the date for the first prehearing conference.

Immediately following the May 5 prehearing conference, the parties met to discuss the possibilities for settlement. The Postal Service followed up this formal settlement conference with individual meetings with interested participants, including MMA.

In Presiding Officer's Ruling ("POR") No. 11,[6] Chairman Omas prescribed a procedural schedule that "assumes that the parties will make some progress toward narrowing issues and reducing the need for cross-examination … [and] provides less time for cross-examination, and discovery on the direct testimony of intervenors, than has been the norm in past Commission cases." POR No. 11 at 1-2. POR No. 11 provided for grouping of Postal Service witnesses for purposes of discovery and hearings on the Postal Service's case-in-chief.

MMA made the best use possible of the shortened discovery period permitted by POR No. 11 and cross-examined several Postal Service witnesses. Hearings on the Postal Service's case-in-chief concluded on July 8, 2005.

On July 19, 2005, the revised date for filing of testimony by intervenors, only one party, ValPak,[7] filed testimony directed to the rate for Standard Enhanced Carrier Route ("ECR") Mail. Hearings on ValPak's case-in-chief were held on August 24, 2005. On September 8, 2005, the Postal Service and Advo, Inc. filed rebuttal to ValPak. Hearings on their rebuttal cases were concluded on September 15, 2005.

On July 22, 2005, the Postal Service submitted the final S&A. With very minor revisions, the rates and fees proposed in the July 22 S&A are identical to those proposed in the Postal Service's April 8 Request. To date, MMA, and 35 other parties have become signatories to the S&A. *See* Notice Of United States Postal Service Filing Signatures For Stipulation And Agreement, dated September 23, 2005.

[6] Presiding Officer's Ruling Establishing Procedural Schedule, Docket No. R2005-1, issued May 19, 2005 ("POR No. 11).

[7] Valpak Dealers' Association, Inc., Valpak Direct Marketing Systems, Inc., Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.

Argument

I. The S&A Is A Reasonable Response To Unique Circumstances

A. The Commission Should Give Substantial Weight To The Fact That The S&A Enjoys Overwhelming Support By Parties Representing All Mail Classes

The S&A now before the Commission is the product of a good faith effort by the Board Of Governors of the Postal Service ("Governors") in the face of the rather unusual Congressional mandate contained in Public Law 108-8. The fact that the rates and fees adopted in the final S&A are essentially identical to those originally proposed in the Service's April 8 Request is due at least in part to the fact that the Postal Service consulted with many of the parties prior to filing its across-the-board rate increase proposal.[8]

In the Bank One NSA case,[9] the Commission recently discussed at some length its policy favoring settlements. As the Commission stated:

> The Commission has a longstanding policy favoring the settlement of important issues through negotiations among participants, independent of Commission action. The settlement process allows participants to formulate proposals that represent a consensus as to the optimum approach to resolve contested issues. The settlement proposals that are generated facilitate the Commission's independent decision making process by informing the Commission of approaches to resolving contested issues that have been thoroughly considered and have the support of the participants agreeing to the settlement.
>
> The settlement of contested issues facilitates the Commission's review of Postal Service requests because of its inherent efficiency and cost effectiveness. If settlement resolves all factual issues, whole portions of the hearing process may be eliminated. Settlements may obviate the need for rebuttal and surrebuttal testimony and the related discovery process, providing a substantial cost benefit to the participants. This also will preserve the Commission's resources and allow the Commission to make decisions in a more timely fashion as the procedural schedule will not have to accommodate the eliminated tasks.[10]

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8 *See* USPS Expedition Request at 5-6.

9 *Rate and Service Changes to Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation*, Docket No. MC2004-3 ("*Bank One*").

10 *Bank One*, Order Establishing Procedural Framework For Reconsideration, issued August 23, 2005 at 14-15.

In this omnibus rate proceeding, the Commission acted proactively in facilitating settlement negotiations. Only two business days after the Postal Service filed the April 8 Request, the Commission authorized settlement negotiations and appointed the Postal Service to be the settlement coordinator. Order No. 1436 at 2-3, 11.

This is the second omnibus rate proceeding in which almost all parties have been able to settle rather than litigate. Settlement of the R2001-1 omnibus rate case came in response to truly extraordinary events having significant impacts not only on the Postal Service, but the Nation as a whole. It was no wonder then that most parties were able to settle the issues in that case.

This case presents less extraordinary circumstances than those present in the last case. Nevertheless, once again the parties successfully negotiated a near unanimous settlement. Equally important, the settling parties were able to reach settlement within the short timeframe permitted by expedited procedures, thereby sparing most of them the substantial time and expense involved in pursuing fully the litigation alternative and preserving the Commission's resources in the bargain. MMA credits the successful negotiating experience gained in R2001-1 as a major reason why most parties were able to settle this case. Success builds upon success. A favorable recommendation on the instant S&A will build upon the parties' successful experience in R2001-1 and pave the way for similar fruitful negotiations in future omnibus rate cases. For this reason alone, the Commission should look favorably on the S&A before it.

The Commission should also give considerable weight to the S&A because it enjoys affirmative support from all sectors of the mailing industry, competitors of the Postal Service, and Postal Service employee groups. Moreover, MMA understands that the S&A is not opposed by several other parties who decided not become signatory parties. The fact that the S&A enjoys affirmative support by all but one of the mailers who will pay the increased rates is a testament to the basic fairness of those rates, a prime consideration under the criteria of § 3622 (b) of the Postal Reorganization Act ("Act").

II. The Across-The-Board Approach Is Reasonable Under The Circumstances

The S&A is structured to provide the Postal Service with additional revenues of approximately $3.1 billion, about one-half from First-Class. Under the S&A, the burden of funding the escrow obligation is shared equitably by all segments of the mailing industry.

As USPS witnesses Potter and Robinson testified, the circumstances that made this omnibus rate increase filing necessary are relatively unique. But for imposition of the escrow fund obligation, the Postal Service acknowledges it would not have filed to increase its rates and fees at this time.[11] And the rate and fee increases proposed in both the original April 8 Request and the S&A are only what is required to generate the additional $3.1 billion that Public Law108-8 requires be placed in escrow.

These facts suggest that the Commission should examine the S&A rates in two parts. First, the underlying R2001-1 rates and fees were found by the Commission to be fair, equitable and otherwise in accordance with the policies of the Postal Reorganization Act.[12] No party has suggested that these current rates and fees were unlawful when implemented or that they have been rendered unlawful by the passage of time or material changed circumstances.[13] Therefore, the Commission's primary focus can and should be upon whether the proposal to generate the necessary additional revenues through 5.4% across-the-board rate and fee increases is fair and reasonable in light of the unique circumstances presented. The Commission should assess the agreed upon S&A rates by applying "a standard of reasonable consistency with past ratemaking practices, as illustrated in pre-existing rates and rate relationships"

[11] Exhibit USPS-T-1 at 1 (Potter); Exhibit USPS-T-27 at 6 (Robinson).

[12] *Postal Rate And Fee Changes, 2001,* Docket No. R2001-1, Opinion And Recommended Decision Approving Stipulation And Agreement, issued March 22, 2002 ("PRC Op. R2001-1") at Summary, p. ii, Recommended Decision at 1.

[13] As the Commission stated in PRC Op. 20001-1 at 26 (footnote omitted),

> Existing costing methods and rate relationships, as well as the Commission's recent rate recommendations, are particularly useful alternative sources of benchmarks for conducting its analysis here. In most respects, the current rate schedule reflects the Commission's most recent recommendations as to ratemaking methodology. It also provides reference points for determinations of reasonable contributions to institutional costs under § 3622(b) generally, and for assessment of impact for particular subclasses under the § 3622(b)(4) factor.

and analyzing the record “through the lens of established methodologies.” PRC Op. 2000-1 at 27.

MMA is convinced that, *as part of this comprehensive settlement,* the 5.4% across-the-board approach is both fair and reasonable for several reasons. First, the across-the-board approach appears to be the most expedient and inherently fair means to raise the required revenues under the unique circumstances presented here. The evidence indicates that the sole impetus for this case was truly an exogenous factor: Congress’ imposition of revised CSRS funding requirements on the Postal Service. As such, these costs do not have any natural connection with the provision of one particular class of mail or service more than any other class or service.

Second, a key factor in MMA’s affirmative support of the S&A is the manner in which the Postal Service has applied the 5.4% across-the-board increase. Specifically, in conjunction with raising the basic First-Class rate from 37 to 39 cents, the Postal Service acted scrupulously to increase all rate elements by the same uniform percentage. Because the Postal Service has applied the across-the-board approach in a consistent, even handed manner, workshare mailers are not faced with shouldering a disproportionately large share of the necessary rate increase.

