

**BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001**

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**POSTAL RATE AND FEE CHANGES  
PURSUANT TO PUBLIC LAW 108-18**

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**Docket No. R2005-1**

**JOINT INITIAL BRIEF  
OF  
ADVO, INC.  
AND THE  
SATURATION MAILERS COALITION**

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## **STATEMENT OF POSITION**

As signatories to the Settlement Agreement, Advo and the SMC urge the Commission to approve the Agreement and recommend the postal rates that have been proposed by the Postal Service in this proceeding.

Like some other signatories, our participation in the settlement does not mean we necessarily believe that the proposed rates are “the optimum” set of rates. We concur with Valpak, for example, that the cost coverage for ECR mail is too high. And contrary to Valpak, we believe that the combination of the proposed ECR saturation letter-nonletter rate differential plus the proposed pound rate -- rate elements that are intrinsically interrelated -- overcharges saturation flats relative to saturation letters, particularly in the case of heavier flats above the 3.3-ounce breakpoint.

In the circumstances of this proceeding, however, Advo and the SMC concur that these issues should be deferred in favor of the 5.4 percent across-the-board approach proposed by the Postal Service. Specifically, Advo and the SMC urge that:

1. The Commission adopt the nearly-unanimous Settlement Agreement;
2. The Commission recommend to the Governors the rates proposed by the Postal Service;
3. The Commission adopt the new city delivery carrier cost study presented by the Postal Service;
4. The Commission reject Valpak’s proposal to increase the ECR letter-flat rate differential; and
5. Should the Commission depart from the Settlement Agreement and recommend an increase in the letter-flat rate differential, then it must also recommend a fully-offsetting reduction in the ECR pound rates to avoid double-charging flats for weight-related costs that are embedded in the letter-flat cost differential.

## **SUMMARY OF ARGUMENT**

As the only party that filed direct testimony, and as virtually the only party that extensively cross-examined Postal Service witnesses (many of them), Valpak has held “center stage” before the Commission for most of the litigation phase of this proceeding. Its direct testimony (totaling more than 160 pages) spins a tale that on casual reading is superficially appealing: that USPS costs are unreliable and skewed against ECR saturation letters; that costs for saturation letters are artificially high due to the Postal Service’s manner of handling saturation flats; that letters bear an excessive institutional cost burden compared to flats; and that the remedy is to significantly increase the letter-flat rate differential, even to the point of applying a “cost coverage” markup to the cost differential and/or constructing artificial “modeled marginal costs” for letters and flats.

Just this month, the Commission has finally had the opportunity to see the other side of the story. As the rebuttal testimonies of Advo witness Crowder and USPS witness Lewis clearly lay out, Valpak’s arguments rest on conjecture and speculation, and are inconsistent with the real-world characteristics of saturation letter and flat mail and the realities of postal operations. As is often the case, it is easy to spin a yarn; more difficult to delve deeply and grasp the true nature of the issues. Crowder, in particular, has delved deeply and exposed the fatal flaws in all of Valpak’s arguments.

Valpak’s proposal to increase the letter-flat rate differential through a 100-percent-or-greater passthrough of the letter-flat cost differential ignores the acknowledged fact that the cost differential reflects not just shape-related costs, but also weight-related cost differences that are separately recovered through the pound rate.

The saturation letter-flat passthrough must be set well below 100 percent to avoid double-charging flats for weight-related costs.

When properly analyzed, at the Postal Service's proposed rates, saturation/high-density flats will have a higher cost coverage than saturation/high-density letters, primarily due to the excessively-high pound rate. Valpak's proposal to increase the letter-flat rate differential would skew that coverage even more, further overcharging flats for weight-related costs. The real problem is not, as Valpak contends, that the letter-flat rate differential is too low, but that the ECR pound rate is too high.

If the letter-flat differential nevertheless were to be increased, then the pound rate would *have* to be reduced by a fully-offsetting amount.

Valpak's "capacity constraint" argument -- that letters are "bumped" from the "low cost" mode of delivery as third bundles because flats are given priority for this capacity-constrained delivery mode -- is wrong on many levels.

Valpak's primary evidence of "bumping" is the fact that most saturation letters are DPSed and some are cased, whereas it believes that the more efficient way to process letters would be to bypass the DPS operation and be carried directly to the street as third bundles. Lewis and Crowder have destroyed this key contention. Because of the ergonomic difficulty of handling two bundles of letters on the street (a DPS bundle and a sequenced letter bundle), the Postal Service prefers *not* to carry letters as third bundles *even on days when there are no saturation flat mailings*. It is not flats, but the characteristics of letters that act as the constraint on third-bundle letters. This, in fact, is a major reason why the Postal Service prefers to DPS as many letters as possible.

Contributing to this DPS preference are the facts that (1) DPS is an “all or nothing” proposition because a letter mailing cannot be broken down to process just the walking (or third bundle) portions of a route; (2) most saturation letter mailings are entered upstream from the DDU delivery office and pass through the SCF facilities where DPS processing is done, thereby readily available for DPS; and (3) because DDUs do not receive advance mailer notice on the expected arrival of mail entered upstream, a decision not to DPS the mail will cause unexpected volumes at the DDU that may cause additional, unplanned work for the carriers. In short, DPS is the preferred method to handle letters irrespective of the existence of saturation flats in the system. The letter costs in the current operating environment are caused by letters, not flats.

On this ground alone, Valpak’s capacity argument is wrong. Flats are not the cause of current letter costs, and their removal (i.e., if flats did not exist) would not meaningfully change the Postal Service’s preference to DPS letters, or change letter costs, in the future.

In any event, Crowder demonstrated that the Postal Service has considerable operational flexibility to handle substantially more saturation mailings. Moreover, the remedy Valpak proposes for this non-problem – to calculate artificial “modeled marginal delivery costs” for letters and flats as if all saturation mail were manually cased – is ludicrous and draconian in the extreme. This “marginal cost” theory necessarily presumes that there is *no* remaining capacity on *any* city delivery route on *any* day in the entire postal system to handle an additional saturation mailing. To state the proposition is to refute it.

In sum, Valpak's arguments and proposals should be rejected in their entirety.

## **ARGUMENT**

### **I. VALPAK'S ECR RATE STRUCTURE PROPOSAL IS INCONSISTENT WITH SOUND RATEMAKING PRINCIPLES.**

The current ECR subclass rate structure consists of a number of rate elements that are interrelated: (1) minimum-per-piece rates for pieces weighing up to the 3.3-ounce breakpoint, with walk-sequence density discounts off of the basic rate for high-density and saturation mail; (2) a per-piece letter-nonletter rate differential for high-density and saturation mail; and (3) per-piece plus per-pound rates for nonletters above the breakpoint. The costs underlying these rate elements are not only interrelated but in some cases overlapping. Changes in any one of these rate elements therefore have ripple effects on other rate elements that must be carefully balanced to avoid distorted rate results.

Valpak has focused simplistically on only one of these rate elements: the letter-nonletter rate differential. Technically, and as a matter of sound pricing, this rate differential should be designed to recover only those *piece-related* cost differences between letters and nonletters that are due to *shape*. It should not recover any cost differences that are due to *weight*, because weight-related cost differences are recovered separately through the pound rate.

Witness Mitchell did not address this interrelationship between shape- and weight-related costs. Instead, he simply assumed (without discussion) that the letter-nonletter cost differences reflect solely shape-related differences. From this faulty premise, he advocated as a "default solution" that the letter-nonletter cost differential

should be “marked up” by an amount equal to the ECR cost coverage (i.e., more than 200 percent; Tr. 9/5414-15), ostensibly as a means to equalize the cost coverages of letters and nonletters, as though they were separate products or subclasses. At a minimum, he contends that in no event should the passthrough be less than 100 percent.

In her rebuttal, witness Crowder showed that Mitchell’s novel pricing approach incorrectly mixes ratemaking concepts, and is wrong in both concept and application. She also demonstrated why Valpak’s failure to address the well-recognized interrelationship between the letter-nonletter rate differential and the pound rate is fatal to its proposal.

A. The Letter-Nonletter Cost Differential Reflects Both Shape- and Weight-Related Cost Differences.

The problem that Valpak has overlooked is that the letter and nonletter unit costs, from which the cost differential is derived, reflect both shape-related *and* weight-related cost differences. ECR saturation nonletters, for example, are more than three times heavier on average than saturation letters (2.92 ounces v. 0.85 ounces); while ECR basic-tier nonletters are more than four time heavier than basic letters (3.57 ounces v. 0.80 ounces).<sup>1</sup> The resulting unit costs for letters and flats include all shape- and weight-related cost effects for all ECR mail pieces across the entire weight spectrum from zero to sixteen ounces. To the extent that the heavier weight of nonletters causes extra costs in mail processing and in-office/street delivery operations,

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<sup>1</sup> LR-K-77, 2004 Billing Determinants, “Standard Mail BD2004.xls,” pages G2-1 and 2.

those higher weight-related costs (including piggybacks) are fully “baked into” the letter-nonletter cost differential.<sup>2</sup>

As Crowder demonstrated, Mitchell’s proposal to pass through “at least 100 percent” of the letter-flat cost differential is wrong. It would lead to a clearly improper double-charging for weight-related costs imbedded in the letter-flat cost differential that are already over-recovered through the pound rate. ADVO-RT-1 at 10-13. Indeed, Mitchell was unaware that the letter-flat cost differential reflects not just shape-related but also weight-related cost differences. Tr. 9/5417-19. He was also unaware that the Commission had addressed this issue in Docket R2000-1 and agreed with Crowder’s analysis. *Id.* at 5419-20. As the Commission there said:

“However, because the weight of letters and flats varies, the letter/flat cost differential by density level likely reflects differences in both weight and shape. As the pound rate is supposed to reflect the effect of weight on cost, passing through a substantial portion of the ECR letter/flat differential amounts to a double counting of the effect of weight.” PRC RD, Docket 2000-1, at 365.

This glaring defect in Valpak’s proposal, by itself, is sufficient grounds for its rejection.

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<sup>2</sup> The rate structure, of course, can never perfectly match costs in every instance, and as a practical matter necessitates some element of cost-averaging. A good example is the “minimum per piece” structure which charges the same rate for pieces up to 3.3 ounces. Although weight-related costs are not significant over this range, there may be some weight-related effect that is averaged in the current structure. Indeed, Valpak is a primary beneficiary of this cost-averaging. Its coupon envelope letters, for example, are nearly three times heavier than the average ECR saturation letter (2.34 ounces versus 0.85 ounces; ADVO/VP-T2-17), yet under the minimum-per-piece rate structure it pays the same averaged rate.

B. The Letter-Nonletter Passthroughs Must Be Far Less Than 100 Percent To Avoid Double-Charging For Weight-Related Costs.

Because the letter-flat cost differential includes weight-related costs that are separately recovered through the pound rate, the passthrough must be far less than 100 percent to avoid double-charging for weight-related costs. Indeed, the passthrough and the pound rate are, inherently, directly but inversely related to one another. For example, under the extreme assumption that 100 percent of the cost differential were due solely to shape-related cost effects rather than weight (as Mitchell apparently assumed), then there would be no cost justification for a pound rate. Conversely, if 100 percent of the cost differential were weight-related, then the letter-flat rate differential should be zero. Tr. 10/5820, 5824-25, 5827-29.

The precise breakout of shape- versus weight-related costs within the letter-flat cost differential is unknown, and perhaps unquantifiable due to the correlation between shape and weight. However, the implicit (although we submit, unproven) justification for the current high pound rate is that there are substantial weight-related costs within ECR mail that must be recovered through the pound rate. This necessarily implies that there are substantial weight-related costs embedded in the letter-flat cost differential, and leads logically and inevitably to the conclusion that the passthrough of that cost differential, in the form of a per-piece letter-flat rate differential, must be held low to avoid double-charging for weight. *Id.* and 5830-32.

Using revised estimates of the number of detached address labels, Crowder calculated the actual letter-nonletter passthroughs at the Postal Service's proposed rates under both the Postal Service and Commission costing methodologies. Under the Postal Service methodology, the saturation letter-flat cost differential is 0.987 cents,

which at the Postal Service's proposed 0.9 cent saturation letter-flat rate differential represents at 91.2% passthrough. ADVO-RT-1 at 12. As she explained, this is an excessively high passthrough "given that only 65.6 percent of Saturation flat TYAR revenue is from pieces (i.e, given the implicit ratemaking assumption that 65.6 percent of Saturation flat cost is shape-related)." *Id.*

Under the Commission methodology, due largely to the substantially higher delivery cost for saturation flats under the old carrier cost methodology, the cost differential between saturation flats and letters is larger, at 1.483 cents. However, it nevertheless yields a passthrough of 60.7 percent, "quite close to the 65.6 percent of revenue that is piece-related." *Id.* Given the substantial questions surrounding the reliability of the Commission's dated carrier cost methodology and the margin of error in its results (as discussed in detail in Section III below), Crowder's analysis amply shows that there is no reason to increase the proposed 0.9 cent letter-flat differential at the saturation level.

C. High-Density/Saturation Nonletters Have A Higher Percentage Cost Coverage Than High-Density/Saturation Letters.

Mitchell's proposal to adopt a 100-percent-or-greater letter-flat passthrough was predicated on the faulty contention that saturation letters were bearing a disproportionate institutional cost burden compared to saturation flats. He characterized ECR letters and flats as "separate products" for which application of cost coverage markups was appropriate. He believed that "marking up" the letter-flat cost differential by the ECR subclass cost coverage would rectify this supposed inequity – in essence treating them for rate purposes as separate product subclasses, and producing

the same rates as though priced as separate subclasses. VP-T-1 at 83-84, and Tr. 9/5414-15.

In her rebuttal, Crowder explained how Mitchell's approach incorrectly mixed and confused two different pricing concepts: (1) the traditional rate-category approach to pricing within a subclass; and (2) the proper approach for pricing of separate products that are treated as separate subclasses. Mitchell's approach of "marking up" the letter-flat cost differential is not only patently incorrect but would greatly exacerbate the double-charging for weight-related costs that are embedded in the letter-flat cost differential. ADV0-RT-1 at 8-9, 13-14; Tr. 10/5734-35, 5739-40.

Crowder then presented the correct approach to the pricing of separate products as distinct subclasses, explaining that the correct measure of a product's cost coverage is its *total* revenues (including, for example, pound-rate revenues) divided by its *total* costs. Mitchell's approach of "marking up" a single cost element while ignoring the excessive revenue contribution that flats make from the pound rate is nonsensical.

As Crowder explained, the correct product comparison should look not just at differences in shape, but at market differences. By that standard, the most apt product comparison is between (1) saturation and high-density flats, and (2) saturation and high-density letters.<sup>3</sup> Using corrected estimates of detached address labels, Crowder calculated test year unit costs, unit revenues at the USPS proposed rates, and cost coverage for these products under both the USPS and PRC costing methodologies. Under the USPS method, saturation/high-density flats have a cost coverage of 325

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<sup>3</sup> ADV0-RT-1 at 14-16, Tr. 10/5740-42. Advo, for example, mails 7 million weekly shared mail pieces at high-density rates (Tr. 9/5682-84), which on an annual basis comprises about 20 percent of total high-density flat volume.

percent, compared to only 293 percent for saturation/high-density letters. Even under the PRC method based on the old carrier cost methodology, saturation/high-density flats have a higher cost coverage, 290 percent versus 283% for letters. ADV0-RT-1 at 17; Tr. 10/5743.

In sum, under either (1) the traditional approach to setting passthroughs and rates for rate categories within a subclass, or (2) the correct approach for setting cost coverages and rates for separate products, there is no basis to increase the saturation letter-flat rate differential beyond that proposed by the Postal Service.<sup>4</sup>

D. If The Letter-Nonletter Rate Differential Were To Be Increased As Valpak Proposes, Then The Pound Rate Must Be Reduced By A Corresponding Amount To Avoid Overcharging For Weight-Related Costs.

As Crowder's testimony and the above discussion demonstrate, the letter-flat rate differential cannot be manipulated in a vacuum, independently of the pound rate. The Commission for those reasons should reject Valpak's proposal to increase the letter-flat rate differential. However, if the Commission were to nevertheless decide to reject the Settlement Agreement and increase the rate differential, it must also reduce the ECR pound rate by a corresponding amount to avoid overcharging flats for weight-related costs. Crowder, ADV0-RT-1 at 18, Tr. 10/5744.

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<sup>4</sup> Mitchell's criticisms were directed not only at the saturation letter-flat passthrough but also at the passthrough at the ECR basic tier. Unlike the saturation level, letters and flats pay the same rate at the basic tier. There are established policy reasons for this related to the crossover between the Standard Regular and ECR subclasses, and we oppose any change. If, however, the Commission were to impose a rate differential at the basic tier, that differential should not "flow through" in the form of an increased differential at the saturation tier, as that would unfairly overcharge saturation flats for the weight-related costs that are already over-recovered through the high pound rate.