Third, the rates and fees contained in the S&A likely will remain in effect only for a relatively short period. The Postal Service has indicated that the $3.1 billion annual revenue increase herein will only serve to delay the filing of a more typical omnibus rate increase proposal. This consideration is important for MMA because, as discussed in Part VI, *infra*, there are important cost and rate structure issues that the Postal Service should and the Commission must address in the next omnibus case.

Finally, for MMA in particular, a very important, related consideration is that the Postal Service has stated that “[I]n a traditional omnibus case we could potentially reexamine costing methodologies and the alignment of discounts, as well as consider potential classification changes. These issues will be reviewed prior to the filing of the next omnibus rate filing. In fact, we believe it is more appropriate to examine the entire array of discounts at that time.”[14] This undertaking is extremely important to MMA.

[14] Response Of The United States Postal Service To Presiding Officer’s Information Request No. 1, dated May 9, 2005 (“POIR No. 1 Response”) Part B (Taufique). Tr 3/607

III. The Postal Service Failed To Provide Specific Justification For The First-Class Workshare Discounts It Proposed

The Postal Service's First-Class rate and workshare discount proposals are well reasoned and fair. However, MMA was dismayed to discover that what little "support" the Service provided for the First-Class workshare discounts was woefully inadequate and unreasonable.

In recent omnibus cases, the Postal Service has followed the unhelpful practice of creating cost studies that understate or ignore almost entirely cost savings resulting from worksharing. Then, in what apparently is intended to appear as a magnanimous gesture to workshare mailers, Postal Service witnesses offer up independent, largely judgmental reasons why discounts should be higher than the corresponding cost savings.[15]

In this case, the Postal Service requested expedited procedures to facilitate an earlier than normal effective date for the proposed 5.4% across-the-board increases in rates and fees. In support of expedition, the Postal Service claimed that certain policy decisions made by the Board Of Governors resulted in a streamlined omnibus rate filing designed to avoid or minimize controversy and enhance possibilities for settlement. For example, the Postal Service pointed to the fact that "proposals for rate and fee increases sufficient to meet [the Public Law 108-8] obligation are simple, straightforward, and equitable." Expedition Request at 6**.** MMA agrees. Further, the Postal Service averred that the Governors "decided not to propose any classification or rate structure changes in conjunction with the request for rate and fee increases" to eliminate controversy. *Id*. MMA also agrees that this policy decision of the Governors advanced the prospects for settlement.

In R2001-1, the Commission relied upon the results of its workshare cost savings analyses from R2000-1[16] and, significantly, did not consider much less rule on any of the methodological changes proposed by the Postal Service in R2001-1. PRC Op.

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[15] For example, in R2001-1, the Postal Service's proposed First Class discounts produced percent passthroughs that ranged from 115% to 122% for the various non-carrier route, automation presort levels. In R2000-1, the range was from 117% to 123%.

[16] PRC Op. 2001-1 at 74. The Commission noted that, with one exception, evidence replicating its cost avoidance analysis from R2000-1 "generates a result close to what the Commission would have calculated, given the same inputs." Id., fn 55.

2001-1 at 74-75. Therefore, updating the Commission's workshare cost savings analysis from R2001-1 would have been the simplest, most straight forward, and least controversial approach for the Postal Service to take in its filing. Such an approach also would have facilitated an earlier settlement. However, in a departure from the Governors' guiding principles, USPS witness Abdirahman's "updated" workshare cost savings analysis relied almost entirely on the controversial methodology USPS witness Miller introduced for the first time in R2001-1. The obvious problem with this approach is that the Commission never endorsed this method. Another obvious problem with this approach is that witness Miller's R2001-1 cost presentation was submitted as a litigation position that the Postal Service did not pursue once the case settled. PRC Op. 2001-1 at 73. It was counterproductive for the Postal Service to use such an approach in a filing that supposedly was intended to foster opportunities for an early settlement. The Postal Service's misguided approach to workshare cost savings required MMA and other mailers to expend significant resources to demonstrate the flaws in the Postal Service's workshare cost savings analyses and develop record evidence showing the results of the Commission-approved method. In sum, the Postal Service's untested approach to measuring workshare cost savings injected unnecessary controversy into this case.

Moreover, the Postal Service's presentation makes no sense on its face. Table I compares the proposed workshare discounts with the unit cost savings under the USPS method and shows the resulting percentage passthroughs.

Table I
Comparison Of S&A Discounts With USPS Cost Savings
And Resulting Passthrough Percentages
(Cents)

First-Class Workshare Category	(1) S&A Proposed Discount	(2) Unit Cost Savings Using USPS Methodology	(1) / (2) % Passthrough
Mixed AADC	6.4	5.1	125%
AADC	7.3	6.1	120%
3-Digits	8.2	6.5	127%
5-Digits	9.7	7.6	127%
Carrier Route	10.0	8.6	117%

Sources: Column (1): S&A, Attachment A, p. 5
Column (2): Library Reference USPS-LR-K-48, p. 1

As Table I shows, in every instance the unit cost savings ***appear*** to be lower than the proposed discount, and, as the percentage passthroughs illustrate, the Postal Service ***appears*** to be paying out substantially more in discounts than it saves. If the Postal Service presentation represented the true state of facts, there would be no economic justification for the proposed workshare discounts.[17]

MMA was not the only party confused by the Postal Service's workshare cost analyses in this case. Presiding Officer's Information Request ("POIR") No. 1, dated April 22, 2005, pointed out one glaring inconsistency between the results of USPS witness Abdirahman's workshare cost savings analyses and the discounts the Postal Service proposed in its April 8 Request:

> The workshare-related savings for (machinable) First-Class Mail Nonautomation Presort letters is *negative* 1.413 cents using the USPS proposed methodology and *negative* 1.652 cents using the methods in the R2001-1 PRC Opinion. These results imply that presorted First-Class letters that are not prebarcoded are more costly for the Postal Service to process than similar letters that are not presorted.

[17] In R2001-1, the Commission agreed with the proposition that rate design is not a mechanical application of one principle and recognized that consideration of other relevant factors could justify a departure from its general policy limiting discounts to 100 percent of avoided costs. PRC Op. R2001-1 (at 72-73).

POIR No. 1 at 1 (emphasis in original). The Presiding Officer directed the Postal Service to provide possible reasons for this obviously anomalous result and to "explain the rationale for preserving and increasing the rate incentive for mailers to perform work that increases Postal Service costs." POIR No. 1 at 2.

The Postal Service's response, authored by USPS witnesses Abdirahman and Taufique is very revealing. After first providing technical reasons why this particular anomalous result occurred, Mr. Abdirahman stated:

> ***The Postal Service's across-the-board rate increase proposals do not rely on the results of the special cost studies presented in this case***; those results have only been used to estimate final adjustments to the rollforward model. Under these circumstances, the Postal Service used the cost methodology from the R2001-1 case, the BY 1999 nonautomation/automation cost methodology, to develop the cost studies found in USPS-LR-K-48 and USPS-LR-K-110. ***However, the Postal Service expects to continue consideration of alternative cost study approaches prior to the filing of the next omnibus case***.[18]

USPS witness Taufique echoed the thrust of Mr. Abdirahman's statement, adding:

> Moreover, this filing is designed to fairly and equitably distribute the escrow burden to the classes of mail, and within the mail classes to individual rate categories. The proposed prices are based on the application of a 5.4 percent target increase for each rate category, adhering to the rounding conventions for that particular rate category. ***In a traditional omnibus case we could potentially reexamine costing methodologies and the alignment of discounts, as well as consider potential classification changes. These issues will be reviewed prior to the filing of the next omnibus rate filing. In fact, we believe it is more appropriate to examine the entire array of discounts at that time.***[19]

Subsequently, in an institutional response to Interrogatory MMA/USPS-10, the Postal Service clarified further that it did not rely upon the new delivery cost study sponsored by USPS witness Kelley and presented in Library Reference LR-USPS-K-67. Tr 8D/4577.

In view of the fact that the Postal Service itself does not place any reliance on the special cost studies presented by USPS witnesses Abdirahman and Kelley, the

[18] POIR No. 1 Response, Part A (Abdirahman). Tr 4/1077 (emphasis added)
[19] POIR No. 1 Response, Part B (Taufique). Tr 3/607 (emphasis added)

Commission can and should disregard the results of those studies in judging the appropriateness of the First-Class workshare discounts proposed in the S&A.[20]

IV. Independent Record Evidence Supports The First-Class Workshare Discounts Included In The Settlement

The proposed First-Class workshare discounts are ***absolutely critical*** to workshare mailers willingness to accept the rate increases embodied in the S&A. Without a true across-the-board increase in ***all*** rate elements, First-Class workshare mailers would be unfairly burdened with a disproportionately large share of the overall revenue responsibility associated with funding the $3.1 billion increase.