That action would be necessary to avert unintended and unreasonable distortions in the marketplace. Such potential marketplace distortions were described by Advo witness Godfred Otuteye, the President and Chief Executive Officer of Money Mailer, LLC. As he explained, Money Mailer's saturation coupon envelope program competes directly with Valpak, the dominant competitor in the coupon envelope market. Although Money Mailer's envelope is letter-shaped, it employs a larger format to distinguish its product from that of its main competitor. Consequently, Money Mailer currently pays the letter-flat surcharge and pound rate on an appreciable portion of its mailings, but does not oppose the 5.4 percent increase in those rate elements proposed by the Postal Service. What he does oppose is Valpak's proposal to substantially increase that letter-flat rate differential between his program and Valpak's, as that would harm his ability to compete. ADVO-RT-2.

Otuteye made clear that he does not oppose cost-based rates, but that he believes the current rates, for the reasons cited by witness Crowder, are already skewed against mailers like Money Mailer whose letters exceed the 3.3-ounce breakpoint. Tr. 10/5922-23.

As Commissioner Goldway correctly observed, the Commission's role is not to protect individual competitors. *Id.* at 5922. However, the Commission should pay careful attention that its recommended rates not distort the marketplace, as a part of its proper role to "protect competition." Clearly, a decision to further raise the letter-flat rate differential (as Valpak advocates) but which ignores the interrelationship between that rate differential and the pound rate, would unreasonably and unjustifiably burden heavier-weight mailers with excessive overcharges for weight-related costs that are

already recovered through the pound rate. Such an outcome would, indeed, skew the competitive playing field and harm not just individual competitors but competition.

## **II. HALDI'S CAPACITY CONSTRAINT THEORY IS CONTRARY TO OPERATIONAL REALITIES**

Valpak witness Haldi incorrectly assumes that saturation letters are "bumped" from being delivered as third bundles because of a (1) a capacity constraint and (2) a policy of giving priority handling to flats. In his simplistic and result-driven assessment of the issues,

- He ignored (or was unaware of) the policy and operational reasons -- unrelated to flats -- why the Postal Service generally prefers to DPS saturation letters rather than handle them as extra-bundles/trays;
- He ignored the mail characteristics and makeup of most saturation letter mail, and the differences from flats, that make letters better and more efficient candidates for DPS-processing than for delivery as third bundles;
- He ignored the fact that city carriers have a variety of ways to expand their extra-bundle/tray capacity;
- He did not review available evidence on the subject that shows ample capacity in the city carrier system;
- He ignored the fact that the USPS cost data already reflect conditions where some saturation mail is DPSed or cased rather than treated as extra-bundles/trays; and

Finally, Haldi's proposed "solution" -- to use casing costs as the "marginal" delivery cost for all saturation letters and flats -- presumes that there is no capacity on *any* city route on *any* day to handle an additional saturation mailing as an extra-bundle/tray. This is so far from reality that he has difficulty supporting that assumption (response to ADVO/VP-T2-24). His theory and proposed modeled costs should be rejected.

A. The Postal Service's Preference To DPS Saturation Letters Whenever Possible Is Based On Sound Operational Reasons Unrelated To Flats, And Does Not Prejudice Valpak.

The goal of the Postal Service's letter DPS program is to minimize carrier in-office work so that carriers can spend more time on the street, delivering mail to more addresses. This enables the USPS to increase route sizes and thereby minimize the total number of routes, carriers, and carrier cost in the system.

The Postal Service's policy to DPS as much saturation letter mail as possible (Tr. 12/6237) is entirely consistent with this goal, irrespective of the existence of saturation flats. Valpak's attempt to construct a hypothetical world – arguing that saturation letter mailers would supposedly be better off if their mail bypassed DPS and instead were carried out to the street as third bundles – ignores the realities of saturation letter mailings and USPS operations.

There are a number of sound operational reasons why the USPS prefers to DPS saturation letters whenever possible.

1. Letters Are Less Physically Suitable To Be Carried Out As Third Bundles.

Saturation letters are not as physically suitable to be carried out as a third bundle on walking sections of city delivery routes as are flats. USPS witness Lewis, USPS-RT-2 at 3-4, Tr. 11/5940-41; Crowder, ADVO-T-1 at 37-38, Tr. 5763-64. Due to their small format, letters cannot be as easily nestled as a third bundle in the crook of the carrier's arm as flats, and are awkward to carry in the carrier's hand alongside the bundle of DPS letters. *Id.* Such mailings, if not DPSed, would have to be manually cased at the delivery office, incurring greater carrier time and cost.

Significantly, this preference *not* to carry saturation letters out as third bundles holds *even when there is no “conflict” with a saturation flat mailing*. As Lewis explained during rebuttal cross-examination, if a carrier received two saturation letter mailings on the same day (but *no* conflicting saturation flat mailings), the optimum solution is to send *both* letter mailings back for DPS processing rather than to carry an extra letter bundle to the street. Tr. 11/5973. When pressed as to whether only one or both of the letter mailings would be sent back to be DPSed, Lewis reiterated, “They would both go.” *Id.* at 5974. He further explained:

“As a delivery manager, *I like to avoid having two letter bundles*. My answer, I guess – the intuitive answer I would give you is, yes, the last resort would be to case it, but you might be able to come back and say, well, when you asked me this question, you said to avoid having a bundle, you would case it, then I would have to say, yeah, I probably would, but, in theory, the last resort would be to case this stuff, *but I really don’t [like] having two letter bundles whenever I have to walk in between delivery points.*” *Id.* at 5990 (emphasis added).

This, of course, blows away Haldi’s contention that, but for alleged third-bundle capacity constraints and the priority given to saturation flats, saturation letters would be carried out as third bundles. Even when there is *no* capacity constraint and *no* saturation flat mailing, carriers prefer *not* to carry saturation letters out as a third bundle because of the difficulty of handling two letter bundles (i.e., the DPS letter bundle plus the saturation letter third bundle).

Changing course, Valpak’s counsel attempted to get Lewis to agree that DPS-processing of saturation letters “destroy[s] the potential value in that mail that was already sequenced by mailers.” Tr. 11/5991-92. Lewis responded that, of those two features – DPS automation compatibility and walk sequencing – automation

compatibility was of greater value to the Postal Service *because it minimized instances where a carrier had to carry out more than one letter bundle:*

“I would think that a decision to move this mail back and put it onto DPS recognizes that, to us, to *manage down the instances where I have to have a carrier using more than one letter bundle*, taking advantage of the automation-compatibility features of this mail is of more value to me.” *Id.* at 5992 (emphasis added).

Again, this disproves Haldi’s hypothesis that saturation flats are to blame for the DPS-processing of saturation letters, as well as his speculative assumption that but for capacity constraints and “bumping” by saturation flats, saturation letters would be carried out as third bundles rather than being DPSed. The Postal Service’s policy to DPS as much letter mail as possible is driven not by concern about potential conflicts with flats, but by the broader objective of optimizing system efficiency in the handling of letters.

Significantly, the determination whether a particular saturation letter mailing will be ergonomically suitable to be carried out as a third bundle can only be made by the carrier and delivery supervisor, *after* the mail has reached the delivery unit. The manager at the upstream DPS plant, through which most saturation letters transit, cannot make this determination.

2. DPS Processing Is An “All Or Nothing” Proposition.

The decision of the DPS plant manager whether to DPS a saturation letter mailing is an “all or nothing” proposition. DPS plants do not have the carrier route scheme information to break a mailing apart by delivery segment so that just the walking portions of routes (foot and park & loop segments) could be DPSed,

and such a manual breakout in any event would be costly and impractical. USPS response to ADVO/USPS-5, Tr. 12/6240-41.

Lewis explained this impracticality during cross-examination:

“In a plant, I don't conceive how they would know which parts of a delivery route had territory that was constrained to three bundles and which parts didn't, and in a delivery unit, to go through that process would mean you would have to go through all of the mail and take certain pieces out and give them to the carriers and send other pieces to the plant. *It would be an ugly operation, I think. That's why we don't do it.*” Tr. 11/6023 (emphasis added).

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“Q: So in either case, it would be impractical.

“A: I don't think you would make money doing it. From a delivery perspective, I don't think you would save time doing it, and I'm not sure of the quality you would get out of it, so, yeah, I would say it was impractical.” *Id.*

In response to Valpak counsel's question whether the Postal Service could reduce costs by carrying all saturation letters out as third bundles rather than DPSing the mail, Lewis explained:

“I think, again, you would have to look at how would you identify the ones that you could take to the street and then separate them? [sic] Our delivery geography is set up to be gridded in five-digit Zip codes. Within there, I've got territories that are smaller. Our infrastructure now is not set up to be able to pull out of all of the mail for a five digit just those pieces that could go to the street and avoid processing just those pieces. The cost of designing a system like that would probably [be] more than what it costs to run the mail in the machine.”

“Q: So if it were possible, you have no idea whether that would save money.

“A: That's fair to say.” Tr. 11/6011.

This broader operational preference to DPS saturation letters applies even to those portions of a saturation letter mailing destined to motorized sections of a route

that are *not* subject to a third-bundle limitation. As Lewis explained, because of the difficulty at the DPS facility in breaking a saturation letter mailing up by delivery section,

“it is just far less complicated to handle this mail on a five-digit basis. There are fewer fail points, the more than [sic] I generalize the mail flows. It is just much less complicated.” *Id.* at 5992-93.

And,

“The fewer things that complicate my mail flows, the more effective I can be at managing them and that I can bring my cost of operations down. When we do things by exception, all of those things are places where you [can] have a failure, and the cost of fixing a failure might be more than what you give up by having a more simplified mail flow.” *Id.* at 5993.

It is for these reasons (contrary to those speculated by Haldi) that DPS plant managers, not knowing whether a particular saturation letter mailing will be ergonomically suitable to be carried as a third bundle, and unable in any event to split the mailing by delivery segment, understandably choose to DPS the entire mailing whenever possible.

3. Delivery Offices Receive No Advance Notification And Cannot Plan For Most Saturation Letter Mailings, Unlike The Situation With Saturation Flats.

The priority given to DPS processing of saturation letters is also a function of the different characteristics of saturation letter and flat mailings, and the regulations governing advance notification and scheduling of drop-shipped mailings. USPS regulations require that drop-ship mailers give advance notification to the specific postal facility where the mailing will be dropped, and further require that the mailer schedule a specific appointment for the drop shipment. DMM §346.2.8.3. For non-DDU drop-shipped mail, these required appointments must be made with the appropriate

“district control center.” For DDU mailings, appointments must be made directly with the DDU. *Id.* at subsections a and c.

Most ECR saturation flats (61 percent) are drop shipped to the destination delivery unit . Thus, through the advance notification and scheduling requirements, delivery supervisors and carriers know when most saturation flat mailings will be arriving, and they can plan for that mail. Moreover, a significant portion of these DDU saturation flat mailings are regular weekly programs that arrive the same time each week. This predictability further enhances workload planning at the DDU.

By contrast, the great majority of ECR saturation letters (74 percent/2.5 billion) are entered *upstream* from the delivery office, typically at the destination SCF where DPS processing takes place. The mailer’s drop-ship notifications and appointments for these non-DDU mailings are sent to the upstream facility, *not* to the delivery office. The DDU has no advance warning that a non-DDU saturation letter mailing might be coming. Moreover, because saturation letter mailings, unlike saturation flats, have a less-than-monthly frequency (Tr. 9/5377), DDU personnel cannot predict when they will arrive or plan for them.

This lack of advance notification at the DDU, and the consequent inability of DDU personnel to anticipate or plan for saturation letter mailings, has important practical consequences on the decision whether to DPS saturation letters upstream at the plant. If, as Valpak apparently advocates, these non-DDU saturation letter mailings were to bypass DPS processing and be transshipped to the delivery office, the delivery supervisors and carriers would have no warning until the mailings showed up at the DDU.

If that unexpected letter mailing were ergonomically unsuitable to be carried as a third bundle, the carrier would have to spend unplanned time to break the mailing apart and manually case the portions going to walking sections of the route. Alternatively, if that extra, unplanned in-office time would jeopardize the carrier's ability to complete his deliveries without overtime, the mailing would most likely have to be re-transported back to the plant for DPS processing. As Lewis testified, saturation letter mailings are often returned to the plant even when there is no conflict with a saturation flat mailing, because of the undesirability of carrying two letter bundles (a DPS bundle and a saturation letter third bundle) to the street. See discussion, Section I.A.1. above.

4. The Great Majority Of Saturation Letters Pass Through DPS Plants And Are Readily Availability for DPS Processing.

The great majority of ECR saturation letters (74%) are entered upstream of the delivery office and pass through SCF plants that have DPS equipment.<sup>5</sup> In Valpak's case, more than 99 percent of its saturation letters are entered at SCFs or further upstream. Tr.12/6383, 9/5588. These mailings are therefore readily available for DPS processing.

This might seem like an unremarkable statement, but it has great practical and operational significance on the decision whether or not to DPS a saturation letter mailing. As explained above,

- The mailing cannot be split for partial DPS processing, but must be DPSed in its entirety or not at all.
- DPS plant managers cannot know whether a particular saturation letter mailing will be physically suitable to be carried out as a third

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<sup>5</sup> USPS-LR-K77, Sheets G2-2 and G2-4.

bundle. That determination can only be made by the carrier and delivery supervisor *after* the mailing reaches the delivery office.

- Delivery managers and carriers prefer not to carry letters as third bundles even on days when there are no saturation flat mailings.
- Because delivery units do not receive advance notification of saturation letter mailings entered upstream, a decision not to DPS a mailing may burden the delivery office with unexpected mail that has not been planned for, and that will cause unanticipated extra in-office work for the carriers.

Thus, *wholly apart from the possibility of a “conflict” with a flat mailing*, a decision by the DPS plant manager *not* to DPS a letter mailing carries the risk of creating in-office handling and delivery problems at the delivery office. As Lewis fully explained (*supra*), DPS-processing of the mailing eliminates those potential (and, from the DPS manager’s perspective, unknowable) problems.

\* \* \*

Witness Crowder aptly summarized the fallacies of Haldi’s speculative hypothesis:

“[T]he fact that Saturation letters are not handled as extra bundles/trays as often as Dr. Haldi would like has nothing to do with the city carriers’ capacity to take out extra bundles or the presence of Saturation flat mailings, but has everything to do with the physical characteristics of Saturation letters and the USPS DPS policy.”

ADVO-RT-1 at 38, Tr. 10/5764.

B. Contrary To Haldi’s Simplistic Speculation, The City Delivery System Is Not Capacity-Constrained

In witness Haldi’s vision of the ideal world of handling saturation letters, almost all saturation letters would be expected to bypass DPS processing and be carried directly to the street, and hardly ever be cased. From this artificial and

disproved construct, he jumps to the conclusion that the high proportion of DPSed saturation letters and the existence of cased letters must be the fault of saturation flats. He therefore presumes that the only plausible cause for this circumstance must be capacity constraints in the Postal Service's ability to handle third-bundle saturation mailings, coupled with a preference to carry saturation flats as third-bundles, "bumping" saturation letters from what he views as being the ideal "low cost" method of handling letters.

The discussion in the preceding section, explaining the Postal Service's broad policy reasons to DPS as much saturation letter mail as possible (reasons unrelated to the handling of flats), exposes the myth of Haldi's result-driven, letter-centric vision of how the Postal Service should ideally handle letters. Indeed, it renders largely moot Haldi's core argument that "but for" capacity constraints and saturation flats, substantially more saturation letters would bypass DPS processing and be carried directly to the street at lower cost. Even in the absence of saturation flat mailings, the Postal Service would still prefer to DPS saturation letters rather than carry them out as third bundles.

Yet even on the thin (and non-dispositive) remaining reed of Haldi's argument – his presumed existence of significant capacity constraints – he is wrong.

1. USPS Techniques To Expand Extra-Bundle Capacity.

As Crowder explained, the Postal Service has considerable capacity to handle all mail that, in its opinion, can be most efficiently handled as extra-bundle mail (ADVO-RT-1 at 32-33 and the sources cited therein, Tr. 10/5758-59):

- For curblines, centralized/cluster boxes, and dismount deliveries that account for over 60 percent of all city delivery points, city carriers

can take out multiple extra bundles/trays. This applies to both saturation letters and saturation flats.

- For all deliveries, city carriers, if they have too many saturation mailings to handle as an extra bundle on one day, may defer some of those mailings to the next day or two.
- For saturation flat mailings on walking sections of a route (park-and-loop and foot deliveries), city carriers can take out multiple mailings by collating them into a single extra bundle.
- However, for saturation letter mailings on walking sections, city carriers may not carry many saturation letter mailings out as extra bundles because of the physical difficulty of handling two letter bundles (a DPS bundle plus a saturation letter third bundle), for the reasons described above and by witnesses Lewis and Crowder.