In the end, MMA and other workshare mailers were able to clarify the record, incorporating evidence that provides a far more realistic worksharing cost analysis, one that provides solid support for the S&A proposed discounts. For example, as a result of MMA's efforts during discovery, the record now contains an independent evidentiary basis for measuring workshare savings. The cost savings that MMA elicited from the Postal Service are predicated on the Commission's current workshare cost savings methodology, a much more reasonable measure of cost savings adopted by the Commission in R2000-1, the last proceeding in which these vital issues were fully litigated.[21]

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[20] There is one useful observation made by USPS witness Abdirahman in the POIR No. 1 Response:

> Due to the large volume differences between the two categories, the nonautomation presort letters unit costs increased dramatically, while the automation presort letters unit costs decreased slightly. Consequently, the worksharing related savings estimates for the nonautomation presort letters rate category decreased, while those for the automation presort letters rate categories increased. The nonautomation presort letters volumes have also declined steadily over time. This trend appears to have magnified the effect of the BY 1999 methodology on nonautomation costs.

Tr 4/1075. In other words, a very small inaccuracy in the costs associated with the automation discount categories can magnify ***apparent*** unit cost results for the nonautomation presort letters. Since nonautomation letters now make up only 4% of total workshare letter volumes, **minor** inaccuracies associated with IOCS costs for automation letters constituting 96% of total volume can have a ***"magnified"*** impact on the IOCS costs for nonautomation letters. Tr 4/1166, 1175. Accordingly, the apparent anomaly observed in POIR No. 1 need not concern the Commission in this case.

[21] *See Postal Rate and Fee Changes, 2000*, Docket No. R2000-1, Opinion And Recommended Decision, issued November 13, 2000 ("PRC Op. 2000-1").

In response to Interrogatory USPS/MMA-T21-41, USPS witness Abdirahman confirmed for MMA the cost savings that result from application of the Commission's R2000-1 methodology. See Tr 4/1015. Those unit cost savings are shown in the following table.

Table II
Comparison Of S&A Discounts With Cost Savings and Resulting
<u>Passthroughs Percentages Based On Current PRC-Approved Methodology</u>
(Cents)

First-Class Workshare Category	(1) S&A Proposed Discount	(2) Unit Cost Savings Using PRC 2000-1 Methodology	(1) / (2) % Passthrough
Mixed AADC	6.4	8.2	78%
AADC	7.3	9.3	78%
3-Digits	8.2	9.7	84%
5-Digits	9.7	11.1	88%
Carrier Route	10.0	12.1	82%

Sources: Column (1): S&A, Attachment A; p. 5
Column (2): Tr 4/1016

As Table II shows, the First-Class workshare discounts in the S&A are all lower than the corresponding unit cost savings.[22] The resulting percentage passthroughs range from 78% to 88%. As Table III shows, these percentage passthroughs are significantly lower than the passthroughs reflected in the discounts the Commission recommended in R97-1 and R2000-1, the last two cases in which these issues were fully litigated.[23]

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[22] The cost savings using the Commission's methodology that USPS witness Abdirahman provided still appear to be understated because they exclude workshare related cost savings that were originally reported in cost pool 1SUPP_F4. The Commission included cost pool 1SUPP_F4 as worksharing related fixed in R2000-1. Tr 4/1048. *See*, also, R2000-1 Library Reference PRC-LR-12, Part B. However, since then the Postal Service modified its data systems. Tr 4/1017.

[23] In R2001-1, the Commission found that "the Docket No. R2000-1 discounts and the discounts reflected in the Stipulation and Agreement are reasonably close in magnitude" and that "the proposed discounts do not vary by any significant amount from discounts based on accepted cost avoidance methodology that have recently been shown to satisfy all the requirements of the Act." PRC Op. R2001-1 at 76.

Table III
Comparison of Recent PRC Recommended Percent Passthroughs
<u>For First-Class Workshare Letters</u>
(Cents)

	R97-1			R2000-1		
First-Class Workshare Rate Category	**(1) Discount**	**(2) Cost Savings**	**(1) / (2) % Passthrough**	**(4) Discount**	**(5) Cost Savings**	**(4) / (5) % Passthrough**
Basic	6.0	7.2	83%	6.2	6.2	100%
3-Digit	6.9	8.1	85%	7.3	7.3	100%
5-Digit	8.7	9.9	88%	8.7	8.7	100%
Carrier Route	9.2	10.4	88%	9.7	10.2	95%
PRC Opinion Source	PRC Op. R97-1 at 297[24]			PRC Op. R2000-1 at 243		

Under the Commission's cost savings methodology, the Postal Service's projected cost coverage for First-Class bulk letters is **313%.**[25] By itself, this unprecedented high cost coverage clearly supports the conclusion that the Postal Service's purported cost savings are seriously understated. Paired with the S&A workshare discounts, the resulting revenues and attributable costs make First-Class bulk much more profitable than ever before. It is astounding that ***profits are more than twice the attributable costs***.[26] There must be some rational limit on how much profit the Postal Service is allowed to extract from one monopoly product.

In R2001-1, the Commission registered its concern about the increase in the First-Class markups, stating "the Commission is concerned that the result is a shift in the institutional cost burden among the subclasses, with the monopoly class bearing a greater burden than historically found to be appropriate." The Commission announced its intent to analyze the issue and "urge[d] the Postal Service to likewise devote

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[24] *Postal Rate And Fee Changes, 1997*, Docket No. R97-1, Opinion And Recommended Decision, issued May 11, 1998 ("PRC Op. R97-1").

[25] Under the Postal Service's cost attribution methodology, the cost coverage reaches an astounding 332%. Exhibit USPS-27B.

[26] If the discounts were set equal to the Postal Service's flawed unit cost savings, the First-Class bulk cost coverage would increase to 330% under the Commission's cost attribution method and 350% under the Postal Service's costing method, all other things being equal.

resources to this important issue." PRC Op. 2001-1 at 49-50. There is nothing in the evidentiary record in R2005-1 that serves to alleviate the Commission's concern on this score.

V. First Class Workshare Mailers Have Borne More Than Their Fair Share Of Rate Increases Resulting From The S&As In R2001-1 And This Case

The unique circumstances presented in R2001-1 and this case have persuaded MMA to join and support both settlements. Nevertheless, as Table IV demonstrates, First-Class and especially First-Class bulk mailers, have borne the brunt of these increased rates.

Table IV
<u>Comparison of Cost Coverages For Major Mail Categories</u>
(PRC Cost Attribution Methodology)

Subclass or Category	(1) R2000-1 PRC Recommended	(2) R2001-1 PRC Recommended	(3) R2005-1 Before Rates	(4) R2005-1 After Rates	Relative Increase (4) / (1) –1	Absolute Increase (4) - (1)
First-Class Single Piece Letters	154%	160%	169%	178%	16%	24%
First-Class Workshare Letters	**248%**	**266%**	**296%**	**313%**	**26%**	**65%**
First-Class Cards	133%	143%	156%	164%	23%	31%
Priority Mail	162%	160%	139%	146%	-10%	-16%
Periodical Outside County	100%	101%	96%	101%	1%	1%
Standard Regular	137%	135%	145%	153%	11%	15%
Standard ECR	199%	201%	215%	226%	14%	27%
Parcel Post	115%	114%	110%	116%	1%	1%
Bound Printed Matter	114%	124%	117%	123%	8%	9%
All Mail and Services	157%	163%	169%	178%	13%	21%
% Of Costs Attributed	**63%**	**61%**	**54%**	**56%**	**-12%**	**-8%**

***Sources*:** Column (1) PRC Op. R2000-1, App. G and App. J, p. 1-2
Column (2) PRC Op. R2001-1, App. F, p. 1-2 and App. G
Column (3) Tr 7/2459
Column (4) Tr 7/2460

As Table IV shows, the cost coverages for First Class and, most notably, First-Class workshare letters, have increased the most on both a relative and absolute basis. Most significantly the cost coverage for First-Class workshare letters will increase to

313% when the S&A rates are implemented. Additional rate increases for workshare mailers simply are not equitable in the face of revenues that are now more than three times the cost of providing this very profitable product.