This latter constraint on saturation letter third bundles, of course, is *not* a capacity constraint of the type alleged by Haldi. *Nor* is it in any way caused by the existence of saturation flat mailings. As Lewis explained, carriers would prefer not to carry letters as third bundles even in the absence of flats, and the Postal Service's preference would be to DPS those mailings except where service requirements do not allow time for DPS processing. See the citations to Lewis in Section B above.

Thus, city carriers have substantially more capacity to handle extra bundles than recognized by Dr. Haldi.

## 2. Evidence Of Extra-Bundle Capacity.

The database from the City Carrier Street Time Survey (CCSTS) sponsored by USPS witnesses Stevens and Bradley includes information on the number of extra-bundle or "sequenced" pieces delivered on each sampled route and on each day. Crowder's analysis of that data shows substantial capacity in the system to accommodate extra-bundle mailings (ADVO-RT-1 at 33-35, Tr. 10/5759-61):

- Of the 32,064 *route-days* from 3,396 sampled routes surveyed in the CCSTS, 66 percent of route-days received no extra-bundle mail, and would be available to accommodate either a new or deferred saturation mailing, if the latter were necessary.
- Of the remaining 34 percent of *route-days* that received extra-bundle mail, 26 percent had only one full or a partial extra-bundle mailing while 6 percent had one to two such mailings. (A partial mailing means not all deliveries on the route received an extra-bundle piece.) Fewer than 1% of route days had three or more extra-bundle mailings.
- Of the 3,396 CCSTS sampled *routes*, 13 percent received no extra-bundle/tray mail during the sample period. For the remaining 87 percent routes that received some extra-bundle mail during the period, on average, 61 percent of their delivery days had no extra-bundle mail.

Thus, in the vast majority of cases, the USPS has sufficient capacity to handle additional Saturation mailings as extra bundles either (1) on the many days that do not have a saturation mailing, or, if there is already another saturation mailing on that same day, by (2) deferring the mailing to a subsequent day, or (3) collating the mailings. And, on non-walking sections of a route that are not subject to a third-bundle limitation, multiple mailings can be carried out as extra trays (rather than bundles).

3. Actual Levels Of DPSed, Cased And Sequenced Saturation Mail Do Not Support Valpak's Capacity Constraint Contention.

Haldi cited what he believed was a high proportion of cased saturation letters as evidence that city carriers do not have capacity to carry them as extra bundles, and that letters are deprived of extra-bundle treatment due to the priority given to carrying saturation flats as extra bundles. But as Crowder explained, the Postal Service's estimate of cased letters was too high and its estimate of DPSed letters too low, due to its underestimate of the number of DALs in the system.

After correcting for the revised number of DALs, the proportion of DPSed letters increases from 47.5 percent to 56.5 percent, closer in line with the Postal Service's DPS policy. Conversely, the proportion of non-DPS letters (consisting of cased plus "sequenced" letters carried directly to the street) declines to 43.5 percent, roughly half of which are cased and the other half sequenced. *Id.* at 36-37, Tr. 10/5762-63. This is a lower proportion than assumed by Haldi. Moreover, as Crowder explained, the Postal Service's estimate of the number of cased saturation letters is overstated because it was derived from 15-year-old letter casing productivities that pre-dated the conversion from more efficient letter cases to lower-productivity vertical flat cases. *Id.* at 37 fn. 31.

This reduced proportion of cased saturation letters would include DPS rejects that the DPS facility forwards to the DDU for manual casing, and letters that are physically ill-suited to be carried as third bundles on walking sections of routes – circumstances that are *unrelated* to saturation flat mailings. Even in the absence of flat mailings, these letter casing costs would still be incurred – costs that Haldi simplistically assumed could only be caused by conflicts with flats. *Id.* at 37. There is no evidence that these letters are cased due to "bumping" by saturation flats.

This does not mean that saturation letters are "denied the benefits" of being carried as third bundles due to flats. The Postal Service's policy to DPS most saturation letters is dictated by broader factors than just a concern over conflict with flats, as discussed earlier. In any event, somewhere over 20 percent of saturation letters are carried directly to the street as "sequenced" mail. Indeed, even those letters that are unsuitable as third bundles on walking sections of a route can still be carried out in extra trays on curblines, dismount, and centralized delivery sections. It is the Postal Service's

broader DPS policy objectives and the physical characteristics of saturation letters, rather than extra-bundle capacity or the presence of saturation flats, that constrain the volumes of sequenced letters below the level that Haldi believes appropriate.

Nor does it mean that saturation letters are harmed by the DPS program (despite the impression from Valpak's arguments that it believes the DPS program has been detrimental, and that it would supposedly prefer to have its SCF-entered mailings bypass DPS processing and be sent directly to the delivery office to be delivered as third bundles). In fact, Valpak and other ECR letter mailers benefit from the DPS program not only in the form of a more efficient overall system for processing and delivering their mail, but also in the form of better and more reliable service. Once Valpak's mailings are DPSed, they are no longer deferrable, but must be delivered the day they reach the delivery office, the same as accompanying First Class letters included in the DPS bundles.

C. Haldi's Proposed "Marginal Cost" Model For Deriving A Letter-Flat Cost Differential Should Be Rejected.

Predicated on his speculation that saturation letters are being denied the benefit of low-cost delivery as third bundles due to (1) a lack of system capacity to handle additional third-bundle mailings and (2) a preference given to delivering saturation flats as third bundles, Haldi proposes that saturation letter and flat delivery costs should be modeled as though city carriers cased all letters and flats 100 percent of the time. This theory is wrong on multiple levels.

First, Haldi has not shown that, *even in the absence of saturation flats*, the Postal Service would choose to handle saturation letters differently. This is a necessary predicate for Haldi's theory. But as witness Lewis emphatically and repeatedly

explained, the Postal Service's preference to DPS saturation letters, and its disinclination to carry them as a second letter bundle, are functions of the characteristics of *those* mailings and the overall efficiency of handling them – unrelated to saturation flats. Stated another way, removing saturation flats from the system would not likely change in any appreciable way the processing – or the costs – of saturation letters. They would still be primarily DPSed, and the Postal Service would still prefer not to carry them as third bundles for reasons related to *their* characteristics. In short, saturation flats are not responsible for artificially driving up the costs of letters. Their costs are what they are, and what they would be, whether or not there are capacity constraints in the system.

Second, Haldi has not shown that the postal city carrier system lacks capacity to handle additional saturation mailings as “sequenced” mail. There are constraints on carrying letters as third bundles due to the difficulty of handling two letter bundles, but that is neither a capacity constraint nor caused by saturation flats. As the rebuttal testimony of witnesses Crowder and Lewis demonstrate, the system is nowhere near a capacity constraint.

Third, Crowder and Lewis have shown that the postal system has considerable capacity to handle saturation flats as third bundles. Moreover, when the flats are cased rather than “sequenced,” the postal data systems accurately record those events and attribute costs properly. Thus, as explained by Crowder and USPS rebuttal witness Bradley, contrary to Haldi's assertion, there is no capacity constraint problem afflicting

postal data, and the postal delivery data are reliable indicators of marginal saturation flat and letter delivery costs.<sup>6</sup>

Finally, Haldi's proposed novel remedy for his unproved capacity constraint scenario – to construct artificial delivery costs for saturation letters and flats as though all the mail were cased all the time – is ludicrous in the extreme. It necessarily presumes that there is no remaining capacity on any city delivery route on any day in the entire postal system to handle an additional saturation mailing. To state the proposition is to refute it.

D. Valpak's "Two For The Cost Of One" Cross-Examination Hypothetical Is Bogus And Grossly Misrepresents Postal Operations And Costs.

On the last day of rebuttal hearings -- the day after Advo witness Crowder testified -- Valpak's counsel surprised USPS witness Bradley with a complex hypothetical consisting of six cross-examination exhibits filled with numerous assumptions, including five pages of calculations purporting to derive various unit costs for different kinds of saturation mailings. Tr. 11/6134-39. Contrary to Rule 30(e)(3) of the Commission's Rules of Practice, counsel did not provide the witness or USPS

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<sup>6</sup> There is a temporary problem with estimating the number of saturation pieces taken out as extra bundles (which should be corrected by the next rate case). But, as explained by Crowder (Tr. 10/5746-49), that problem causes saturation *flat* costs to be substantially more overstated than saturation *letter* costs. And, contrary to Haldi's implications of bias against saturation letters, Crowder shows that this one problem overshadows any other of Haldi's incorrect implications concerning the postal data systems. Indeed those other implications (that data systems are biased against saturation letters and that there are DAL mail processing costs attributed to saturation letters) have been shown by Crowder to be extremely trivial if not non-existent. ADVO-RT-1 at 20-29. Tr. 10/5746-55.

counsel with copies of the exhibits in advance of the hearing.<sup>7</sup> Moreover, the hypothetical and exhibits delved into areas of mail characteristics and operations that went far beyond the scope of the witness Bradley's testimony and areas of expertise. They were, indeed, subject areas that were well within witness Crowder's expertise. The reason why Valpak's counsel chose *not* to present his hypothetical to Crowder is obvious.

Counsel's hypothetical, and the exhibits underlying it, fabricate a fantasy world that bears no relation to actual mail characteristics or postal operations, and which is, in any event, flat out wrong in its calculation of costs. Correcting for just the calculational errors flips his results and disproves the point that he sought to make: that a detached label mailing might somehow cost less than a saturation letter mailing.

Before addressing the manifold and manifest flaws in this fantasy hypothetical, we note that Valpak's counsel did not attempt to move his cross-examination exhibits into evidence. Tr. 11/6133. Instead, the purpose of the hypothetical and the cross-examination seems to have been to leave the (patently erroneous) impression in the minds of the Commissioners that DAL mailings somehow get a "free ride," with the two

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<sup>7</sup> Rule 30(e)(3) provides that (emphasis added):

A participant intending to use complex numerical hypotheticals, or to question using intricate or extensive cross-references, shall provide adequately documented cross-examination exhibits for the record. Copies of these exhibits *should be filed at least two calendar days (including one working day) before the scheduled appearance of the witness*. They may be filed online or delivered in hardcopy form to counsel for the witness, at the discretion of the participant.

elements of a DAL mailing costing less than a single letter. The ploy worked, as evidenced by Commissioner Goldway's apparent concern that "I don't quite get how we came up with lower costs for the two-for-one. . . ." *Id.* at 6130. Her reaction is understandable because, as explained below, we, too, did not unmask the errors and distortions in the complex exhibits until after the hearings. That is why we are compelled to correct the gross misimpression that counsel's "hypothetical" may have left.

1. The DDU-Entry Assumption For Saturation Letters.

Valpak counsel's hypothetical began by assuming the creation of a new separate subclass for saturation mail subject to the requirement that "all saturation mail *must be entered at the DDU . . .*" Tr. 9/6134 (emphasis in original). Currently, however, barely one-fifth of saturation letters are entered at the DDU, despite the existence of DDU discounts. Valpak, in particular, has never drop-shipped more than 1 percent of its volume to DDUs. Tr.12/6383, 9/5588.<sup>8</sup> If DDU entry were a requirement, one might legitimately question whether Valpak (or the majority of existing saturation letter mail) would qualify for this hypothetical subclass given the substantial extra

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<sup>8</sup> Valpak prepares all its mailings at two Southeastern plants (St. Petersburg, Florida and Elm City, North Carolina), from which they are trucked to SCFs across the entire country. Transforming this operation to drop ship to all DDUs – a more-than-ten-fold increase in the number of drop points -- would be a monumental and costly undertaking, and is presumably the reason Valpak does not do so today despite the DDU discount.

transportation costs it would impose – costs that those mailers are not willing to bear today despite drop-ship discounts.<sup>9</sup>

This is not a trivial departure from reality. By hypothesizing DDU entry, counsel's scenario neatly sidesteps the inconvenient fact that most saturation letter mail today is entered upstream and passes through an SCF before reaching the DDUs, and is therefore readily available for DPS processing. By contrast, most saturation flats are entered at DDUs. This difference is not happenstance, but instead is reflective of Valpak witness Mitchell's statement that saturation letters and flats are "different products." VP-T-1 at 82-83, Tr. 9/5348-49. Those distinctive product differences are real and cannot be hypothesized away.

There is an even more serious problem with this "DDU-entry" requirement hypothesized for saturation letters. As witness Lewis explained repeatedly, letters are not particularly well-suited to be carried as third bundles due to ergonomic difficulties in carrying two bundles of letters. It is one of the reasons the Postal Service prefers to DPS letters. Yet in its "DDU-only" construct, Valpak conveniently assumes that the only reason a saturation letter would be sent back upstream to be DPSed is due to "bumping" by a saturation flat mailing – and not due to the more likely cause, the Postal Service's preference to DPS letters rather than carry them as third bundles. Beyond

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<sup>9</sup> The economic feasibility of drop shipping is a function of piece weight. The average saturation letter weighs 0.85 ounces, which for a 500-delivery route would total about 27 pounds per route. Valpak's heavier letters, however, greatly skew the average. Excluding its 64 million annual pounds from the letter total, the average for the rest of saturation letters is closer to 0.5 ounces, or about 16 pounds for a 500-delivery route. Tr. 9/5609-10. The notion that those letter mailers who do not drop ship to the DDU today would do so under Valpak's hypothetical -- sending trucks across the country to deliver 16 pounds per route -- is absurd.

this, given the existing (mostly non-DDU) entry characteristics of saturation letters and the preference not to carry them as third bundles, it is inconceivable that the Postal Service would ever propose a subclass that *required* saturation letters to be entered at the DDU. A reasoned hypothetical is one thing. A fairytale construct is something entirely different, and not worthy of credence.

2. The Inconsistencies With Actual Postal Operations.

Counsel's hypothetical includes other bare assumptions that are internally inconsistent and/or directly contrary to actual postal operating procedures:

- It assumes that unaddressed flats *and* their accompanying DALs will never be cased, but will be taken directly to the street “a hundred percent of the time.” Tr. 11/6114. In reality, on the walking portions of a route constrained to three bundles, the DALs would have be cased. Those casing costs are picked up in the In-Office Cost System and properly charged to the accompanying flat, but not in Valpak's hypothetical which assigns “zero” in-office cost. *Id.* at 6138.
- It assumes that addressed saturation flats will be “bumped” by DAL mailings, and therefore have to be cased. Tr. 11/6115. In reality, on walking portions of a route, the addressed and unaddressed flats would be collated and carried out together as a unitary third bundle, while the DAL would be cased (since it is less costly to case than the addressed flat). On other portions of the route not constrained by the third bundle rule (the majority of addresses), all of the pieces would be carried to the street in trays.
- It assumes that DDU-entered letters (the only kind allowed in the hypothetical subclass) would be sent back upstream to the plant to be DPSed “as a contingency as against the possibility of getting another flat mailing.” Tr. 11/6116. In reality, for DDU-entered mail, there is no “contingency” because the carrier will know the day it arrives whether there is another flat mailing. The “contingency” concern applies only to letters entered upstream of the DDU (which under the hypothetical are not eligible for the subclass), because the DPS plant manager will not know about the possibility of other flats at the DDU.
- It assumes a severe capacity constraint that has been shown not to exist.

- It assumes that the only reason for not carrying out a saturation letter mailing as a third bundle is the actual or potential possibility of being “bumped” by another flat mailing. Tr. 11/6115-16. The reality, as witness Lewis explained, is that the carriers prefer not to carry out two bundles of letters (a DPS and a “third bundle”) even when there are no other saturation mailings.

Each of these flaws, individually, affects the outcome of the hypothetical’s alleged “unit costs,” and taken together render it meaningless. But the most egregious error is one that we discovered only the day after the hearing, having had a chance to review the assumptions and calculations – a chance that witness Bradley was not given – as we discuss next.

3. The Fallacious “Two For The Cost Of One” Delivery Cost Assumption.

Counsel’s hypothetical assumed not only that all DALs and their accompanying flats would be carried directly to the street, but further, that the *combined* delivery cost for a DAL *plus* its accompanying flat would be the same (2.0¢) as for a *single* letter or addressed flat. Tr. 9/6124-25, 6138. This assumption was not immediately obvious due to the peculiar way counsel phrased the assumption:

“Q: And let’s take the assumption one step further and just assume that *every one* of these had a street time marginal cost of two cents, *whether it is a letter, flat or other piece*, if you can keep that in mind also.” Tr. 11/6124 (emphasis added).

From that seemingly-unambiguous phrasing, one would reasonably conclude that the “other piece” counsel was referring to must be a DAL (the only item that is neither a letter nor a flat), and that under his hypothetical, a DAL would incur a two-cent street-time marginal cost, as would the accompanying flat. But in his cross-examination exhibit Valpak XE-4, the DAL and accompanying flat *together* were charged as though they were a *single* piece, the same as a single letter. Tr. 11/6138.