The last, highlighted row of Table IV illustrates another trend in postal finances. Since R2000-1, institutional costs as a percentage of total costs have been growing. In R2000-1, 37% of total postal costs were institutional. This percentage will increase to 44% in the test year (after rates). With total costs of more than $72 billion, the Commission must determine institutional cost contributions of about $5 billion more in this case than in R2000-1, all other factors being equal. In this regard, even without the rate increases incorporated in the S&A, the cost coverage for First-Class workshare mail has increased from 248% to 296%.[27] This makes the Commission's task of considering the factors in § 3622(b) of the Act in determining the appropriate contribution of each mail category more important than ever

VI. The Rapidly Changing Nature Of Worksharing Will Require An Overhaul Of The Current Workshare Mail Rate Structure In The Next Omnibus Rate Case

Recognition that certain First-Class mailers perform "worksharing" activities that reduce postal costs and that, in fairness, these mailers should receive a reasonable share of the resulting savings through appropriate discounts from the otherwise applicable First-Class basic rate has been incorporated in the rate structure since 1976. *See* Library Reference USPS-LR-K-73. Initially, the discount of 1 cent was based on cost savings that the Postal Service enjoyed when mailers presorted their mail. As the Postal Service increasingly moved to automate processing of mail and adopted expanded zip codes and barcodes that enabled properly prepared mail pieces

[27] Another reason why the cost coverage for First-Class workshare letters has increased so significantly over the last few years is that improvements in worksharing technologies and mailing practices have reduced postal costs in spite of labor increases. *See* Exhibit XEMMA-1. Tr 3/547.

to be “read” automatically and sorted very rapidly, additional discounts were added to encourage mailers to prebarcode their mail pieces.

While worksharing has evolved over time, the Postal Service and the Commission have focused narrowly on cost savings that result solely from specific mail preparation activities -- presorting and prebarcoding. Moreover, discounts are based on the minimum mailing size, currently 500 pieces. Workshare mailers receive **exactly** the same discounts based solely on cost savings that result from presortation and prebarcoding regardless of whether their mailings are one ***thousand*** pieces or one ***million*** pieces. In other words, the current system of workshare discounts gives absolutely no recognition to increased savings realized by the Postal Service when mail is specially prepared and presented in high volumes.

More specifically, the current system of workshare discounts has failed to change in response to significant changes in mailing technologies and innovative mailing practices implemented in recent years. These changes include implementation of the Merlin System, PostalOne!, pallet sortations and adoption of plant loading arrangements for high volume workshare mailers. There can be no doubt that consistent high volume mailings and the consolidation of mail volumes at a few main locations are both significant cost drivers.

Nor have workshare discounts changed to reflect changes in the workshare market. During Fiscal Year (“FY”) 2004, there were 90,100 total First-Class workshare mailers. Of that number, 38 PostalOne! mailers accounted for over 9.4 ***billion*** (Tr 8D/4578) of the 46.5 billion First-Class workshare letters sent during that period.[28] In other words, these 38 mailers, who constitute about **0.04%** of total workshare mailers accounted for more than 20% of the total volume of workshare letter mail. These statistics point up the fact that the workshare market is increasingly comprised of a few very large mailers who account for the vast bulk of the workshare mail being entered on one end of the spectrum and, on the other end, a very large number of much smaller

[28] Library Reference USPS-LR-K-48, p. 52.

workshare mailers who send mail in relatively small volumes. In this latter regard, the Postal Service confirmed that 39% of all workshare mailings contain 1,500 or fewer pieces and account for just 2% of all volumes. Similarly, about 90% of all mailings representing just 23% of all volumes contain fewer than 25,000 pieces. Tr 8D/4585.

High volumes matter for several reasons. First, sending out high volumes of mail requires mailers to invest in the latest, most efficient ***and very expensive*** mail preparation equipment such as advanced computers, improved software programs, printers, mail inserters, automatic scales, banding equipment, and mail moving equipment such as conveyors, fork lifts, and shrinkwrapping machinery. Using new, high tech equipment and systems leads to better quality mail pieces that are more uniform, reliable, and readable than mail pieces prepared by small volume mailers with older equipment and systems.

Second, when mailers routinely send out mail in high volumes, the Postal Service has greater control over the mail and the mailers. Using fewer resources, the Postal Service can much more effectively enforce very complex mail design and address quality requirements with high volume mailers than it can with the multitude of low volume mailers. Third, Postal Service acceptance procedures are much more efficient and less expensive when individual mailing volumes are high.[29]

Finally, when mail is presented in very high volumes, the Postal Service can avoid several time consuming and expensive operations that Postal Service employees must perform when small mailings are tendered by low volume mailers. These operations include,

- ♦ **Traying letters**
  - ③ Removing old tray labels and printing and inserting new labels;
  - ③ Sleeving the trays;
  - ③ Banding the trays;
  - ③ Preparing and applying Destination and Routing (D&R) labels, including the use of PostalOne!;
  - ③ Weighing the trays;
  - ③ Postage verification, including on-site MERLIN systems;

[29] Obviously, it is much more efficient to have one mailer tender one mailing containing 100,000 pieces than it is to have 100 small mailers tender one mailing each containing 1,000 pieces. Yet, under the current rate structure, the rates for all of these letters will be identical if the degree of presort is the same.

- ③ Electronic transmission of weight and volume data to Postal data centers, including the use of PostalOne!;
- ③ Electronic transmissions of all postal paperwork, including the use of PostalOne!; and
- ③ Presorting the trays of mail prior to placing them onto pallets or other containers.

- ♦ **Palletizing the trays**

  - ③ Stacking trays onto pallets;
  - ③ Shrinkwrapping full pallets to secure trays during transport by USPS;
  - ③ Labeling pallets; and
  - ③ Separating and presorting pallets prior to the point at which they are loaded onto trucks.

- ♦ **Loading mail onto trucks**

  - ③ Moving full labeled pallets to the workshare mailer's loading dock;
  - ③ Loading pallets onto USPS trucks;
  - ③ Meeting USPS scheduling requirements; and
  - ③ Presorting trucks with presorted pallets.

See, e.g. Tr 8D/4571, 4572-73. Large First-Class mailers can and do perform all of these operations. For the vast majority of smaller First-Class mailers, Postal Service employees must perform almost all of these operations. Yet ***all*** First-Class mailers pay the exact same rates.

PostalOne! is a particularly important innovation because it allows much greater automation and integration of mail preparation, billing, mail dispatch, and transportation processes.[30] As the Postal Service stated (Tr 8D/4565):

> The Postal Service encourages mailers to participate in the PostalOne! Transportation Management program if their participation provides a positive return on investment (ROI) for the Postal Service. The factors that contribute to the ROI include volume, dispatch quality, handling, processing, collection, transportation, and other factors associated with the induction of mail.

[30] The Postal Service takes the position that PostalOne! "may facilitate worksharing" but does not constitute worksharing. Tr 8D/4581. Such hair splitting is a transparent attempt to play down the substantial cost sparing attributes of PostalOne! High volume mailers who invest considerable sums in the PostalOne! program consider such investment to be an integral part of their worksharing effort and have every reason to expect the resulting cost savings to be reflected ***directly*** in the Postal discounts they receive.

The enhanced efficiencies and extra cost savings that PostalOne! makes possible can only be achieved by mailers who regularly send out workshared mail in very high volumes.

There are several inequities built into the current, outdated First-Class workshare mail rate structure. First, because the current methodology for measuring workshare cost savings are narrowly focused just on savings due to presortation and prebarcoding, high volume workshare mailers get no credit whatsoever for additional cost savings that worksharing activities make possible.[31] Second, the one size fits all workshare discount structure gives high volume workshare mailers no credit from the additional cost savings that result from economies of scale. Indeed, to the extent that the existing cost savings methodology does capture such additional savings, the rate structure discriminates against high volume mailers because the additional savings they generate for the Postal Service are spread over all workshare mail volumes. The rate structure has simply not kept up with the changing technologies that define worksharing operations.

This is not the first time that the Commission has faced a situation where determining rates based on outmoded cost analyses produced inequitable results. In R87-1, the Commission faulted the Postal Service for continuing to rely upon an outdated special study of Business Reply Mail ("BRM") per piece fee costs where new, automated methods of counting and rating BRM reduced such costs.[32] The re-examination led to significantly reduced per piece fees in subsequent cases. Eventually, the Postal Service proposed and the Commission recommended classification and rate structure changes for Qualified BRM ("QBRM') that established a separate fee category for High Volume QBRM, to recognize economies associated with the counting and rating of QBRM received in high volumes.[33] MMA submits that the current QBRM rate structure can serve as a model for re-examining the 30-year old concept of First-Class workshare discounts.

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[31] USPS witness Abdirahman admitted that his workshare cost savings analysis excludes savings that result from activities high volume workshare mailers routinely perform. Tr 4/973-74, 979-83.