This “two for the cost of one” assumption is patently incorrect. Under the USPS delivery cost model, the DAL and the accompanying flat *each* incur a *separate* delivery charge. There is no free ride. Correcting for just this one flagrant error, by doubling the delivery cost for the DAL mailing to correlate to the treatment of DAL mailings in the delivery cost model, flips the hypothetical’s results so that the DAL mailing would have the *highest* total marginal cost, not the lowest!

Valpak’s complex but flawed cross-examination hypothetical demonstrates the wisdom of Commission Rule 30(e)(3), requiring a participant “intending to use complex numerical hypotheticals” in cross examination to supply the documents to the witness and opposing counsel at least two days before the witness’s appearance. This is particularly true where the cross-examination goes beyond the scope of the witness’s testimony and expertise. Surprise as a tactical device, whether in the form of last-minute substantive additions to testimony or complex numerical hypotheticals posed to unsuspecting witnesses, confuses rather than clarifies the record and should not be condoned.

In the final analysis, a “hypothetical” is no better than its underlying assumptions. Here, Valpak’s does not even rise to the dignity of a hypothetical. Professor Bradley at numerous points expressed reservations about the many things Valpak’s counsel was asking him to accept. See, e.g., Tr. 11/6117-18, 6118-20, 6122-23, 6127-28. Counsel tried to assuage him by stating:

“We’re just making these numbers up. It’s not that important what the numbers are *until we get to the end.*” *Id.* at 6109 (emphasis added).

That statement is truer than counsel intended. It reveals his real purpose: to cook up an improbable scenario unrelated to (indeed, contrary to) actual postal operations,

embellished with a veneer of contrived mathematics, designed to reach a predetermined numerical result -- a result that, in the end, is patently wrong and meaningless.

Its only value is as an illustration of the lengths to which Valpak has gone to shore up a baseless case. Valpak's proposal, like its hypothetical, should be rejected.

### **III. THE COMMISSION SHOULD ADOPT THE POSTAL SERVICE'S NEW CITY CARRIER STREET TIME STUDY**

Finally, after eighteen years, the Postal Service has come up with a conceptually well-founded, integrated, full-scale, statistically reliable study of city carrier street time variability based on how city carriers deliver the mail under current conditions. The new City Carrier Street Time Study (CCSTS) replaces a set of mismatched "special" studies that attempted to separately estimate the individual costs and variabilities for such activities as time spent walking along the route, accessing a stop, and loading mail into receptacles. Those studies were a mix of diverse analyses based on four relatively small-scale collections of data from the mid-1980s – the Street Time Survey (STS), the Load Time Variability (LTV) Study, and the Curblin and Foot Access Tests (CAT and FAT).

#### **A. The Old Studies Are Afflicted With Numerous Severe Problems**

##### **1. The Old Studies Do Not Reflect Current Operations**

The data used in these five "special" studies are from the mid-to-late 1980s. Since then, postal service operations and mail characteristics have changed dramatically. Among other changes:

- The USPS has implemented its DPS automation program that now delivery-sequences most letter mail, eliminating much carrier in-office casing time;
- The introduction of line-of-travel and walk-sequence discounts for various mail categories has further facilitated in-office activities;
- In conjunction with the DPS program and other changes, city carrier casing and delivery methods have changed significantly;
- The entire system of city routes has been restructured, with substantially larger city carrier route sizes and a greater proportion of carrier time spent on the street rather than in-office;
- The number and proportion of curblines and centralized/NDCBU deliveries have increased, while the proportion of walking deliveries has declined;
- Parcels and Express Mail have become important postal products; and
- The amount of household-originating mail that carriers collect from delivery points has increased substantially, due to factors such as reductions in “blue” collection boxes and changing lifestyles.

All these changes mean the cost pools and variabilities determined from the old studies cannot possibly be representative of the current set of street time delivery technologies and activities.

## 2. The Old Studies Were Small-Scale And Unreliable

By attempting to functionally divide and separately measure interrelated carrier street-time activities (e.g., accessing a delivery point, placing mail in a receptacle, taking collection mail out of a receptacle, walking or driving the route), the four “special” studies were necessarily technically complex to conduct. Because of their complexity, substantial cost, and potentially intrusive and distortive impact on carriers during the study, these studies were small scale and, in some instances, simply pilot tests for full-scale studies that were never implemented.

As a result, the data from the studies are contaminated with large sampling errors as evidenced by significant coefficients of variation (CVs). For this reason, the marginal costs and variabilities derived from these studies have always been subject to a large degree of uncertainty. (See, e.g., the 1999 Data Quality Study, Technical Report #3: Simulation Analysis of Data Quality Issues, at 59.)

3. The Model Results From These Studies Are Problematic

Each of the special studies focused on individual, relatively limited carrier activities, collecting data on a large number of variables. The combination of (1) a small number of observations with a large number of variables, (2) inconsistent approaches in database and analysis design, and (3) a single-minded focus on individual activities, made it difficult to develop model results that were easily interpretable and conceptually acceptable. Consequently, model outputs from the data have always been open to an array of serious questions.

For example, the Street Time Survey and the Load Time Variability Study were conducted on actual street operations, but the Curblin and Foot Access Tests were simply time-and-motion studies of carriers “pretending” to be conducting their street operations. Separate cost models and variabilities were developed from the LTV and CAT/FAT data, even though their data design approaches were entirely inconsistent and even distortive of normal carrier operations. Further, the quality of the collected data and model results from the time-and-motion studies has always been suspect. The abject artificiality of the CAT/FAT studies is apparent from the fact that actual pieces of mail were never even carried when simulating carrier operations.

These and other serious econometric issues concerning the CAT/FAT and LTV data and models are described in greater detail by Dr. Michael Bradley in his direct testimony, USPS-T-14, at 4-7.

4. The Separate Model Results From These Four Old Studies Cannot Be Integrated Into An Acceptable Route-Level Or System-Level Whole

Results from the old studies cannot provide reliable variable cost results at either the route- or system-level. The STS identified proportions of total carrier street time assigned to various “cost pools:” load time, run time, support time, etc. The LTV and CAT/FAT studies were used to determine the variabilities of each of those cost pools. However, the STS, LTV, and CAT/FAT were different studies, collecting data from different time periods and different routes, and perhaps using different definitions for some of the studied activities. Moreover, because each of the special studies was designed to analyze an individual activity, they ignored complex interrelationships between and among activities on a route (e.g., walking time vs. driving time on a route).

In addition, there is a notable lack of consistency in the terms and definitions applied to individual carrier activities. A good example is the controversy over where “load” time begins and “access” time ends. The same occurs for the relationship between “access” time and “route” time. There are no clean breaks among these activities as they flow into each other. Not surprisingly, each of the studies employed slightly different definitions of these activities, causing further confusion. The resulting lack of clarity across study designs as to activity definitions has produced a serious

fundamental defect: the variabilities from the LTV and CAT/FAT studies do not match the STS-based cost pools with which they are used.

The four studies are also defective at the system-level. In the real world of carrier operations, route splitting occurs when workloads for existing carriers become too large as volume grows. However, by design, route-splitting effects on carrier workloads are ignored in the LTV and CAT/FAT studies. Consequently, it is impossible to integrate the model outputs from these studies to meaningfully measure city carrier street costs and variabilities at the system level.

5. Large Portions Of The Route-Day Were Not Studied

Relatively large portions of the route-day identified by the STS involved activities such as driving to and from the route, driving time along the route, time at the vehicle or relay box preparing mail for delivery or collection, and time at the vehicle while still at the delivery office. However, no data were collected to specifically analyze the variability of these activities. Lacking data, the variabilities for these activities were simply assumed to be related to various combinations of other, actually measured activities.

B. The New CCSTS Study Corrects The Numerous Shortcomings Of The Old Fragmented Approaches

1. The CCSTS Is Large-Scale, Well-Conceived, Interpretable, and Easily Updatable

The CCSTS represents a tremendous improvement in all dimensions over the old studies. First, it is based on a large-scale, nationwide stratified sample of very recent detailed operational data collected from 161 zip codes containing 3,668 routes. The data, collected over a two-week period in FY2002, captures the

physical characteristics and delivery technologies of today's postal delivery network. Moreover, the CCSTS employed a consistent set of definitions and data collection instructions. The result of this massive effort is a database of 40,668 route-day observations where volumes and time data are properly matched by location and time. Additionally and not surprisingly, this large data collection effort has also caused sampling errors to drop dramatically compared to the older studies. Coefficients of variation are now 6 percent or less for the majority of variables. USPS-T-16, at 13.