[32] *Postal Rate And Fee Changes, 1987*, Docket No. R87-1, Opinion And Recommended Decision, issued March 4, 1988 at 791-92, 794-95.

MMA is not asking the Commission to make any change in its workshare cost savings methodology in this case. In light of the special nature and limited scope of the instant case, these issues did not receive a full airing on the record. However, it would be helpful if the Postal Service reexamines these issues before it files its next omnibus rate proceeding. Such a reexamination will be entirely consistent with the Postal Service's promise to undertake a thorough review of costing methods and discounts. As the Postal Service stated (Tr 3/607 (emphasis added)):

> In a traditional omnibus case we could potentially reexamine costing methodologies and the alignment of discounts, as well as consider potential classification changes. ***These issues will be reviewed prior to the filing of the next omnibus rate filing. In fact, we believe it is more appropriate to examine the entire array of discounts at that time.***

MMA expects the Postal Service to live up to this commitment and the Commission should hold the Postal Service to its promise.

VII. The Cost Savings Derived By USPS Witness Abdirahman Do Not Provide A Reasonable Yardstick For Judging The First-Class Workshare Discounts Incorporated In The S&A

A. Introduction

For reasons that are not clear but certainly were ill-conceived, when it came to supporting First-Class workshare discounts the Postal Service chose to ignore the Governors' policy that the Service's filing should be simple, straight forward, and avoid unnecessary controversy. Instead of updating First-Class workshare cost savings using the Commission's methodology from R2000-1, USPS witness Abdirahman updated the Postal Service's flawed and controversial R2001-1 workshare cost savings presentation, which proposed material changes from the Commission's R2000-1 established methodology.

None of the revisions originally proposed by USPS witness Miller in R2001-1 ***before the parties reached a comprehensive settlement*** and simply updated by Mr. Abdirahman in R2005-1[34] have been considered by the Commission, and there is

[33] PRC Op. R2000-1 at 543-44, 550.

[34] USPS witness Abdirahman originally claimed that he used the same methodology presented by USPS witness Miller in R2001-1. USPS-T-21 at 2. Later, however, he disclosed that he deviated from Mr. Miller's method, by accepting one aspect of the Commission's R2000-1

no basis to assume that the suggested changes are indeed improvements. Moreover, USPS witness Abdirahman admitted that he did not present any independent justification for the revisions in this case. Tr 4/959. For this reason alone, the Commission should not rely on Mr. Abdirahman's presentation in this case. In addition, the Postal Service has now admitted that its across-the-board rate increase proposal does not rely on the special cost studies of Messrs. Abdirahman and Kelley. Tr 3/607; Tr 4/1077; Tr 8D/4577. Certainly, if the Postal Service does not rely on its own costing presentation to support the proposed rates, the Commission should not rely on it either.

B. Two Major Methodological Differences Account For The Widely Divergent First-Class Workshare Cost Savings Based On The Commission's And Postal Service's Methods

Table V illustrates just how far apart the derived workshare cost savings are depending on whether the cost savings are measured using the Commission's established methodology or the unapproved methodology preferred by the Postal Service. Table V also isolates and quantifies the major causes for such widely different results.[35]

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method that Mr. Miller had rejected: categorizing cost pool 1SUPP_F1 as workshare related fixed. Tr 4/1017.

[35] Table V separately quantifies how the Postal Service's substitution of its own attributable cost methodology and its choice of a different delivery cost benchmark mail piece affect the derived cost savings compared to the results of the Commission methodology established methodology established in R2000-1.

Table V
Comparison of Workshare Cost Savings Methodologies
(Cents)

Workshare Letter Category	(1) PRC Workshare Unit Cost Savings	(2) Impact of Using USPS Cost Attribution Method	(3) Impact of USPS Assumption on Delivery Cost Benchmark	(4) USPS Workshare Unit Cost Savings
Mixed AADC	8.2	-0.6	-2.5	5.1
AADC	9.3	-0.7	-2.5	6.1
3-Digit	9.7	-0.8	-2.5	6.5
5-Digit	11.1	-1.0	-2.5	7.6
Carrier Route	12.1	-1.1	-2.5	8.6
Weighted Average	10.1	-0.8	-2.5	6.8

Sources: Column (1): Tr 4/1016
Column (2): Tr 4/1016, USPS-LR-K-48, Table 1
Column (3): Tr 4/1016, USPS-LR-K-48, Table 1
Column (4): USPS-LR-K-48, Table 1

Fully 2.5 cents or 25% of the total workshare unit cost savings is wiped out due to the Postal Service's use of non-automation, machinable mixed AADC (NAMMA) letters as the benchmark from which delivery cost savings are measured. That "refinement" was first introduced by USPS witness Miller in R2001-1, notably ***before*** that case was settled. He claimed that NAMMA letters could serve as a proxy for BMM letter delivery costs, notwithstanding the fact that one striking difference between the two categories of mail is that NAMMA letters are workshared while the BMM letters are not workshared. In this case, Mr. Abdirahman adopted by rote Mr. Miller's NAMMA benchmark, without offering any evidence in support of using NAMMA[36] and not even acknowledging that using NAMMA represented a ***significant*** departure from the benchmark that Mr. Miller had recommended and the Commission adopted in R2000-1.[37]

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[36] Mr. Abdirahman stated simply that his adoption of certain revisions proposed by USPS witness Miller in R2001 are "not revisited in my testimony." Tr 4/959.
[37] In R97-1, USPS witness Hatfield proposed and the Commission adopted the concept that delivery cost savings due to worksharing should be measured from a benchmark representing

The Commission did not even consider, much less adopt, the new NAMMA benchmark in R2001-1. Again, MMA can only wonder why the Postal Service put forward a change that reduces workshare cost savings by so much when the Governors apparently instructed the Service to ***avoid*** controversy and the Postal Service admits it does not rely on this methodology. In view of the fact that use of the NAMMA benchmark has a profoundly adverse impact on the discounts for more than 47 billion test year pieces of First-Class workshare letters, as well as the obvious disconnect between the Governors' instructions and the Postal Service's filing, the Commission can and should find use of the NAMMA benchmark to be entirely without merit.[38]

The Commission has already set the standard for measuring delivery cost savings due to worksharing. That standard requires comparison of the unit costs of workshare letters to the unit costs of "similar letters" that are not workshared. *See* POIR No. 1 at 1. The high degree of worksharing NAMMA exhibits makes it an inappropriate benchmark.[39] To identify and isolate the impact of worksharing on delivery costs, the benchmark must come from a ***non-workshare*** category within First-Class single piece.[40] Accordingly, the Postal Service's delivery cost analysis presented in Library Reference USPS-LR-K-67 does not provide a reasonable estimate of cost savings due to worksharing.

As Table V also shows, almost 1 cent of the difference between the two unit cost savings is due to the Postal Service's "theory" that attributable costs do not vary 100% with changes in volume. The Postal Service's continued reliance on this attributable cost concept is especially perplexing since the Commission has soundly rejected that

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the average delivery cost for all workshared, non-automation letters. In R2000-1, USPS witness Miller recommended and the Commission agreed to use that same benchmark.

[38] As discussed in Part C, there are also significant technical flaws that cast serious doubt on the accuracy of the Postal Service's derived unit delivery costs, including those for NAMMA. Such additional methodological flaws, by themselves, provide adequate justification to reject the Postal Service's NAMMA benchmark.

[39] In R2001-1 MMA witness Bentley testified about the serious shortcomings of comparing two worksharing categories as a means to isolate the impact of worksharing on costs. *See* R2001-1 Exhibit MMA-ST-1at 22 and Exhibit MMA-4A at 6-8.

[40] USPS witness Kelley admitted that his delivery cost analyses failed to provide the Commission with key data necessary to isolate the impact of worksharing on delivery costs: Tr 7/2809. Mr. Kelly explanation: obtaining such information was "not part of my task." Tr 7/2810.

"theory" on at least two occasions.[41] The Commission should not have to reconsider the Postal Service's cost attribution theory in every case. Instead, the Commission should direct the Postal Service to present its case using the Commission's cost attribution methodology unless and until it can demonstrate that a material change in circumstances renders the Commission's methodology unfair or unreasonable.

C. The Postal Service's Method For Deriving Unit Costs For The Mail Processing And Delivery Functions Is Inherently Flawed And Requires A Complete Overhaul

1. The Postal Service's Cost Savings Analyses Are Based On Fundamental Misunderstandings About The Goals And Methods Being Employed.

The Postal Service's workshare cost savings analyses in this case were compromised from the outset because USPS witnesses Abdirahman and Kelley failed to communicate effectively.

The USPS witness who develops processing cost savings due to worksharing and the delivery cost witness who deaverages unit delivery costs for various mail categories both need to have an understanding of what each is doing and how information that they exchange "fits" into the overall cost savings analysis. That necessary level of communication and understanding did not occur in this case, probably because each witness was so intent on parroting what had been done in R2001-1 for litigation purposes.

For example, the unit delivery costs derived by USPS witness Kelley were used by his colleague, Mr. Abdirahman, to derive unit delivery cost savings that result from worksharing. Mr. Abdirahman relied on Mr. Kelley to provide him with the volume-variable unit delivery cost of all First-Class letters that are actually delivered by city and rural carriers, i.e. ***excluding*** letters that incur no delivery costs because they are addressed to a post office box. But that was not what Mr. Kelley gave him. Instead, Mr. Kelley provided Mr. Abdirahman with the average unit delivery costs for all

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He also confirmed that he did not study this issue for any kind of "similar letters that are not workshared." Tr 7/2956.

[41] *See* PRC Op. R97-1 at 126; PRC Op. R2000-1 at 85.

originating pieces, including letters that incur no delivery costs because they are addressed to a post office box. During discovery, Messrs. Abdirahman and Kelley acknowledged this miscommunication,[42] and Mr. Kelley confirmed that, in his analyses, letters addressed and delivered to a post office box do **not** incur delivery costs. Tr 7/2798-9.

The failure to communicate effectively also occurred because Mr. Kelley simply lacked basic knowledge about Mr. Abdirahman's objective. Mr. Kelley had no idea that having an estimate of the delivery cost for BMM was important for Mr. Abdirahman's analysis. Tr 7/2774-5. Similarly, Mr. Kelley did not realize that the goal was to obtain delivery costs for a benchmark consisting of "similar letters" that are not workshared. Tr 7/2955-7. Moreover, Mr. Kelley had no idea that, except for collection costs, single piece metered letters are "similar" to workshared letters but without the associated worksharing. Tr 7/2962

Because these two witnesses began with such very fundamental misunderstandings and miscommunications, it is not surprising that their analyses are so flawed.

2. The Erroneous Derivation Of Unit Delivery Costs That Dates From R97-1 Remains A Problem In R2005-1

The Postal Service first attempted to measure delivery cost savings due to worksharing in R2000-1. Embedded in Library Reference USPS-LR-I-95 was an estimate of delivery costs in a manual environment. To accomplish this, USPS witness Daniel used delivery costs and volumes from FY1993, the last year prior to implementation of delivery point sequencing of mail. The problem arose because the Postal Service erred in computing the unit delivery cost by dividing total delivery costs by total originating volumes. However, many originating pieces bypass the delivery

[42] Mr. Kelley confirmed that what he gave to Mr. Abdirahman "do[es] not represent the volume variable cost of a First-Class letter that is actually delivered by a city or rural carrier." Tr 7/2797-8. And Mr. Abdirahman confirmed that he understood these unit delivery costs to "represent the volume variable unit cost for the Postal Service to deliver a letter for each of the First-Class rate categories shown." Tr 4/1051

network and, therefore, do not incur any delivery costs because they are addressed to post office boxes. Accordingly, the result of this computation does ***not*** represent the unit cost to deliver a piece of mail; instead it simply represents total delivery costs divided by all mail pieces whether or not they were actually delivered. The problem was undetected and remained so until the next omnibus rate case.

In R2001-1, the Postal Service updated the delivery unit cost study in Library Reference USPS-LR-I-117 but failed to correct this important methodological flaw. Although MMA brought the problem to the Commission's attention,[43] the Commission failed to correct this error[44] and the same flaw has now been carried forward into R2005-1 in Library Reference USPS-LR-K-101. To correct this error unit delivery costs should be computed by dividing total delivery costs by the total volumes delivered, as shown in Table VI.

Table VI
Correct Computation of FY 1993 Unit Delivery Costs
(000's Except Unit Costs)

First-Class Workshare Rate Category	(1) FY 1993 Delivery Costs	(2) FY 1993 Originating Volume	(3) FY 1993 Delivered Volume	(4) Incorrect Unit Delivery Cost (1) / (2)	(5) Correct Unit Delivery Cost (1) / (3)
Nonpresort	1,076,586	50,443,703	23,815,756	0.0213	0.0452
Presorted	652,975	29,486,424	22,324,833	0.0221	0.0292

Sources: Library References USPS-LR-I-95, USPS-LR-J-117, USPS-LR-K-101, PRC-LR-7 and MMA-J-2

Table VI shows that, when unit delivery costs are calculated using the Postal Service's flawed methodology, as shown in Column 4, presorted letters cost ***more*** to deliver than nonpresorted letters. Such a result defies logic. Presortation (sometimes to carrier sequence) most certainly reduces in-office sortation costs.

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[43] *See* R2001-1 Exhibit MMA-ST1, pages 20-22 and Exhibit MMA-4A
[44] See R2001-1 Library Reference PRC-LR-7

When unit delivery costs are calculated correctly, as shown in Column 5 of Table VI, presorted letters can be delivered for about two thirds of the cost to deliver nonpresorted letters. This relationship makes much more sense.

USPS witness Kelley agreed that the FY1993 unit delivery costs in Library Reference USPS-LR-K 101 are "open to question." Tr 7/2761-2. However, the Postal Service still has not corrected this error. Accordingly, if the Commission decides to utilize the current-approved cost methodology for attributing city carrier delivery costs,[45] the Commission must correct the FY1993 non-automated unit delivery costs in the manner provided in Table VI.

3. Problems With USPS Witness Abdirahman's Mail Processing Analysis

The methodology the Postal Service uses for measuring the mail processing unit cost savings that result from worksharing has several serious problems. First, there have been persistent, fundamental problems associated with the simulated mail flows since the methodology was first introduced in R97-1. Stated simply, the simulated mail flows produce inaccurate and illogical results.

The central problem involves estimation of the Remote Barcode System (RBCS) costs. The RBCS processes nonprebarcoded letters by reading the addresses, determining the appropriate barcode, and spraying on a barcode. Having an accurate, readable barcode makes for efficient processing by automation. By definition, bulk metered mail (BMM), the benchmark from which workshare savings are measured, must pass through the RBCS because it does not have a pre-applied barcode. In contrast, workshare automation letters do not pass through the RBCS, since they already bear accurate, readable barcodes. Therefore, accurately and reliably measuring the cost of the RBCS is critical to determining unit processing cost savings that result from worksharing.

[45] USPS witness Kelley claimed that the Commission endorsed the Postal Service's R2001-1 delivery cost study on the merits. Tr 7/2772. In MMA's opinion, the Commission in R2001-1 used the analyses provided in PRC-LR-7 not as the basis to derive unit delivery costs, but only to support the roll forward model. As such, MMA believes that the current Commission-approved method for estimating unit delivery costs is that provided by the Postal Service and accepted by the Commission in R2000-1.

To date, the Postal Service has failed to accurately measure RBCS System costs. Table VII compares, since R2000-1, the Postal Service's model derived unit costs for BMM with the corresponding CRA costs, and shows the CRA Proportional Adjustment Factor ("CRA Factor") that results when the model-derived and actual costs are compared to one another.

Table VII
Comparison of BMM Workshare Related Unit Costs
(Cents)

	Bulk Metered Mail Workshare-Related Unit Costs		
Docket No. (BY)	**CRA Cost (1)**	**Model Cost (2)**	**CRA Prop Factor (1) / (2)**
R2000-1 (1998)	6.979	5.269	1.325
R2000-1 (1999)	6.856	5.407	1.268
R2001-1	6.447	4.276	1.508
R2005-1	6.476	4.454	1.454

Source: Tr 4/986-7

In ***every*** case, the model-derived unit cost is considerably *understated* in comparison to the CRA-derived actual cost. MMA understands that the Postal Service's models are very complicated particularly because there are so many input variables.[46]. With so many inputs, it is obviously difficult to pinpoint exactly what causes this problem. Nevertheless, as Table VII makes abundantly clear, *one major cause* of the problem is the Postal Service's persistent underestimation of costs associated with the RBCS operation.[47]

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46 For each category of First-Class mail, there are literally dozens of input parameters that go into the derivation of the model-derived workshare unit costs. These inputs include volumes, assumptions regarding the operations to which mail flows, productivities, mail densities, wage rates, accept and reject rates, piggyback factors, and leakage rates, among others.

47 When asked if his models understate actual RBCS costs, USPS witness Abdirahman first stated, "No. The cost models are a simplified representation of reality and reflect the best data available." (Tr 4/997-9) When pressed, Mr. Abdirahman stated "[I]t is possible that the RBCS costs are either overstated or understated. The extent to which the costs may be overstated or understated, however, is unknown." (Tr 4/1027-8) The data in Table VII obviously do not support Mr. Abdirahman's contentions.