The richness, size and detail of collected data, its reflection of current delivery technologies, and the integrated character of the analysis corrects the serious problems associated with the earlier studies. Further, the model results derived from these data are robust, easily interpreted, and statistically reliable. Dr. Bradley has presented several alternative models with the data and all are reasonably consistent in their results.

2. The CCSTS Is Complete In Scope And, For The First Time, Directly Records Carrier Street Times By Activity

The data collection procedures employed in the CCSTS are non-intrusive on the carriers' normal delivery activities. Carriers participating in the study were asked to enter start and stop times for certain delivery "events" into beepers they normally carry and use. These events marked boundaries, well-understood and used by the carriers, for detailed activity times important for effectively capturing detailed, unbiased carrier time responses to volume fluctuations. Most importantly, the procedure for the first time allows direct estimation and distribution of all carrier street time by delivery activity. By contrast, the old STS system relied on an indirect and less

precise method of assigning recorded carrier tallies to specific activities, and then determining proportions of carrier time by activity based on the tally distribution.

3. The CCSTS Allows System-Level Estimation of Volume Variable Costs

One of the most important conceptual contributions made by the new study design is its capability to determine the time-volume response for defined geographic areas and to aggregate these location-specific responses into a meaningful system-level whole. Witness Bradley accomplished this task by summing the route-day observations within particular zip-codes to create the corresponding zip-day observations containing the same volume and time data captured at the route level. He then easily subsumed route splitting effects into the analysis by noting the total cost response at the zip code level as a function of differently shaped delivery volumes, sequenced mail, collected mail, and accountable mail.

This approach is consistent with management of the postal delivery network. Postal managers observe city carrier workloads at the delivery unit and zip code level and adjust the number of routes accordingly. Therefore, the observed cost-volume responses by zip code contained in the data base and in the resultant cost models reflect not only the peculiar physical characteristics and delivery technologies of various locations but also the delivery management practices.

4. The CCSTS Detailed Data Structure and Provision For Future Updates Will Promote The Structured Evolution of Street Time Models

The CCSTS presents an unsurpassed opportunity to depart markedly from the past and the often-conflicting ways that delivery costing issues were resolved. In particular, given the flexible design and non-intrusive character of the

standardized data collection procedures, future database updates can be readily performed as required. And, use of the CCSTS database will undoubtedly result in an orderly and structured evolution of city carrier costing models consistent with changing postal operations and mail characteristics.

C. The USPS Has Greatly Improved The Method Of Distributing Delivery Costs Within ECR; However, The ADVO Estimates Of PRC-Version ECR Delivery Costs Are More Accurate Than Those In LR K-151

The Postal Service has also greatly improved the distribution of delivery costs among ECR rate categories (as presented in USPS LR-K-67). It correctly distributes volume-variable delivery costs among ECR shape-density rate categories on the basis of cost causation. In sharp contrast, the PRC-version methodology (LRs K-101 and K-151), originally developed by the Postal Service and adopted by the Commission in R2000-1 and R2001-1, is extremely crude, distributing costs categories on the basis of volumes rather than on cost causation.

On September 16th, following the last day of hearings, the Postal Service filed its response to POIR-14, Questions 1 and 2, which requested an “update” of the PRC-version methodology in LR K-101. Despite the Postal Service’s update attempt, the approach remains afflicted with serious problems and cannot be viewed as a reliable distribution of the PRC-version of city and rural delivery costs among ECR shape-density categories.

Advo witness Crowder in her ADVO-LR-1 adapted the PRC-version (LR K-101) to provide an estimate the impact of DALs on the PRC-version of ECR delivery costs. A brief comparison to her approach reveals some of the flaws in the K-151 approach. Both K-151 and Crowder’s ADVO-LR-1 agree on total PRC-version ECR city and rural

costs, and for city in-office and load time distributions among shape-density categories. However, they differ on distribution of (1) city route, coverage-related, and single subclass stop costs, and (2) rural delivery costs.

LR K-151 distributes each of these four ECR subclass component costs among the ECR shape-density categories, *including DALs*, on the basis of volumes: national volumes for the city costs (route, coverage-related, and SSS-related), and RCCS volumes by shape for rural costs by shape. This distribution ignores actual cost causation, particularly for DALs. Among subclasses, city route costs are distributed on the basis of weight, while coverage-related and single subclass stop costs are distributed on the basis of volume (that causes stop coverage) and the number of single subclass stops caused by the subclass.

Because a DAL is a component of its accompanying saturation flat, the DAL weight is *already included* in the flat weight. Moreover, a DAL alone does not (cannot) cause a change in stop coverage or the number of single subclass stops independently of its accompanying flat. Saturation flats should be and are attributed the relevant route, coverage, and single subclass stops costs. But, to attribute those costs to the flat, and then to attribute *additional* costs to the DAL, results in charging the flat-DAL combination *twice*. For example, if the flat-DAL combination caused only one single-subclass stop, the LR K-151 approach nevertheless would charge the flat-DAL combination for *two*. When that is done, not only are saturation flats plus DALs overcharged, but the remaining ECR volumes are thereby undercharged for these costs.

Accordingly, DALs should *not* be distributed any costs from those three city cost pools. But they should be distributed their correct portion of ECR city letter load cost (and its burden impact on all other costs) -- as is correctly done by Crowder in ADVO-LR-1.<sup>10</sup>

LR K-151 also ignores differences in rural costs caused by the several ECR shape-density categories. For example, the low-unit boxholder costs are almost entirely caused by saturation volumes. However, LR K-151 averages these low unit costs with the other rural unit costs (by shape) so that each ECR rate category (by shape) is distributed the same unit shape cost for its rural pieces. The result is that ECR saturation rural costs are too high while ECR non-saturation rural costs are too low. USPS LR-K-67, in contrast, correctly distributes rural delivery costs among the ECR shape-density categories that cause them. Crowder, in ADVO-LR-1, uses the correct K-67 rural cost distribution to develop the PRC-version of rural delivery costs.

In sum, the LR K-151 delivery cost distribution among ECR shape-density categories is inherently unreliable. This flawed distribution inherent in the PRC-version is yet another reason for the Commission to finally abandon the old, outdated methodology. Crowder's estimate of PRC delivery costs is based on a more accurate distribution of the PRC-version of delivery costs among ECR shape-density categories.

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<sup>10</sup> Separately, the LR K-151 approach of distributing city costs on the basis of RPW volumes is also inaccurate because it ignores the fact that different ECR shape-density categories use city and rural delivery in different proportions. This problem was not corrected in ADVO-LR-1 (PRC-version of delivery costs) as it was too all-encompassing. However, USPS-LR-K-67 does correct that problem and correctly distributes all delivery costs, including those caused by DALs.

The *best* approach by far, however, is the Postal Service's, as presented in LR K-67. Not only does it distribute ECR costs on the basis of cost causation, but it distributes the far more reliable and accurate USPS-version of city delivery costs. The LR K-67 USPS-version of ECR delivery costs, as modified by Crowder to reflect the DAL estimate, is the most current, most reliable, and most accurate distribution of delivery costs among the ECR shape-density categories. It should be adopted by the Commission.

D. The Commission Should Not Use The Old Studies And Methodologies, In This Proceeding, As A Basis To Depart From The Rates Proposed By The Postal Service

As Crowder pointed out in response to Commissioner Goldway's question about the reliability of postal cost studies, any study – no matter how well conceived and executed – can be subjected to criticism as being “imperfect” in some manner. Tr. 10/5887-90. This is especially true with studies of city carrier delivery costs because of the inherent complexity of the activities being studied. Compared to the old fragmented studies, however, the CCSTS is light-years ahead and far superior. It should be adopted by the Commission.

If, however, the Commission for some reason decides not to formally adopt the CCSTS at this time, it should not -- in this proceeding -- use the old, outdated carrier costing studies and methodologies as a basis to depart from the across-the-board rates and rate structures proposed by the Postal Service.<sup>11</sup> Surely, the Commission must

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<sup>11</sup> The only exception might be in the isolated instance where application of the old methodology results in costs for a subclass that exceed its revenues at the proposed rates, presenting a legal constraint under the attributable cost “requirement” of 39

conclude that the new CCSTS is superior in concept to the old methodology; and just as surely, the Commission cannot conclude that the results of the old methodology are particularly reliable. At best, the old methodology (we hesitate to call it the “current” methodology because it is decidedly out-dated) produces results that are suspect and subject to a significant margin of error, and that will likely be superceded (if not in this case) in the not-too-distant future.

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U.S.C. §3622(b)(3). Given the high cost coverage of the ECR subclass, well in excess of 200 percent, the subsection (b)(3) attributable cost requirement is clearly satisfied.