Another problem with the Postal Service's mail flow models is that they consistently and reliably *overstate* the workshare unit costs for automation letters, as Table VIII shows.

Table VIII
Comparison of Automation Worksharing-Related Unit Costs
(Cents)

	Automation Letters Workshare-Related Unit Costs		
Docket No. (BY)	**CRA Cost (1)**	**Model Cost (2)**	**CRA Prop Factor (1) / (2)**
R2000-1 (1998)	2.553	2.866	0.891
R2000-1 (1999)	2.630	2.923	0.900
R2001-1	2.138	2.683	0.797
R2005-1	1.886	2.668	0.707

Source: Tr 4/988-9

In contrast to the BMM model (which involves processing within the RBCS) that tends to ***understate*** actual costs, the automation letter models tend to significantly ***overstate*** actual costs. In other words, the Postal Service's models not only understate the actual costs of RBCS processing, they also report phantom costs for automation letters that bypass the RBCS. In R2005-1, the USPS model-derived estimates for automation letters overstate actual costs by more than 40%.

Comparing the model-derived processing costs for BMM to the costs of workshared automation, mixed AADC letters (MAADC) also serves to reveal the flaws inherent in the Postal Service's mail flow models. According to the Postal Service, the unit cost to process BMM (4.45 cents) is *less* than the unit cost to process MAADC letters (4.54 cents). Tr 4/1030 Such a result makes no sense.[48] Again, the reason for

[48] Compared to BMM, MAADC letters are not only properly prepared in labeled trays, but are prebarcoded and have more readable addresses (addresses in the correct location, no conflict with colors, simple font), more reliable addresses (fewer UAA pieces), better addresses (full and correct), are more likely to be machinable, (correct stiffness, not flimsy, square corners, no enclosures), and are presorted so as to completely bypass the RBCS operation. (Tr 4/997-8)

this result may be found in the Postal Service's illogical ***assumption*** that fewer MAADC letters are processed by automation (88.39%) than BMM letters (91.25%). Tr 4/1001

The implication of this comparison, between BMM and MAADC, is extremely important. According to the Postal Service's models, if BMM were prebarcoded, prepared according to workshared standards *and* presorted to the mixed AADC level, the costs to process this mail would go ***up***. Conversely, if the prebarcodes on MAADC letters were removed and such letters were simply trayed, without being presorted, and not subject to any of the other design and preparation requirements applicable to workshare letters[49], the models indicate that postal costs would go ***down***. Such obvious anomalies call into question the accuracy and usefulness of the models.

To date, the Postal Service has simply disregarded these inherent flaws in its models and applied CRA Factors to true up (or down) the model derived costs. However, application of CRA Factors is a palliative, not a proper cure for the problem.[50] The underlying problems should not be ignored any longer because the discrepancies are growing. For automation letters, the degree to which the USPS model *overstates* actual CRA costs has increased from about 11% in R2000-1, to 25% in R2001-1, and to 41% in R2005-1.[51]

4. Problems With USPS Witness Kelley's Delivery Cost Analysis

Another reason why the inaccuracies in the mail processing models should be addressed directly is that the inaccuracies adversely affect the derivation of delivery

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[49] USPS design and preparation procedures are extremely detailed and complex. According to the September issue of *Memo to Mailers* (page 6), the Postal Service now offers a 4-day comprehensive seminar to certify and train Postal customers on how to design and prepare workshare mail.

[50] MMA agrees that using the CRA Proportional Factor to de-average automation letter mail processing costs by degree of presort is both reasonable and necessary. But MMA has grave reservations about the Postal Service's secondary use of its models -- to derive DPS %'s. The Postal Service needs to find some reasonable mechanism for reconciling its derived DPS %'s to other data sources so their accuracy can be verified.

[51] For BMM letters, the degree to which the model *understates* actual costs increased from 21% in R2000-1 to 34% in R2001-1, but then dropped back modestly to 31% in R2005-1.

point sequence percentages ("DPS %'s"). DPS %'s are very important outputs of USPS witness Abdirahman's mail processing cost savings analysis because they are used as the ***key*** inputs in USPS witness Kelley's derivation of delivery costs. In a nutshell, the additional problem is this: ***overstated*** model-derived unit costs for automation letters result in ***understated*** associated DPS %'s and, conversely, ***understated*** model-derived unit costs for BMM result in ***overstated*** associated DPS %'s.

The inter-relationship between these problems and their impact on delivery costs is shown in Table IX.

Table IX
Relationship Among the Model's Unit Cost Derivation Inaccuracies, and the Resulting Inaccurate DPS %'s and Unit Delivery Costs

	Effect on			
Cause	**% Processed by Automation**	**DPS %**	**% of De-Averaged Delivery Costs**	**Unit Delivery Cost**
Understatement of RBCS Costs	Too High	Too High	Too Low	Too Low
Overstatement of Non-RBCS Costs	Too Low	Too Low	Too High	Too High

This problem is exacerbated by the comparison of BMM with MAADC, the same example discussed above. According to Mr. Abdirahman, the DPS % for BMM (**82.14%**) is higher than the DPS % for MAADC (**79.57%**), even though MAADC is ***significantly*** more automation-compatible than BMM. USPS witness Kelley's use of these anomalous DPS %'s in the delivery cost model produces a higher delivery cost for MAADC than for BMM. Such results make no sense. Accordingly, Mr. Kelley's de-averaged delivery costs for all 15 subcategories of presorted First-Class class, including that for NAMMA, the benchmark mail piece preferred by the Postal Service, must be viewed with suspicion.

The end result of these inter-related problems is a shrinking of the unit delivery cost differences. This goes a long way to explain why the Postal Service's unit cost savings differs from that derived under the Commission's established methodology by a whopping 2.5 cents. When multiplied by more than 47 billion test year pieces, the erroneous analysis translates into more than $1 billion in delivery cost savings that are completely wiped out by the Postal Service's use of inaccurate DPS %'s for BMM and automation letters.

MMA urges the Commission to direct the Postal Service to determine, before the next omnibus rate proceeding, why its models consistently understate the costs for nonprebarcoded letters (BMM) that require processing within the RBCS and, simultaneously, consistently overstate the costs for prebarcoded automation letters that bypass the RBCS.[52]

D. MMA's Suggested Solutions To These Problems

1. Mail Processing Costs

The heart of the problems described above lies in the Postal Service's assumptions regarding how much of the mail is processed by automation and how much mail is processed manually. Since manual processing is 12.5 times more expensive than automated processing,[53] it seems intuitively obvious that costs will be understated if the assumption regarding the percentage processed by automation is too high and vice versa.

Because the BMM model understates actual costs, the percentage of letters assumed to be successfully barcoded in the RBCS operation probably is too high. Similarly, because the automation letter models overstate actual costs, the percentage of letters assumed by the automation letter models to require manual processing probably is too high. Record data support these conclusions.

[52] Mr. Abdirahman confirmed that in his mail flow models the most significant factor contributing to the differences between the processing costs of BMM and workshared letters was that BMM letters require RBCS processing while workshared letters do not. Tr 4/988-9. Yet, in response to MMA interrogatories about the apparent anomalies that point directly to inaccuracies of the RBCS costs, Mr. Abdirahman had no answers other than the Postal Service's typical refrain: he relied on the "best data available". Tr 4/997-9.

[53] See USPS-T-29 at 9.

For example, the Postal Service's model ***assumes*** that **99.23%** of all BMM can be successfully barcoded within the RBCS. Tr 4/1001-2. There are ample grounds to question that assumption. First, only **89%** of all letters processed in the RBCS are successfully barcoded. Tr 8B/3540. There is no reason to believe that BMM letters can be successfully barcoded at a rate that is a full 10% higher than an average nonprebarcoded letter. Second, it is overly optimistic to think that virtually 100% of all BMM can be successfully barcoded in the RBCS because BMM letters have absolutely no address cleanliness requirements, suffer from poor and stale addresses that characterize all computerized address lists which are not continually reviewed and updated, and there are no regulations whatsoever that prevent BMM from exhibiting numerous other characteristics that render such letters nonmachinable.[54] Tr 4/984-85.

Similarly suspect is the Postal Service's ***assumption*** about the percentage of prebarcoded workshared letters that will be rejected by automated equipment and, thereafter, require much more expensive manual processing. For example, the Postal Service models assume that same reject rate applies to ***all*** mail, regardless of whether the letter is prebarcoded and subject to stringent address cleanliness and reliability requirements, or the letter is simply hand-addressed. While the reject rates might ***average*** 3-4% for ***all*** letters, applying this average reject rate to automation letters implies that an unrealistically high portion of automated requires very expensive manual processing. The results of this unsupported and illogical assumption are inflated unit costs for automation letter categories.

MMA questioned USPS witness Abdirahman at length about the assumptions regarding how much mail would be processed manually and how much mail would be processed by automation that are built into his mail flow models. After repeated

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[54] According to Postal Service studies, approximately 30% of all First-Class letters have one or more address deficiencies. Such deficiencies include incorrect apartment number (18%), directional suffix (25%), street name/number (25.0%), other (22%) or the person had moved (10%). *See* R2000-1 Library Reference USPS-LR-I-192, pp. 6-7. In addition, 88 percent of First-Class UAA mail originates from businesses and the major reduction in UAA processing costs, saving approximately $1.5 billion ***per year***, can be directly tied to the 1997 Move Update requirements instituted for workshare letters. *See* R2000-1 Library Reference USPS-LR-I-82, pp. 27, 68-69. Finally, PMG Potter recently stated that "UAA mail accounts for as much as five percent of business mail." Postcom Bulletin 37-05; dated September 16, 2005.

questioning,[55] USPS witness Abdirahman finally conceded that built in assumptions regarding the percentages of mail processed by automation and manual means "could be one of the reasons" why the results of the Postal Service mail flow models are so out of sync with actual CRA costs. Tr 4/1163

For these reasons, the Commission should direct the Postal Service to re-examine its mail flow models and begin by focusing on the proportions of mail that are processed by automation and manual operations. This reexamination should entail a fresh, hard look at the accept rates, particularly within the RBCS, and the reject rates for workshare letters in the automation operations. Such a reexamination should bring the model results much closer to the CRA-derived unit costs, which in turn would foster greater confidence in the accuracy of the unit costs, the derived cost savings, and the derived DPS %'s.

2. Delivery Costs

As far as delivery costs are concerned, the Commission should reject the Postal Service's proposal to use the NAMMA letters as the benchmark from which to measure delivery cost savings due to worksharing.[56] The most reasonable benchmark, as well as the most obvious benchmark, is precisely the same as that used to measure mail processing cost savings: BMM. As is the case with using BMM as the mail processing cost benchmark, delivery costs for BMM are not available. The best proxy for BMM delivery cost is the delivery cost of all metered mail letters (with collection costs removed). The difference between the delivery costs for BMM and metered mail letters likely is very small, particularly since both BMM and metered mail letters are defined as clean and machinable and exhibit essentially the same characteristics by the time they

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[55] See Tr 4/1151-63. MMA counsel had to ask virtually the same question eleven times before finally obtaining a responsive answer.

[56] USPS witness Kelley, the delivery cost expert acknowledged he was not even aware that the Postal Service's method for deriving delivery cost savings -- in this case and in previous cases -- relied upon a unit delivery cost estimate for BMM. Tr 7/2774-75. USPS witness Abdirahman was asked if he was able to derive a unit delivery cost for single piece metered mail, and whether he could have used such a unit cost as a proxy for BMM. His evasive answer seems to indicate that he did not do so simply because it has never been done before. Tr 4/969. Similarly, USPS witness Kelley incorrectly claims that a unit cost for BMM is "not needed for rate design purposes." Tr 7/2763-64. The Commission cannot accept such poor excuses for using a

reach delivery operations. In fact, since a significant portion of metered mail letters could be machine addressed and pre-barcoded, it is likely that the unit delivery costs for all metered letters is lower than the actual unit delivery cost for BMM.

Delivery costs for metered mail letters are readily available. While it will take some analysis and assumptions to completely isolate the unit delivery costs for single piece metered mail, MMA is confident that the Postal Service is capable of deriving such costs. MMA provided such a delivery cost study in R2001-1 and, but for the settlement, had available the necessary data from the Postal Service to update that study again in this case.

The Postal Service should be directed to forego its use of NAMMA letters as the benchmark in favor of a non-workshared, single piece category. That category should be BMM approximated by the delivery costs for single piece metered mail.

3. The Newly Proposed Delivery Cost Attribution Methodology Should Not Be Accepted in this Case

For the time being, the Commission should not place any reliance upon the Postal Service's new delivery cost attribution methodology for city delivery carriers. First, the parties and the Commission need much more time to fully explore and understand the complexities and impacts of these new cost attributions. The special nature of this proceeding and the shortened schedule have precluded this necessary examination.

Second, based on what little MMA has learned about the new methodology, there are sound reasons to proceed cautiously. One fact, which was revealed only late in the discovery process, *presumably because not even the Postal Service was aware of it*, is that the new attribution methodology converts what heretofore have been institutional costs into attributable costs, most of which are categorized as collection

workshared category, NAMMA, as the benchmark against which to measure delivery cost savings due to worksharing.

costs that are directly tied to First-Class single piece.[57] Something caused collection costs to increase more than four fold from $197 million from TY2003 in R2001-1 to $910 million in TY 2006 in R2005-1. Tr 13/6466. Because these facts were revealed by the Postal Service so late in the game, and then followed up in quick succession with further revisions,[58] the record regarding the causes for this disturbing phenomenon is bare.[59]

On the surface, the new delivery cost methodology appears to increase the total amount of attributable costs and to increase the amount attributable to First Class.[60] In the context of this special proceeding and in view of the Postal Service's statements to the effect that this study was used for very limited purposes and that it intends to reexamine this and other special studies before the next omnibus rate case (Tr 3/607, 4/1077, 8D/ to MMA/USPS-10, it would be premature for the Commission to make any merits determination regarding this new, untested methodology.

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[57] See Library Reference MMA-LR-1 (revised September 6, 2005), which was reviewed and confirmed by the Postal Service. Collection costs have increased more than $650 million dollars as a result of the new attributable cost methodology.

[58] Tr 13/6459-67. The Postal Service deserves high marks for honesty and diligence in trying to correct the record**.**

[59] The Postal Service's further revisions were not filed until August 25, 2005, in response to MMA's interrogatory requesting confirmation that figures presented in an earlier response were accurate. Tr 13/6459. Obviously, there has been no time to "test" the reasonableness of the Postal Service's answers

[60] The significant increase in collection costs raises other new issues. Currently, First-Class workshare mail is saddled with a large portion of collection costs, even though, by definition and postal regulation, workshare mailers do not and can not use the Postal Service's collection system. Workshare mailers have not opposed this treatment of collection costs in the past because the adverse impact on them was not very significant ***and*** the Postal Service claimed such costs were mostly institutional. The sudden quadrupling in collection costs and the claim that they are attributable to First-Class has made the issue much more important for workshare mailers.

Proposed Findings Of Fact And Conclusions Of Law

General Findings And Conclusions

1. The Postal Service's proposed uniform across-the-board approach to increasing rates and fees is fair and reasonable under the unique circumstances presented in this case.

2. The specific rates and fees incorporated in the S&A, which are identical to those proposed by the Postal Service in its April 8 Request, are supported by substantial record evidence.

3. The S&A rates and fees are consistent with all applicable standards and policies of the Postal Reorganization Act, including relevant criteria of § 3622 (b) of the Act.

4. The S&A rates and fees should be recommended without modification.

Specific Findings And Conclusions For First-Class Workshare Discounts

1. The Postal Service's controversial approach to measuring mail processing and delivery cost savings due to worksharing is not appropriate under the circumstances of this case.

2. Cost Savings due to worksharing should be based on the Commission's methodologies, including its attributable cost method, established in R2000-1.

3. The unit cost savings due to worksharing that result from application of the Commission's established methodology are those shown in Column 2 of Table II which appears on page 13.

4. The First-Class workshare discounts proposed in the S&A, which appear in Column 1 of Table II, are all lower than the comparable unit cost savings.

5. The First-Class workshare discounts proposed in the S&A are supported by substantial record evidence, consistent with the ratemaking criteria and policies of the Act, and will be recommended without any modification.

Conclusion

For the foregoing reasons, the Commission should recommend the S&A without modification. The Commission should also provide the Postal Service with helpful guidance on how best to improve the special cost studies utilized to determine processing and delivery cost savings due to worksharing. Finally, the Commission should indicate that it expects the Postal Service to reexamine the existing rate structure for First-Class workshare discounts and propose appropriate modifications so that the rate structure conforms with the changed nature of the worksharing market and important technological developments and changes in mailing practices.

Respectfully submitted,

Major Mailers Association

By: ______________________________

Michael W. Hall
35396 Millville Road
Middleburg, Virginia 20117
540-687-3151

Counsel for
Major Mailers Association

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